UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE:		: CHAPTER 7
		:
MARY ELLEN DIENER,		:
	DEBTOR	: BANKRUPTCY NO. 00-32892 (SR)
MELLON BANK, N.A.		:
	PLAINTIFF	:
VS.		:
MARY ELLEN DIENER		: ADV. NO. 01-1094
	DEFENDANT	:

OPINION

By: STEPHEN RASLAVICH, UNITED STATES BANKRUPTCY JUDGE.

I.

Plaintiff, Mellon Bank, N.A., ("Mellon") objects to the discharge of a debt owed to it by the Defendant/Debtor, Mary Ellen Diener.[1] In support of its position Mellon invokes the exceptions to discharge set forth at 11 U.S.C. §523 (a)(2)(A) and (B). Mellon's complaint was filed on November 7, 2001. The Debtor filed an answer on December 10, 2001 and on April 29, 2002, the parties filed a voluminous pre-trial statement. A lengthy trial was held in May, 2002 and each party thereafter submitted a post-trial memorandum of law. This is a core proceeding under 28 U.S.C. §157 (b)(2)(I). For the reasons which follow, a portion of the debt in question will be excepted from discharge, however the remainder of the relief Mellon seeks will be denied.

[1] Mellon is actually the nominal Plaintiff herein, as it has apparently assigned its interest in the claims raised against the Debtor to Citizen's Bank of Pennsylvania.

II.

The Debtor is the former owner and operator of a business corporation named Advantage Healthcare, Inc. ("Advantage"). Advantage sold and leased durable medical equipment to the general public for the treatment of circulatory disorders. Revenue to Advantage typically came from third-party payors, such as insurance companies and Medicare. In 1996 Advantage entered into a banking relationship with Mellon to finance its operations. The Debtor became a personal guarantor of her company's obligations to Mellon in March of 1998. Advantage ceased business operations in October, 2000 and is itself now a debtor in a Chapter 7 case pending in this District at Docket No. 00-32893. At present, Advantage owes Mellon approximately $527,000.00. Mellon seeks to have this entire amount declared non-dischargeable in the Debtor's personal bankruptcy case.

Mellon's factual contentions concerning the non-dischargeability of its debt fall into a variety of categories. Generally, Mellon maintains that as the President of the Company the Debtor misrepresented to it the financial condition of Advantage. More specifically, Mellon contends that the Debtor misled it into loaning money to Advantage by overstating Advantage's inventory and accounts receivable, by providing Mellon with false corporate financial statements, and by failing to disclose to Mellon adverse information about Advantage, such as pending litigations, Medicare audits, and cash flow problems. The Debtor disputes the particulars of virtually all of the allegations leveled against her by Mellon, and a great deal of trial time was devoted to the parties efforts to confirm their respective versions of events. This notwithstanding, the parties' joint pre-trial submission does contain a rather lengthy recital of details incident to the loan transactions in issue as to which they profess to be in agreement.

These are repeated here as stated:

1. Bank has offices located at 2001 Market St., Suite 600, Philadelphia, PA 19103-7053.

2. Bank is the assignee of Mellon in respect to all claims of Mellon against Advantage and Diener.

3. Advantage is a Pennsylvania Corporation with a last known address of 1604 Liberty Court, North Wales, PA 91446.

4. Diener is an individual with a current address of 304 Regency Drive, North Wales, PA 19454.

5. On or about October 18, 2001, Krasny, was appointed interim trustee for both the Advantage and Diener Chapter 7 bankruptcy cases and serves as trustee in both cases.

6. On or about May 24, 1999, Advantage executed and delivered to Mellon Bank a Note and Line of Credit Agreement ("Note") evidencing the obligation of Advantage to repay to the Mellon Bank all indebtedness owed to the Mellon Bank in the maximum principal amount of $4000,000.00 ("Obligation").

