

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF)	
)	
BRAD WISENBAUGH and)	CASE NO. 12-30625 HCD
ANNA K. WISENBAUGH,)	CHAPTER 7
)	
DEBTORS.)	
)	
)	
LAPORTE COMMUNITY FEDERAL)	
CREDIT UNION,)	
)	
PLAINTIFF,)	
vs.)	PROC. NO. 12-3036
)	
BRAD WISENBAUGH,)	
)	
DEFENDANT.)	

Appearances:

Brooks J. Grainger, Esq., counsel for plaintiff, Post Office Box 6200, South Bend, Indiana 46660; and
Brad Wisenbaugh, *pro se*, 6003 West Zacharie, LaPorte, Indiana 46350.

MEMORANDUM OF DECISION

At South Bend, Indiana, on March 11, 2014.

Before the court is the Amended Motion for Default Judgment, filed by LaPorte Community Federal Credit Union (“plaintiff” or “Credit Union”) against the chapter 7 debtor Brad Wisenbaugh (“defendant” or “debtor”). The plaintiff requests that the court grant a default judgment in its favor and against the defendant and except the defendant’s debt to the plaintiff from his discharge pursuant to 11 U.S.C. § 523(a)(2)(A) and (B). For the reasons set forth in this Memorandum of Decision, the court denies the Amended Motion.¹

¹ The court has jurisdiction to decide the matter before it pursuant to 28 U.S.C. § 1334 and § 157 and the Northern District of Indiana Local Rule 200.1. The court has determined that this matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I).

BACKGROUND

The background for this adversary proceeding was set forth in the court's prior Memorandum of Decision. *See* R. 10. Briefly, the plaintiff Credit Union brought an adversary proceeding against the debtor Brad Wisenbaugh pursuant to 11 U.S.C. § 523(a)(2)(A) and (B).² When he failed to appear or respond to the plaintiff's Complaint, the plaintiff filed a Motion for Default Judgment. In its Memorandum of Decision, the court denied the plaintiff's Motion for Default Judgment but allowed the plaintiff another opportunity to demonstrate its entitlement to an entry of default and a default judgment.

The court now finds that the plaintiff, in its subsequently filed documents, remedied the procedural errors that led to the denial of its original Motion. Its Affidavit of Default complied with the requirements of Rule 55(a). *See* R. 15. Therefore the court issued the Clerk's Entry of Default against the defendant. *See* R. 17; *see also Target Nat'l Bank v. Redmond (In re Redmond)*, 399 B.R. 628, 632 (Bankr. N.D. Ind. 2008). Thereafter the plaintiff filed its Amended Motion For Default Judgment pursuant to Rule 55(b). *See* R. 20. It was supported by two affidavits: The Affidavit of Debt, filed by the plaintiff's authorized signer, declaring the defendant's debt to be \$2,075.00; and the Affidavit of Non-Military Service, filed by plaintiff's counsel, verifying the defendant's status as not an infant, an incompetent person, or an active military servicemember. Counsel confirmed the defendant's military status through the Report of the Department of Defense Manpower Data Center.³ The court found that the Affidavit marginally complied with the requirements of Rule 55(b) and the Servicemembers Civil Relief Act, 50 U.S.C. App., § 521. *See United States v. Herzberg*, 2012 WL 523651, at *3 (E.D. Tenn. Jan. 25, 2012); *In re Redmond*, 399 B.R. at 632. Proof of the defendant's default thus was deemed acceptable pursuant to Rule 55.

² The adversary proceeding was brought against both debtors. However, the court granted the plaintiff's Motion to Dismiss Anna K. Wisenbaugh as a party defendant. *See* R. 14.

³ The court notes that the plaintiff requested a Status Report for "Wisenbaugh," without a first or middle name, and without a social security number. It therefore questions the accuracy of the Report, as did the Director of the Department of Defense Manpower Data Center. *See* R. 20, Affid., Ex. A.

Nevertheless, “[o]nce the default is established, and thus liability, the plaintiff still must establish his entitlement to the relief he seeks.” *In re Catt*, 368 F.3d 789, 793 (7th Cir. 2004). A motion for default judgment must demonstrate that the allegations of the underlying complaint prove a *prima facie* case for a valid cause of action and establish the defendant’s liability as a matter of law. See *In re Redmond*, 399 B.R. at 933 (citing *In re Taylor*, 289 B.R. 379, 382 (Bankr. N.D. Ind. 2003) and other cases). The court set out this “entitlement” requirement in its earlier Memorandum of Decision.

