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UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF CALIFORNIA

WILLIAM P. LILES and MARCIA H. LILES,  
Debtors.

Case No.-00-54299-MM  
Chapter 7

DAVID J. MILLER,  
Plaintiff,

Adversary No. 00-5429

vs.

WILLIAM P. LILES and MARCIA H. LILES,  
Defendants.

**MEMORANDUM DECISION**

INTRODUCTION

Before the court is the complaint of creditor David J. Miller to determine the dischargeability of a debt arising out of a loan from Miller to debtor William P. Liles. When the loan was not repaid, Miller sued Liles in state court for breach of contract and obtained a judgment against Liles for \$53,833.37. He seeks to except the judgment debt from discharge under 11 U.S.C. § 523(a)(2) alleging that William Liles obtained the loan by intentionally misrepresenting the nature of the loan he sought, the value of a stock option in the stock of Citizens State Bank of Luling, Texas and the value of the Liles' home in San Antonio, Texas. Following trial

1 and having considered the evidence and legal memoranda submitted by the parties, the court concludes that  
2 the debt is nondischargeable, and judgment is awarded to Miller.

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4 **FACTS**

5 Liles is a sophisticated businessman with nearly thirty years of professional banking experience. During  
6 the 1970s and early 1980s, he worked in various capacities including as a loan officer, in trust business  
7 development and as vice president and director of personnel. He earned a Master's degree from the  
8 Southwestern Graduate School of Banking at Southern Methodist University in 1977. In the mid 1980s, he  
9 became President of a small bank in San Antonio, Texas and subsequently worked for the banking regulatory  
10 agency in Texas. In 1989, Liles became Executive Vice President of Citizens State Bank of Luling, Texas, and  
11 was quickly promoted to President and Chief Executive Officer. Liles continued as President and Chief  
12 Executive Officer of Citizens State Bank until March 4, 1998 when he resigned upon request. His resignation  
13 followed a dispute with the bank's Chairman of the Board involving claims that Liles engaged in financial  
14 improprieties.

15 When Liles joined Citizens State Bank, it was a family-owned bank. In 1996, Liles organized an  
16 outside investment group, the Spector Group, that bought the bank. Although Liles did not participate as an  
17 equity owner in the purchase, he received an option to purchase approximately ten percent of the bank's stock  
18 in return for his efforts in structuring the transaction. This option gave Liles the right to purchase 11,167 shares  
19 of Citizens State Bank stock at the book value of \$24.70 per share, the same price the investment group had  
20 paid for its stock. The aggregate purchase price for Liles to exercise the option was \$275,824.90.

21 The option agreement also contained certain limitations. One significant restriction was that the option  
22 became void if not exercised within six months after Liles' employment with Citizens State Bank terminated.  
23 The option was also exclusive to Liles; he could not transfer or assign it. Further, other shareholders of the  
24 bank were entitled to notice of Liles' exercise of the option and, if Liles later offered the stock for sale, they  
25 had a first right of refusal which included the opportunity to acquire the stock from Liles at the same price as  
26 the outside buyer agreed to pay.

1 Under the limitations in the option agreement, once Liles resigned, he had until September 4, 1998, six  
2 months after his resignation, to exercise his stock option. Liles did not have the funds necessary to exercise  
3 the option and there was no public market for the bank's stock. As a result, in April 1998, he enlisted the  
4 services of a securities broker to assist him in marketing the stock option. Liles planned to have a prospective  
5 buyer provide him with the funds necessary to exercise the option, and in return, Liles would agree to convey  
6 the stock to the buyer after Liles received it. An investment opportunity circular was prepared that offered the  
7 option package at \$40 per share, and Liles personally assembled a history of the bank and a summary of its  
8 recent financial performance for prospective investors. Liles also personally approached some parties, including  
9 existing shareholders of the bank, to offer the shares for sale. Although Liles did not receive any concrete  
10 offers, he was aware of various expressions of interest. The most significant inquiry at the time was from Carl  
11 Gamboa, who had previously wanted to acquire a controlling interest in the bank.