7. A copy of the Note is attached as Exhibit 1 and is a true and exact copy of the original Note.

8. The $400,000.00 Obligation represented the following:

Loan Date	Amount	Comment
October 1996	$ 50,000.00	Original Loan
March 1998	$150,000.00	Additional Financing
		Loan Balance $200,000.00
February 1999	$ 50,000.00	Additional Financing
		Loan Balance $250,000.00
May 1999	$150,000.00	Additional Financing
		Loan Balance $400,000

9. As security for repayment of the Obligation on or about May 24, 1999, Advantage executed in favor of the Melon, among other things a Security Agreement ("Security Agreement") granting the Mellon a lien and security interest in personal property of Advantage including, but not limited to all:

(a) equipment, wherever located, including machinery, motor vehicles, furniture and fixtures;

(b) inventory (whether held for sale or lease or to be furnished under contracts of service), raw materials, work in process, and materials used or consumed in the conduct of Advantage's business, and all books, records, invoices or other documents which describe or evidence the same; and

(c) accounts, contract rights, general intangibles, chattel paper, choses in action, instruments, documents (including all documents of title and warehouse receipts) and all rights to the payment of money, however evidenced or arising; (collectively "Collateral") owned by Advantage.

10. A copy of the Security Agreement is attached as Exhibit 2 and is a true and exact copy of the original Security Agreement.

11. The security interest of Bank in the Collateral was perfected by the filing of financing statements (a) in the office of the Prothonotary of Montgomery County on or about November 14, 1996, at no. 264204 and as amended on or about July 20, 1999; and (b) with the Department of State for the Commonwealth of Pennsylvania on or about November 11, 1996, at no. 26060824, as amended on or about July 19, 1999, at no. 30510566.

12. On May 24, 1999, Diener executed a Business Credit Application on behalf of Advantage informing that

A) There were no federal or state liabilities past due for the Applicant; and
B) Advantage was not a party to any claim or lawsuit.

13. A copy of the Business Credit Application is attached as Exhibit 3.

14. On or about March 24, 1998, Diener executed in favor of the Mellon Bank, a Guaranty and Suretyship Agreement ("Guaranty") providing, inter alia, that:

To induce Melon Bank, N.A. ("Bank") to transact business and to make credit accommodations with ADVANTAGE HEALTHCARE, INC. ("Debtor"), undersigned {Mary Ellen Diener}, as defined below, does hereby guarantee, absolutely and unconditionally all, and does hereby become surety for the full and timely payment of the principal of, and interest on, all obligations, debts, dues, instruments, liabilities, advances, judgments, damages, losses, claims, contracts, and choses in action, of whatever nature and however arising, **past, present or future, and any and all extensions and renewals thereof in whole or in part**, whether direct or indirect, absolute or contingent, voluntary or involuntary, now due or to become due, and whether owed to Bank from debtor as drawer, maker, endorser, assignor, guarantor, surety or otherwise whatsoever ("Obligations") ... Undersigned will reimburse Bank or any subsequent holder hereof for all expenses incurred, and not reimbursed by Debtor, in collection of Obligations. If this Agreement is referred for collection to an attorney, Undersigned will pay an attorney's fee equal to the lesser of (a) 20% of the amount due or $500, whichever is greater, or (b) the maximum amount permitted by law, and costs of legal proceedings ... **[emphasis added].**

15. A copy of the Guaranty is attached as Exhibit 4 and is a true and exact copy of the original Guaranty.

16. On or about October 13, 2000, Mellon filed a complaint in the State Court at Civil Action - Law and Equity, No. 00-20957, requesting a judgment for possession of the Collateral located at 1604 Liberty Court, North Wales, PA 19446.

17. Prior to the State Court acting in respect of the state court complaint, at no. 00-20957, the above bankruptcy cases were filed.

18. Under paragraph 9 of the Security Agreement, Advantage agreed that until the obligations secured by the Note had been paid in full, Advantage would inter alia "(b) keep accurate and complete books and records in accordance with generally accepted accounting principles and, at [Advantage's] expense, promptly furnish Mellon such information and documents relating to the Collateral at such times and in such form and detail as Melon may request, including without limitation: (1) copies of invoices or other evidence of [Advantage's] accounts and schedules showing the aging, identification, reconciliation and collection thereof; (2) evidence of shipment and receipt of goods and the performance of services or obligations cover by accounts; and (3) reports as to {Advantage's] inventory and purchases, sales, damage, or loss thereof; all of the foregoing to be certified by authorized officers or other employees of {Advantage];...."