Rule 55(b) requires that a motion for default judgment present a *prima facie* case that demonstrates that the Complaint’s undisputed allegations proved the essential elements of the Bankruptcy Code section under which the Complaint was brought, in this case 11 U.S.C. § 523(a)(2)(A) and (B). There must be factual allegations to support those elements.

R. 10 at 4-5.

In its Complaint the plaintiff asked the court to find the defendant’s loan obligation to the plaintiff nondischargeable under § 523(a)(2)(A)⁴ and (B).⁵ It argued that the financial document provided by the defendant, the Application for Credit, did not reflect his true financial condition. Credit applications are written statements regarding the financial condition of the applicant. See *In re Sapp*, 364 B.R. 618, 627

⁴ Section 523(a)(2)(A) provides, in pertinent part, that “[a] discharge . . . does not discharge an individual debtor from any debt – . . . (2) “for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by – (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s . . . financial condition.” 11 U.S.C. § 523(a)(2)(A).

⁵ Section 523(a)(2)(B) provides, in pertinent part, that:

- (a) A discharge . . . does not discharge an individual debtor from any debt —
 - . . .
 - (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by –
 - . . .
 - (B) use of a statement in writing –
 - (i) that is materially false;
 - (ii) respecting the debtor’s or an insider’s financial condition;
 - (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
 - (iv) that the debtor caused to be made or published with intent to deceive.

11 U.S.C. § 523(a)(2)(B).

(Bankr. N.D.W.Va. 2007). As such, the defendant's Application must be reviewed under § 523(a)(2)(B), which focuses on written financial statements, rather than under § 523(a)(2)(A), which expressly excepts them from that subsection. "Subsections 523(a)(2)(A) and (a)(2)(B) are mutually exclusive." *In re O'Neill*, 468 B.R. 308, 343 (Bankr. N.D. Ill. 2012).

[T]he fact that Congress excluded debts obtained through use of false financial statements from paragraph (A), and dealt with those debts in a separate subparagraph (B), makes clear that a plaintiff must prove different evidence for each subsection.

Giesecking v. Thomas, 358 B.R. 754, 766 (Bankr. S.D. Ill. 2007) (quoted in *In re Bishop*, 420 B.R. 841, 858 (Bankr. N.D. Ala. 2009)). Therefore the court will consider the plaintiff's claim only under § 523(A)(2)(B).

When reviewing a dischargeability complaint, the court is guided by well settled principles.

In bankruptcy, "exceptions to discharge are to be [construed] strictly against a creditor and liberally in favor of the debtor." *In re Zarzynski*, 771 F.2d 304, 306 (7th Cir. 1985). The burden is on the objecting creditor to prove exceptions to discharge.

Goldberg Secs., Inc. v. Scarlata (In re Scarlata), 979 F.2d 521, 524 (7th Cir. 1992).

In order to prevail on a § 523(a)(2)(B) claim, the creditor must prove that: (1) the debtor made a statement in writing; (2) the statement was materially false; (3) the statement concerned the debtor's financial condition; (4) the debtor intended to deceive the creditor; and (5) the creditor reasonably relied on that statement.

In re Carmell, 424 B.R. 401, 415-16 (Bankr. N.D. Ind. 2010) (citing *In re Sheridan*, 57 F.3d 627, 633 (7th Cir. 1995)). Moreover, when the creditor alleges a fraudulent financial statement under § 523(a)(2)(B), it must support its claim of misrepresentation or fraud in the written statement with particularity, pursuant to Federal Rule of Civil Procedure 9(b). See *In re Neale*, 440 B.R. 510, 522 (Bankr. W.D. Wis. 2010).

The Seventh Circuit Court of Appeals, in *In re Morris*, 223 F.3d 548 (7th Cir. 2000), focused on the "reasonable reliance" standard of § 523(a)(2)(B). The reasonableness of the reliance, it stated, should be evaluated in each case by its circumstances.