12 In May 1998, Liles and his wife began exploring a move from Texas to the Monterey Peninsula. They  
13 met with Jerry Schumacher, a real estate broker in Carmel, California, who provided a list of local businesses  
14 that were available for sale. Liles formed SBM Enterprises of California, a limited liability corporation, as a  
15 vehicle to purchase a small coffeehouse called Carmel Caffé & Company. On July 20, 1998, Liles contracted  
16 to purchase the coffeehouse for \$130,000. The purchase contract required cash payments of \$41,250 and  
17 was contingent on Liles' ability to obtain \$83,750 in financing on terms and conditions satisfactory to him. Liles  
18 testified that he intended to make the cash payments from the sale of his Texas home and other assets, namely  
19 the stock option. Escrow was originally scheduled to close on or before September 22, 1998.

20 To finance the balance of the purchase price, Liles applied for a small business loan from First National  
21 Bank of Central California. The financial statement he provided to First National showed various debts  
22 exceeding \$373,825. It included almost no liquid assets but did schedule his home in Texas as an asset valued  
23 at \$ 400,000. He also scheduled his interest in the bank stock option at \$502,605. Liles testified that he  
24 believed he was being conservative in valuing his stock option at one and one-half times the book value of \$30  
25 per share because he believed Gamboa would eventually agree to pay \$60 per share. However, at the time  
26 he applied for the loan, around July 28, 1998, Liles had not received any offers to purchase the shares and was  
27 not in contract for the sale of his residence.

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1 While the First National loan application was pending, Liles asked Gershon Cohen, an attorney in  
2 Texas, to furnish First National with confirmation that an agreement to sell the stock was in place. On August  
3 20, 1998, Cohen sent a letter to the senior lending officer at First National stating that “a client is attempting  
4 to acquire the ownership of Citizens State Bank of Luling.” The letter further provided that “the acquisition  
5 price had not been determined . . . [but] the expected price will be in excess of two times the book value of  
6 the bank.” The letter also noted that the acquisition could be a lengthy process. Although there is no evidence  
7 that an actual agreement to purchase the stock was in place when Cohen wrote his letter, shortly thereafter,  
8 Gamboa did agree to acquire Liles’ stock interest. Liles had received only one other offer, at book value, for  
9 the stock.

10 Gamboa agreed to purchase Liles’ stock through a limited partnership he controlled called CarMarc.  
11 The purchase was documented in a letter agreement dated September 4, 1998 and in a document entitled  
12 Escrow Agreement and Instructions dated September 2, 1998. Attorney Cohen represented both CarMarc  
13 and Liles in the transaction and served as the escrow agent. On its face, the letter agreement stated a purchase  
14 price of \$51.25 per share for Liles’ Citizens State Bank stock, or a total purchase price of \$572,308.75. The  
15 escrow agreement also reflected a sales price of \$51.25 per share, but its terms did not obligate the buyer to  
16 deposit that entire purchase price in escrow. Instead, it only required the buyer to deposit the amount  
17 necessary for Liles to exercise the option, \$275,824.90. At trial, Liles testified that he had another separate  
18 agreement with Gamboa which provided that Liles would receive a minimum profit of \$45,000 from the  
19 transaction. Notwithstanding that the escrow agreement required any changes to its terms to be in writing and  
20 signed by all parties, no separate agreement was offered at trial.

21 On September 4, 1998, the last day before the option expired, Cohen notified Citizens State Bank of  
22 Liles’ intention to exercise the stock option, tendered a cashier’s check in the amount of \$275,824.90 and  
23 demanded the issuance of a stock certificate. A few days later, on September 9, pursuant to the escrow  
24 agreement, Cohen also notified the bank’s other shareholders of their right to purchase Liles’ shares at \$51.25  
25 per share. The notice to shareholders did not disclose that a separate agreement existed that only required  
26 CarMarc to pay \$45,000 above the amount needed to exercise the option.

1           Citizens State Bank responded to the notice it received by refusing to honor Liles' exercise of the  
2 option. The bank alleged that Liles had misappropriated funds from the bank's investor group and questioned  
3 whether Liles or CarMarc was trying to exercise the option. On September 10, 1998, Cohen sent a letter to  
4 counsel for Citizens State Bank demanding compliance with the bank's contractual obligation, under the stock  
5 option agreement, to issue the stock certificate. He admonished that the bank risked litigation if it persisted in  
6 its refusal to recognize Liles' exercise of the option.