19. Under paragraph 9 of the Security Agreement, Advantage also agreed that until the obligations secured by the Security Agreement have been paid in full, Advantage would "(d) at [Advantage's] expense, diligently collect the accounts, an upon notice from Mellon, deliver all proceeds of accounts to Mellon forthwith upon receipt, in the original form in which received; (e) immediately upon Mellon's request, open a cash collateral account ("Cash Collateral account") at Mellon and deposit therein all cash proceeds of collections on the accounts; ..."

20. Subsequent to the commencement of the bankruptcy cases, Mellon obtained relief from the automatic stay in each bankruptcy case in order to proceed with a

collection of the Advantage accounts receivable.

21. Advantage terminated operations prior to the commencement of the bankruptcy cases.

22. A true and correct copy of Diener's Bankruptcy Schedules of Assets and Liabilities are attached as Exhibit 5.

23. A true and correct copy of Advantage's Bankruptcy Schedules of Assets and Liabilities are attached as Exhibit 6.

24. On a personal financial statement submitted by Diener to Mellon, dated May 18, 2000, Diener lists loans due to Advantage from Diener only in the amount of $5,000.00. In Diener's Answer to Mellon Complaint Averment 22, Diener replies "the representation of the $5,000 figure was from Mary Ellen Diener's personal accounts. She did not think to include or list the monies loaned by her father and fiancee. It is further denied that this would have made a difference in the giving of the loan.

25. A copy of the May 18, 2000 Diener personal financial statement is attached as Exhibit 7 and is a true and exact copy of the original Diener personal financial statement.

26. The Year 1999 Advantage tax return report a loss of $303,592. On the Year 1999 Advantage tax return Schedule L "Balance Sheet per Books" Advantage reported an increase of "loans from shareholders: $491,408.00". Deiner is the only shareholder of Advantage.

27. Copies of the Diener original and amended 1997, 1998 and amended personal federal tax returns are attached as Exhibit 8, 9 10 and 11 respectively; the Diener 1999 personal Federal tax return; and the Advantage 1996, 1997, 1998 and 1999 original tax returns are attached as Exhibits 13, 14, 15 and 16, respectfully, and are true and exact copies of the originals.

28. The Advantage accounts receivable and profit/loss were reported as follows:

Source Document	**Date of Record**	**A/R Amount**	**Profit/[Loss]**
Bankruptcy Schedules	10-2000	$1,013,492	
1999 Tax Return prepared October 2000	12-31-1999	$1,171,567	[$303,592]

Advantage balance Sheet	8-31-1999	$1,105,231	
Advantage Statement provided prebankruptcy to Mellon	5-1999	$1,013,493	
1998/1999 Tax Returns	12-31-1998	$ 846,658	21,709
1997/1998 Tax Return	12-31-1997	$ 531,671	173,018
1996/1997 Tax Return	12-31-1996	$ 291,926	8,218
1996 Tax Return	12-31-1995	$ 158,700	

29. As a consequence of filing the Year 1999 Advantage tax return with a loss of $303,592, predicated upon Diener's alleged loan to Advantage in the amount of $491,408, Diener was able to file amended personal tax returns claiming refunds as described as follows; and in addition received the reported cash compensation for each year is shown:

Year	Amount of Refund	Cash Wages	Cash Distribution
1999	$ 6,660.00	$27,000.00	
1998	$13,134.00	86,792.00	
1997	$59,765.00	62,232.00	$ 90,000
Total	$79,559.00		

30. The refunds have been paid by the Internal Revenue Service to Diener who has remitted the refunds to the Trustee except for approximately $6,000.00, which were claimed as an exemption.

31. Prior to May 1999, Advantage and Aetna were engaged in litigation before the Court of Common Pleas of Philadelphia County, Pennsylvania whereby Aetna had been withholding funds from Advantage thereby affecting Advantage's ability to meet its expenses as they came due.