While we understand that the concept of reasonable reliance does not generally require creditors to conduct an investigation prior to entering into agreements with prospective debtors, such a precaution could be the ordinarily prudent choice in circumstances where the creditor admits that it does not believe the representations made by the prospective debtor. See *Coston v. Bank of Malvern (In re Coston)*, 991 F.2d 257, 261 (5th Cir. 1993) (stating that when determining

reasonable reliance, “[t]he bankruptcy court may consider, among other things: whether there had been previous business dealings with the debtor that gave rise to a relationship of trust; whether there were any ‘red flags’ that would have alerted an ordinarily prudent lender to the possibility that the representations relied upon were not accurate; and whether even minimal investigations would have revealed the inaccuracy of the debtor’s representations”).

In re Morris, 223 F.3d at 554. Following *Morris* and other Seventh Circuit precedents, a sister bankruptcy court recently stated:

An investigation is not generally required of creditors. However, reliance may not be reasonable where a creditor “possesses information sufficient to call the representation into question.” In other words, the creditor cannot close its eyes to obvious red flags that should alert it.

In re Gunsteen, 487 B.R. 887, 902 (Bankr. N.D. Ill. 2013) (quotations, citations omitted).

With the essential elements of § 523(a)(2)(B) and those principles in mind, the court turned to the Amended Motion for Default Judgment. To obtain a default judgment against the defendant, the plaintiff’s Amended Motion was required to demonstrate that the plaintiff’s Complaint proved a *prima facie* case entitling the plaintiff to relief as a matter of law under § 523(a)(2)(B).

The plaintiff’s Amended Motion was brief. It asked the court to except the defendant’s debt to the plaintiff from his discharge on these grounds: (a) that the Complaint was filed and timely served on the defendant by first class mail; (b) that the defendant failed to appear or answer; (c) that the Department of Defense Manpower Data Center’s Report revealed that the defendant was not in the military; and (d) that the defendant owes the plaintiff \$2,075.00. The Amended Motion did not mention one element of § 523(a)(2)(A) or (B). It did not attempt to demonstrate the *prima facie* case that would show that the Credit Union was entitled to relief under § 523(a)(2)(B).

The Amended Motion for Default Judgment could be denied without further discussion for failure to satisfy Federal Rule of Civil Procedure 55. *See, e.g., In re Dade*, 2012 WL 1556510 at *6 (Bankr. C.D. Ill. May 1, 2012); *In re Bungert*, 315 B.R. 735, 740-41 (Bankr. E.D. Wis. 2004); *In re Trevisan*, 300 B.R. 708, 719 (Bankr. E.D. Wis. 2003). Nevertheless, the court examined the sufficiency of the Complaint itself to see if it satisfied the “entitlement” requirement of Rule 55(b). The plaintiff’s Complaint based its claim

of nondischargeability on the Application for Credit which the defendant filled out in order to obtain a \$2,000.00 loan from the plaintiff. The court finds that the Application at issue constitutes a “statement in writing” “respecting the debtor’s financial condition” under § 523(a)(2)(B). *See In re Contos*, 417 B.R. 557, 563 (Bankr. N.D. Ill. 2009); *In re Sapp*, 364 B.R. at 627. It therefore satisfied two of the necessary elements of § 523(a)(2)(B). The court then looked for proof of the remaining factors.

The Complaint did not allege that the Application was “materially false,” that the defendant made the Application with “the intent to deceive” the plaintiff, or that the plaintiff “reasonably relied” on the Application. However, the pleading pointed to two sections of the Application: (1) the “Statement of Total Indebtedness and Liabilities” (“Statement of Debts”) that was left blank; and (2) the “No” box checked for the question “any legal proceedings against you?” The Complaint alleged that the defendant’s omission of any debts “indicat[ed] that he had no debt obligations.” R. 1, ¶ 7. It explained that the Credit Union loaned the defendant \$2,000.00 based on its review of the Application and the defendant’s credit bureau report (“Credit Report”), which it obtained from TransUnion. *See id.* at ¶¶ 8-10, Ex. B. The Credit Union later learned, from the defendant’s bankruptcy schedules, which were filed more than 7 months later, that the defendant had incurred 5 debts that should have been disclosed on his Application. It also discovered that there was a pending suit against the defendant in the LaPorte Superior Court at the time he submitted the Application. The plaintiff alleged that it would not have made the loan if it had known of the debts and the lawsuit against the defendant. *See id.* ¶¶ 15, 19. It asserted that the defendant’s “conduct in taking out the loan from [the plaintiff Credit Union] and in misrepresenting his willingness and ability to repay the obligations incurred render[ed] his debt to [the plaintiff] non-dischargeable under 11 U.S.C. § 523(a)(2)(A) and (B).” *Id.* ¶ 21. In the court’s view, that allegation suggested, without alleging, that the written statement, the Application, was materially false.