7           Notwithstanding the challenge by Citizens State Bank, on September 14, 1998, Liles faxed copies of  
8 documents to officers at First National Bank, substantiating the purchase price and the stock sale agreement  
9 between Liles and CarMarc. Throughout the loan application process, Liles never disclosed that Citizens  
10 State Bank was challenging the attempted exercise of Liles' option and the sale to CarMarc, nor that he was  
11 contemplating a lawsuit against Citizens State Bank to enforce his contractual rights under the stock option  
12 agreement.

13           For some reason not apparent from the record, prior to the close of escrow on Caffé & Co. but with  
14 the consent of the seller, Liles, through SBM Enterprises, took possession of the coffeehouse on September  
15 15, 1998. Six days later, shortly before the scheduled close of escrow, First National Bank declined to  
16 approve Liles' loan application and refused to fund the loan. Notwithstanding that Liles could have withdrawn  
17 from the transaction at this point pursuant to the terms of the purchase agreement, he proceeded with attempts  
18 to obtain financing for the coffeehouse. Schumacher referred Liles to Monterey County Bank for a small  
19 business loan as an alternate source for financing. Monterey County Bank agreed to extend a loan in the  
20 amount of \$50,000 for Liles' purchase of the assets of Caffé & Co. It also agreed to provide a \$50,000  
21 revolving line of credit if the line were fully collateralized. Schumacher then introduced Liles to Dale LeClerc,  
22 a real estate broker who represented David J. Miller, a private lender. From Miller, Liles hoped to secure  
23 short term financing in the amount of \$50,000 that he could use to secure the revolving line of credit from  
24 Monterey County Bank. The loan was necessary in order for Liles to close the escrow, which had become  
25 precarious.

26           On September 23, 1998, Liles and Schumacher met at the coffeehouse with LeClerc. During their  
27 discussion, Schumacher described Liles' professional background. Liles and Schumacher also presented  
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1 various documents to LeClerc in support of the loan request, including the stock option agreement between  
2 Liles and Citizens State Bank, the investment opportunity brochure that Liles had assembled to solicit  
3 prospective purchasers for the stock, and the notice to shareholders dated September 9, 1998 of the first right  
4 of refusal on the purchase of Liles' shares. The investment opportunity brochure offered the stock at \$40 per  
5 share, but LeClerc testified that Liles asserted in their meeting that the stated value predated a deal to sell the  
6 shares to a third party for \$51 per share. That assertion appeared to be consistent with the letter to  
7 shareholders, which notified them of the offer by CarMarc of \$51.25 per share. Although Liles testified that  
8 he never authorized Schumacher to provide LeClerc with these documents, it is unrefuted that Liles was present  
9 when they were given to LeClerc.

10 Even more significant is the information not revealed in the meeting with LeClerc. On cross  
11 examination, Liles conceded that he did not disclose to LeClerc that Citizens State Bank had challenged his  
12 exercise of the stock option, that he had threatened litigation against the bank, or that CarMarc was obligated  
13 to pay only \$45,000 for the stock.

14 Liles personally prepared the initial handwritten loan agreement, which was finalized on substantially  
15 the same terms and executed by both parties on October 1, 1998. By its terms, the agreement provided for  
16 Miller to be repaid from the proceeds of sale of Liles' Citizens State Bank stock or the San Antonio residence.  
17 LeClerc testified that he was relying primarily on the stock option for repayment because he knew the Texas  
18 real estate market was poor. The loan agreement provided for prepaid interest of \$5,250 for the first six  
19 months. If it were not repaid then, it provided for interest at 21% per month until the end of the six month  
20 extension. Oddly, Miller had borrowed the funds at a rate in excess of 9% and had to pay LeClerc's  
21 commission of 6%, so the interest rate provided him a return of only 6%.

22 Miller advanced the funds to Liles on October 1, 1998. Liles deposited the proceeds from the loan  
23 by Miller into two certificates of deposit in order to secure the line of credit from Monterey County Bank then  
24 immediately drew down on the line of credit. Liles depleted the \$50,000 line of credit from Monterey County  
25 Bank and subsequently defaulted on the obligation. Monterey County Bank later offset the amount of the  
26 obligation against the certificates of deposit.

1 Marcia Liles moved from Texas to California in January 1999 and underwent surgery in Los Angeles  
2 in February of the same year. She spent one hundred days in the hospital throughout 1999. Because her health  
3 condition required close attention, Liles was not able personally to manage the coffee shop as he had originally  
4 intended.

5 Liles and Citizens State Bank entered into a release on March 9, 1999 resolving the dispute over the  
6 exercise of the option and the issuance of the shares. Pursuant to the terms of the release, Citizens State Bank  
7 issued a stock certificate for 11,167 shares of common stock to Liles, who subsequently transferred them to  
8 CarMarc in exchange for \$45,000. Notwithstanding that Cohen as escrow holder did not receive the balance  
9 of the purchase price of \$572,308.75, he issued the stock certificate to Gamboa. Liles testified under cross  
10 examination that he reached a compromise with Gamboa to sell the stock for \$45,000 after the escrow  
11 instructions were prepared. Gamboa had become disenchanted and wanted to withdraw from the transaction.  
12 Although he already had paid \$275,000 in escrow in September 1998, he still had not received the benefit of  
13 an ownership interest in Citizens State Bank. Moreover, he was not able to acquire a controlling interest in the  
14 bank. Liles testified that he compromised with Gamboa because he could not afford the legal fees necessary  
15 to enforce the agreement and his wife's medical expenses were overwhelming.

16 Notwithstanding that he received \$45,000 in sales proceeds from CarMarc, Liles did not retire the loan  
17 from Miller. Instead, he made several monthly interest payments and defaulted when the loan matured. Miller  
18 commenced a breach of contract action in Monterey County Superior Court against Liles, who stipulated to  
19 a judgment in the amount of \$53,833.37. Liles filed a voluntary bankruptcy petition on August 28, 2000, and  
20 Miller commenced this adversary proceeding for a determination that the Superior Court judgment is  
21 nondischargeable.

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23 **LEGAL DISCUSSION**

24 Under § 523(a) of the Bankruptcy Code, there are two sets of conditions that render a debt  
25 nondischargeable based on a debtor's intentional misrepresentations. First, a debt for money or property is  
26 not dischargeable if it was obtained by "false pretenses, a false representation, or actual fraud, other than a  
27 statement respecting the debtor's . . . financial condition. 11 U.S.C. § 523(a)(2)(A). Second, a debt for  
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1 money or property is not dischargeable if it was obtained through the use of a false written statement of financial  
2 condition. 11 U.S.C. § 523(a)(2)(B). These two provisions, by their terms, are mutually exclusive. The  
3 general fraud provisions of § 523(a)(2)(A) cover both verbal and written misrepresentations, however, they  
4 specifically exclude statements regarding the debtor's financial condition from its coverage. Section  
5 523(a)(2)(B), on the other hand, covers that which is excluded from subsection (A) - misrepresentations  
6 concerning the debtor's financial condition. It adds, however, a requirement that the misrepresentation must  
7 be in writing. *In re Barrack*, 217 B.R. 598, 605-06 (B.A.P. 9<sup>th</sup> Cir. 1998).

8 Miller does not clearly articulate which subsection of 523(a)(2) he believes is applicable to this  
9 adversary proceeding. However, because Miller points to several written statements to support his claims of  
10 fraud, the court will first consider whether the debt is excepted from discharge under § 523(a)(2)(B). To  
11 successfully except the judgment debt from discharge under this section, Miller must prove that: (1) debtor  
12 made a written representation of fact concerning his financial condition, (2) the representation was materially  
13 false, (3) debtor knew the representation was false at the time it was made, (4) debtor made the  
14 misrepresentation with intent to deceive the creditor, (5) the creditor relied on the misrepresentation, (6) the  
15 creditor's reliance was reasonable, and (7) damage proximately resulted from the misrepresentation. *In re*  
16 *Candland*, 90 F.3d 1466, 1469 (9<sup>th</sup> Cir. 1996). Miller must prove each of these elements by a  
17 preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 291, 111 S. Ct. 654, 112 L. Ed.2d 755  
18 (1991).