The Complaint also intimated, without alleging, that the defendant intended to deceive the plaintiff: It noted that the defendant’s Application was proven to be false when the defendant filed

bankruptcy and listed certain debts and the legal action against him. However, it did not allege or show that the defendant intended to deceive the plaintiff at the time he submitted the Application. *See In re Sheridan*, 57 F.3d at 633 (stating required showing that defendant “possessed the requisite intent when he submitted his financial statements” to the plaintiff); *In re Hanselman*, 454 B.R. 460, 465-66 (Bankr. S.D. Ind. 2011) (finding that bank didn’t show that unsophisticated debtor intended to deceive bank when he submitted inaccurate, incomplete evidence). The Complaint’s oblique hints to the required statutory criteria, by themselves, are insufficient allegations, even when the allegations are uncontested. “It must be shown that the debtor’s alleged false statement in writing was either knowingly false or made so recklessly as to warrant a finding that the debtor acted fraudulently.” 4 *Collier on Bankruptcy* ¶ 523.08[2][e] at 523-51 (Alan N. Resnick & Henry J. Sommer, Eds., (16th ed. 2013)).

When considering the last element of § 523(a)(2)(B), “reasonable reliance,” however, the court determined that the plaintiff’s allegations in its Complaint were insufficient to state a claim as a matter of law. The court first found that the Complaint simply implied, without alleging, that it reasonably relied on the Application by insisting that the plaintiff would not have made the loan if it had known of the debts and the lawsuit at the time of the loan. In addition, when the court reviewed the plaintiff’s Application for Credit and the Credit Report, the documents upon which the plaintiff relied when making its loan to the defendant, the court concluded that the plaintiff’s reliance on them could not be found to be “reasonable.”

The law in this circuit is clear that a creditor generally is not required to investigate a credit application unless it questions or does not believe some representations made on the application. *See In re Morris*, 223 F.3d at 554; *see also In re Martin*, 306 B.R. 591, 608 (C.D. Ill. 2004) (“If under a totality of the circumstances, a false financial statement appears to give a complete picture of a debtor’s financial condition, a creditor is entitled to rely on the statement without verification.”) (citing *In re Garman*, 643 F.2d 1252, 1260 (7th Cir. 1980)). Nevertheless, when a credit application does not present a complete picture, the creditor should look for “red flags” that would warn it, as an ordinarily prudent lender, to the chance that the

representations in the application on which the creditor relied were not accurate. *See In re Morris*, 223 F.3d at 554.

The court found that several portions of the Application should have caused the plaintiff to inquire further. The sections left blank – such as the Statement of Debts, Question 4 (“Have you ever had credit in any other name?”), and Question 6 (“Have you any obligations not listed?”) – reflected either incomplete or inaccurate statements, ones which an ordinarily prudent lender would have examined further instead of interpreting the missing answers as a positive statement that there were no debts. *See, e.g., In re Kosinski*, 424 B.R. 599, 612 (1st Cir. B.A.P. 2010) (blank entries on financial statement were warning signs that a reasonably prudent investor would not have ignored); *In re DeGlopper*, 138 F. Supp. 928, 935 (D.C. Mich. 1956) (debtor’s written application to bank, with blank list of creditors, was not materially false statement respecting his financial condition, could not be construed, under Bankruptcy Act, as debtor’s fraudulent representation that he had no “present creditors”); *In re Gallagher*, 72 B.R. 830, 837 (Bankr. N.D. Ind. 1987) (creditor failed to recognize red flags, failed to conduct reasonable inquiry).