19 **1. Written Statement of Financial Condition**

20 To satisfy the first element of proof under § 523(a)(2)(B), Miller must establish that the alleged  
21 misrepresentation was in writing, that it concerned the debtor's financial condition, and that the debtor wrote,  
22 signed or, at least, adopted and used the written statement. *In re Tallant*, 218 B.R. 58, 69-70 (B.A.P. 9<sup>th</sup> Cir.  
23 1998), *citing*, 4 COLLIER ON BANKRUPTCY, at ¶ 523.08[2][a] (Lawrence P. King, 15<sup>th</sup> ed. rev. 1997). Here,  
24 the record establishes that on September 23, 1998, Liles and Schumacher met with LeClerc, Miller's agent,  
25 and gave him copies of several documents, including Liles' option agreement with Citizens State Bank, the  
26 investment brochure that Liles used to market his option shares and the notice to the bank's other shareholders  
27 of Gamboa's offer to purchase the stock for \$51.25 per share. Because Miller's claims of fraud are based on  
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1 statements contained in these documents, he has satisfied the initial requirement that the representations be in  
2 writing.

3 The next question is whether the documents concerned the debtor's financial condition. The court  
4 acknowledges that some courts narrowly construe this statutory requirement to include only representations  
5 of net worth or the overall ability to generate income, similar to that which would be found in a formal financial  
6 statement or balance sheet. Other courts broadly conclude that any representation reflecting on a person's  
7 financial condition is sufficient." *See Tallant*, 218 B.R. at 70 (discussing the two opposing schools of thought).  
8 Even under the narrow construction, it is plain here that the documents given to LeClerc contained statements  
9 concerning Liles' financial condition. The documents described Liles' stock option and his agreement to sell  
10 stock to CarMarc at \$51.25 per share. Although these representations were not in a formal financial statement,  
11 it is clear that the purpose behind giving the documents to LeClerc was to make specific representations  
12 concerning Liles' net worth and ability to generate the income necessary to repay the loan.

13 Liles contends, however, that he did not make the representations to Miller because he never  
14 authorized Schumacher to present the documents to LeClerc. This argument is not helpful. Even where a  
15 debtor makes no false representations himself, he may be bound by the fraud of an agent acting within the  
16 scope of his authority. *In re Smith*, 61 B.R. 742, 747 (Bankr. D. Mt. 1986), *quoting*, 3 COLLIER ON  
17 BANKRUPTCY, ¶ 523.08, pp. 553-44 to 52. Liles does not deny that Schumacher was his agent during the  
18 September 23 meeting. Moreover, Schumacher presented the documents to LeClerc in Liles' presence  
19 without disapproval from Liles and, therefore, with Liles' implicit authority. At the very least, Liles ratified the  
20 actions of his agent by failing to object. In the end, there is no evidence beyond Liles' own self-serving  
21 testimony to limit Schumacher's authority to present the documents to LeClerc. The court finds that Liles'  
22 testimony is unpersuasive and that Liles is bound by Schumacher's actions. The evidence demonstrates that  
23 Liles either wrote, signed or adopted and used the documents in question.

24 Based on the above, the court concludes that Miller has satisfied the first element of proof under §  
25 523(a)(2)(B).

26 **2. Material Falsity**

1 Under Ninth Circuit law, a representation will be materially false for purposes of § 523 (a)(2)(B) if it  
2 contains substantial inaccuracies that would generally affect a lender’s decision. *Candland*, 90 F.3d at 1470.  
3 By this standard, Miller must show “not only that the statements are inaccurate, but also that they contain  
4 important and substantial untruths” and that the untruths are of a type that would affect the creditor’s decision  
5 making process.” *In re Greene*, 96 B.R. 279, 283 (B.A.P. 9<sup>th</sup> Cir. 1989). Both the inclusion of false  
6 information or the omission of important information about a debtor’s financial condition may render a statement  
7 materially false. *Tallant*, 218 B.R. at 71. In addition, the court may consider the surrounding circumstances  
8 in determining whether a statement of financial condition is materially false. For example, in addition to the  
9 monetary amount or the type of information that is misrepresented, a finding of materiality may be supported  
10 by the existence of multiple misrepresentations within a financial statement. *Candland*, 90 F.3d at 1470, *citing*,  
11 *In re Lansford*, 822 F.2d 902, 904 (9<sup>th</sup> Cir. 1987).

12 With these principles in mind, the evidence before the court is sufficient to demonstrate that the financial  
13 documents presented to Miller, via LeClerc, on September 23, 1998 contained substantial and important  
14 inaccuracies regarding the value of Liles’ Citizens State Bank stock. Liles’ investment brochure, the letter  
15 agreement with CarMarc and the escrow instructions concerning the sale to CarMarc all reflect a value near  
16 \$40.00 or \$50.00 per share - well above both the option price of \$24.70 per share and the book value of  
17 \$30.00 per share. Even assuming the figures set forth in these documents were reasonable estimates at the time  
18 each document was created, by September 23, they considerably overstated the value of the stock. It is also  
19 significant that Liles or Schumacher failed to mention that there might be problems obtaining the stock or that  
20 Liles had a second agreement with CarMarc which limited Liles’ net proceeds from the stock transaction to  
21 \$45,000, a value that works out to slightly less than \$30.00 per share.

22 Moreover, the inaccuracy created by the overvaluation of the stock is exactly the type of information  
23 that is likely to affect the creditor’s decision to lend money. Any potential creditor would want know whether  
24 the value of the stock, as reflected in the documents given to Miller, was largely inaccurate, especially where  
25 the overvalued stock was Liles’ most significant asset and was specifically designated as the source of funds  
26 available to repay the proposed loan.

1 Finally, the evidence also demonstrates that the misstatements occurred a number of times in multiple  
2 documents, and this repetition contributes to the finding that the overvaluation was material. The court  
3 concludes that Miller has adequately proven the element of material falsity.

4 **3. Knowledge of Falsity and Intent to Deceive**

5 Even where a statement of financial condition is materially false, the resulting debt will not be excepted  
6 from discharge unless the debtor knew the statement was false and intended to deceive the creditor. Although  
7 *Candland* lists knowledge and intent as two separate elements, in this context, knowledge is often treated as  
8 a component of intent. In any event, the two elements are closely intertwined, and this court will discuss them  
9 together.

10 In addition to actual knowledge of falsity, the Ninth Circuit has held that “reckless disregard for the truth  
11 of a representation satisfies the element that the debtor has made an intentionally false representation in  
12 obtaining credit.” *In re Kong*, 239 B.R. 815, 826 (B.A.P. 9<sup>th</sup> Cir. 1999), *citing*, *In re Anastas*, 94 F.3d  
13 1280, 1283 (9<sup>th</sup> Cir. 1996). In other words, the scienter requirement for the fraudulent misrepresentation may  
14 be established by showing “either actual knowledge of the falsity of a statement, or reckless disregard for its  
15 truth ....” *In re Gertsch*, 237 B.R. 160, 167 (B.A.P. 9<sup>th</sup> Cir. 1999), *quoting*, *In re Houtman*, 568 F.2d  
16 651, 656 (9<sup>th</sup> Cir. 1978). Reckless conduct involves more than simple negligence. Nevertheless, for §  
17 523(a)(2), a person is said to be reckless when that person chooses to make a representation of fact but is  
18 “conscious that he has merely a belief in its existence and recognizes that there is a chance, more or less great,  
19 that the fact may not be as it is represented.” *Gertsch*, 237 B.R. at 68, *citing* Restatement (Second) of Torts  
20 § 526 (1977). *Accord*, *Kong*, 239 B.R. at 826-27.

21 The elements of knowledge and intent are central to this case. Liles maintains that at the time the  
22 various documents were created, he honestly believed his valuations of the bank stock were reasonable and  
23 that his inability to repay Miller’s loan was due to unforeseen circumstances that occurred after he obtained the  
24 loan. In essence, he claims that the documents were originally prepared for other purposes and, therefore, he  
25 did not intend to deceive LeClerc or Miller because he did not know they would be relying on them. This  
26 argument misses the point. The evidence shows that Liles republished the documents on September 23, 1998  
27 at the meeting with LeClerc. The question then is whether, as of September 23, 1998, Liles was aware the  
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1 estimates were false or whether he presented the documents to LeClerc in reckless disregard of the  
2 inaccuracies they contained. Based on the documents in evidence, witness testimony and the factual  
3 circumstances surrounding Liles' dealings with Miller, the court concludes that Liles produced the documents,  
4 at the very least, with reckless disregard of their substantial inaccuracies.