Other red flags appeared when the court compared the information in the Application with the information in the Credit Report. It appears that the Credit Union, perhaps as a matter of normal business practice, made the prudent choice to obtain a Credit Report from TransUnion concerning the defendant’s financial condition. However, it also appears that it did not consult the report or compare the Application to the Credit Report in evaluating the creditworthiness of the defendant. The court found that its comparison of the two documents led to questions that a prudent lender would have raised before granting a loan. It was noteworthy, from the outset, that the plaintiff’s request to TransUnion misspelled the defendant’s name. Nevertheless, TransUnion noted the “ID mismatch” and found a “Brad R. Wisenbaugh” with an address of 1115 Ridge Street in LaPorte, Indiana – the address this defendant listed in the Application for Credit.

The red flags that the court found in its comparison of the Application and the Credit Report included these:

1. The defendant's 1115 Ridge Street address is listed as his *former* address on the Credit Report, but his *present* address on the Application.
2. The defendant's current employer on the Credit Report is Vanair. His current employer on the Application is CompressAir, and the previous employer is Vanair.
3. The Credit Report lists a "High Risk Fraud Alert," and its Model Profile includes "serious delinquency, and public record or collection filed," and "too many inquiries last 12 months."
4. Several collections were listed on the Credit Report.

See R. 1, Exs. A, B.

Even more red flags appeared when the court compared the information in the Application to the docket sheet in the state court case against the defendant, a document attached to the Complaint. *See* R. 1, Ex. D. It finds, from that docket sheet, that on September 27, 2011, the defendant was sent a claim concerning eviction to his "residence," which was listed as 6003 W. Zacharie, LaPorte, Indiana – a different address from the residence reported in the Application for Credit and from the current address in the TransUnion Credit Report.⁶ The eviction (from the Zacharie address) was granted on October 13, 2011, after the Application had been completed and the loan granted. The state court judgment of eviction against the debtors was entered by default. In the view of this court, the different residence addresses of the defendant indicate that there are genuine issues of material fact concerning where the defendant resides and whether the defendant had notice or knowledge of the state court case against him when he filled out the Application for Credit with the Credit Union on October 8, 2011.

The plaintiff has the burden of establishing that it reasonably relied on the defendant's representations. It is not entitled to rely on the information before it when discrepancies arise. *See In re Morris*, 230 B.R. 352, 361 (Bankr. N.D. Ill. 1999) (stating that, "where there are 'red flags,' the creditor has a duty to reasonably investigate before it extends the credit"), *aff'd*, 223 F.3d 548 (7th Cir. 2000); *In re Gunsteen*, 487 B.R. at 902 (stating that "the creditor cannot close its eyes to obvious red flags"). In this case, there was important, material information missing from the Application, and the court finds that the plaintiff

⁶ The street address on Zacharie is the one listed on the debtor's petition and is his current address.

had a duty to probe further, before granting the loan, to clarify the omissions and to discover whether the debtor's representations were inaccurate, careless, or intentionally deceptive. *See In re Gunsteen*, 487 B.R. at 902 (finding that bank should have requested rewritten, fully consistent document); *In re Hanselman*, 454 B.R. at 465 (noting that "a minimal investigation of [defendant's] credit-worthiness would have revealed substantial inaccuracies" in the financial statement). The court determines that the plaintiff's failure to investigate in this case does not constitute "reasonable reliance." On that ground, the court concludes that the plaintiff failed to establish this necessary element of proof under § 523(a)(2)(B).

In sum, the court finds that, as a matter of law, the plaintiff's Motion for Default Judgment failed to show that the allegations of its Complaint proved a *prima facie* case for a valid cause of action under 11 U.S.C. § 523(a)(2)(B). Accordingly, the Credit Union's default judgment motion is denied.

CONCLUSION

For the reasons presented in this Memorandum of Decision, the Amended Motion for Default Judgment of the plaintiff LaPorte Community Federal Credit Union against the defendant Brad Wisenbaugh is denied pursuant to Federal Rule of Bankruptcy Procedure 7055 and Federal Rule of Civil Procedure 55. An evidentiary hearing will be set by separate order, at which the plaintiff may attempt to offer evidence to prove its entitlement to a judgment of nondischargeability pursuant to § 523(a)(2)(B).

SO ORDERED.

/s/ HARRY C. DEES, JR.

HARRY C. DEES, JR., JUDGE
UNITED STATES BANKRUPTCY COURT