5 Unconflicting testimony establishes that Liles presented Miller with documents inaccurately showing that  
6 he would receive \$572,308.75 from the sale of Citizens State Bank stock to CarMarc. However, it is what  
7 Liles did not reveal to Miller that is fatal to Liles' claimed lack of knowledge and intent. First, a September 10,  
8 1998 letter from attorney Cohen to counsel for Citizens State Bank discusses and takes issue with the bank's  
9 decision to contest the exercise of the stock option. This piece of evidence demonstrates that when Liles met  
10 with LeClerc on September 23, Liles was aware that the bank was contesting the exercise of the stock option  
11 and that Liles' ability to get the stock was in jeopardy. This fact was echoed in Liles' trial testimony where he  
12 admitted that it would be difficult getting the stock. The court is not persuaded that Liles failed to mention this  
13 important fact merely because he forgot. Rather, the evidence shows that shortly before the close of escrow  
14 on the coffee shop, First National Bank denied the loan that Liles thought he had in hand. Liles was then under  
15 pressure to obtain financing in relatively short order so he could close escrow on the coffee shop. When  
16 Monterey County Bank came up \$50,000 short in its loan commitment, Liles approached Miller, a private  
17 lender, in something close to a last ditch effort. These circumstances suggest that, despite knowledge to the  
18 contrary, Liles made no mention of Citizens State Bank's opposition to the option because Liles wanted Miller  
19 to believe Liles more creditworthy than the truth would suggest.

20 Liles engaged in a second, similarly disturbing omission in his dealings with Miller. The documents  
21 provided to LeClerc indicated that Liles would receive \$572,308.75 from the sale of stock to CarMarc. From  
22 that amount, Liles would pay \$275,824.90 to Citizens State Bank for the stock. As a result, the documents  
23 indicated that Liles would net \$296,483.85, an amount more than sufficient to repay the loan from Miller. Liles  
24 failed to disclose, however, the existence of the second undocumented agreement with CarMarc which only  
25 guaranteed that Liles would receive \$45,000 above the option purchase price. Liles' testimony regarding this  
26 second agreement does little to help Liles. Although Liles admitted the existence of the second agreement, he  
27 did not recall telling Mr. LeClerc anything about that agreement.

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1 Miller advanced the loan proceeds to Liles on October 1, 1998. Liles testified that he and Gamboa  
2 reached their second agreement sometime in early 1999. Because the agreement itself was not presented at  
3 trial, there is no evidence to support this assertion other than Liles' own testimony. The court finds his  
4 testimony to be less than credible, especially in light of the written escrow instructions that documented the  
5 original agreement with CarMarc. Those instructions never required Gamboa to actually pay any more than  
6 the amount necessary to exercise the stock option. Even if this court found Liles' testimony about the timing  
7 of the undocumented agreement to be credible, Liles' failure to inform Miller of the bank's opposition to his  
8 exercise of the stock option would still constitute an omission of fact in reckless disregard of the truth.  
9 Therefore, Miller has proven by a preponderance of the evidence that Liles acted with the requisite knowledge  
10 and intent to deceive under § 523 (a)(2)(B).

11 **4. Reasonable Reliance by Creditor**

12 Before a creditor is entitled to except a debt from discharge under § 523(a)(2)(B), the creditor must  
13 establish that the creditor relied on the materially false statements at issue and that the creditor's reliance was  
14 reasonable. *Candland*, 90 F.3d at 1471. Although the Ninth Circuit has recognized that reasonable reliance  
15 is a more rigorous standard than that of justifiable reliance, the circuit has not been specific in defining its  
16 parameters. *Id.*; *Gertsch*, 237 B.R. at 170. What is clear, is that "[I]enders do not have to hire detectives  
17 before relying on borrowers' financial statements," nor must they "view each representation with incredulity  
18 requiring verification." *Gertsch*, 237 B.R. at 170. Indeed, once there is proof of a materially fraudulent  
19 statement, little investigation is required for the creditor to clear the hurdle of reasonable reliance. *In re Smith*,  
20 242 B.R. 694, 702 (B.A.P. 9<sup>th</sup> Cir.1999). The hurdle is low because it is only intended to eliminate creditors  
21 who are acting in bad faith. *Gertsch*, 237 B.R. at 170. For example, creditors cannot ignore obviously false  
22 representations. *Id.* Creditors can demonstrate that their reliance was reasonable by showing that they  
23 followed normal business practices in approving a loan. However, such a showing is not a prerequisite. *Id.*  
24 at 170-71.

25 Here, LeClerc's testimony establishes that LeClerc and Miller relied on the financial documents  
26 presented to LeClerc and would not have loaned money to Liles if they had known the truth. That reliance was  
27 reasonable because the misrepresentations contained in the documents were not at all obvious. There was  
28

1 nothing in the documents to alert Miller or LeClerc that Liles had overvalued the stock option. Moreover, there  
2 was no reason to suspect or any way to discover that Citizens State Bank had challenged Liles' exercise of the  
3 stock option. Further, Miller and LeClerc had no reason to doubt that the sale of stock to CarMarc was at  
4 a price other than \$51.25 per share. Liles presented them with documents reflecting the \$51.25 sale price and  
5 neglected to mention the second tacit agreement at a much lower price.

6 Liles also conveyed information concerning his background, including his twenty-seven years of  
7 professional banking experience, to influence LeClerc. In light of this background, LeClerc had a rational basis  
8 to believe that Liles understood the lending business and the need for accurately portraying his current financial  
9 position. Under all of these circumstances, it was reasonable for Miller to rely upon the misrepresentations  
10 presented to him.

#### 11 **5. Damages**

12 Miller's final element of proof is to show that he sustained damages proximately caused by Liles'  
13 material misrepresentations. This element is easily satisfied because Liles failed to repay a debt based on credit  
14 that would not have been extended but for Liles' misrepresentations. It makes no difference why Liles could  
15 not or did not repay the loan. The damage occurred when Miller extended credit based on the material  
16 misrepresentations. Because Liles failed to repay the loan, Miller is entitled to compensation for his losses.

17 In light of the above, the court concludes that Miller adequately established each of the elements  
18 necessary to except the debt at issue from discharge under § 523(a)(2)(B), and, therefore, the court need not  
19 determine whether the debt could also be excepted under § 523(a)(2)(A).

#### 20 **6. Liability of Liles' Spouse**

21 As a final matter, the court must consider whether the exception from discharge is effective against  
22 Marcia Liles, who is a codefendant in this proceeding and a joint debtor in the main bankruptcy case. As noted  
23 above, to qualify for exception from discharge, there must be proof of actual intent to defraud the creditor.  
24 Where no agency relationship exists, courts generally have not imputed the wrongdoing of one spouse to the  
25 other spouse for purposes of establishing nondischargeability. *In re Tsurukawa*, 258 B.R. 192, 198 (B.A.P.  
26 9<sup>th</sup> Cir. 2001), *citing*, *In re Lansford*, 822 at 904-05. Indeed, in *Tsurukawa*, the court specifically held that  
27 the marital relationship alone, without a further agency relationship, cannot serve as a basis for imputing fraud  
28

1 from one spouse to the other. *Tsurukawa*, 258 B.R. at 198. Miller offered no evidence regarding Marcia  
2 Liles' intent to defraud Miller. Moreover, none of the evidence suggests that Liles and his wife were active  
3 partners in the business of SBM Enterprises or that they had any other agency relationship beyond their  
4 marriage. As a result the debt at issue is dischargeable vis á vis Marcia Liles.

5  
6 CONCLUSION

7 For the above reasons, the court concludes that judgment should be entered in favor of plaintiff David  
8 Miller and against defendant William Liles with respect to Miller's adversary complaint to determine the  
9 judgment debt in the amount of \$53,833.37 nondischargeable based on 11 U.S.C. § 523(a)(2)(B). The court  
10 further concludes that judgment should be entered in favor of defendant Marcia Liles and against the plaintiff.

11 Counsel for plaintiff is directed to prepare an appropriate form of judgment in accordance with this  
12 decision and, after service on defendants, submit the same to the court for entry.

13  
14  
15  
16 DATED: \_\_\_\_\_

UNITED STATES BANKRUPTCY JUDGE \_\_\_\_\_