32. In Advantage's Bankruptcy Schedules the following claims were revealed as unpaid:

Creditor	**Claim**	**Amount**
Local Taxing authorities	payroll withholding 1999-2000	$ 2,242.00
Internal Revenue Service	payroll withholding, FICA, medi-care, FUTA	119,969.00

Michigan Dept/Treasury	payroll withholding	1,210.00
Michigan Unemployment	payroll withholding and unemployment	333.00
PA Dept of Revenue	payroll withholding	6,749.00
PA Unemployment	payroll taxes	3,716.00
		$134,219.00

There are, as noted, many other details about their relationship upon which the parties disagree. Before turning to a consideration of these, however, a review of applicable legal principles is in order.

III

Mellon brings this action under the provisions of 11 U.S.C. § 523 (a)(2)(A) and (B), which together provide as follows:

> (a) A discharge under section 727 . . . of this title 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 or an insider's financial condition; [or]
>
> (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)(A) and (B)

Two separate theories are raised by Mellon in this litigation; namely, false representations and actual fraud (§523(a)(2)(A)) and the use of false of financial statements. (§523(a)(2)(B)). While to some degree these theories are similar in character and may be said to overlap, the precise elements of each cause of action are not identical. Numerous courts and commentators have observed and discussed the distinctions.

The leading decision interpreting 11 U.S.C. § 523 (a)(2)(A) is *Field v. Mans,* 516 U.S. 59, 116 S.Ct. 437, 133 L. Ed.2d 351 (1995). In this case, the U.S. Supreme Court held that a plaintiff must establish 5 elements in a fraudulent misrepresentation and/or actual fraud case; to wit: that the Debtor obtained money, property or services through a material misrepresentation; that the Debtor at the time knew that such representation was false; that the Debtor intended to deceive the creditor; that the creditor relied on such representation; and that the creditor sustained the alleged loss and damages as a proximate result of the Debtor's material false representations.

In *Fields*, the Supreme Court settled a conflict among the Courts and held that the other parties' reliance on the false representations of the debtor must be "justifiable" under the circumstances. The inquiry will thus focus on whether the falsity of the representation was or should have been readily apparent to the individual to whom it was made. This is a less exacting standard than "reasonable" reliance, which would focus on whether reliance would have been reasonable to the hypothetical average person. Justification, in other words, is a matter of the particular plaintiff and the circumstances of the particular case, rather than the application of a community standard of conduct to all cases. *See generally,* 4 COLLIER ON BANKRUPTCY ¶ 523.08(1)(d) (Matthew Bender 15th Ed. Revised 2001) The burden of proof as to each element rests with the plaintiff and the plaintiff must meet its burden of proof by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 287-88, 111 S.Ct. 654, 659-60, 112 Led.2d 755 (1991).

Controlling precedent in cases involving 11 U.S.C. § 523(a)(2)(B) may be found in the Third Circuit opinion in *In re Cohn*, 54 F.3d 1108 (3d Cir. 1995). In order to prevail in a case brought under §523(a)(2)(B), the plaintiff must establish that the debt in question was obtained by the Debtor's use of a statement in writing that was 1) materially false; 2) respecting the financial condition of the debtor or an insider of the debtor; 3) on which the creditor reasonably relied; and 4) which the debtor caused to be made or published with intent to deceive. As is the case with claims raising false representations and fraud, each of the individual elements of a false financial statement case has generated considerable interpretative case law.

Material falsity has been defined as an important or substantial untruth. To be materially false under § 523(a)(2)(B) a false statement must be objectively material, meaning that it must misrepresent information of the type that normally affects the particular type of decision at issue. A recurring guidepost used by courts has been to examine whether the lender would have made the loan had it known of the Debtor's true financial condition. A creditor's reliance in this context, however, is not determinative. A false statement can be material for purposes of the materiality element of a § 523(a)(2)(B) case if it is so substantial that a reasonable person would have relied on it, irrespective of whether the particular creditor in question relied on the particular false statement in the case at hand. The omission, concealment, or understatement of liabilities would ordinarily constitute the making of a materially false statement.[2]

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[2] *In re Poskanzer*, 143 B.R. 991,1000 (Bankr. D.N.J. 1992); *Webster City Prod. Credit Ass'n v. Simpson,* 29 B.R. 202, 210 (Bankr. N.D. Iowa 1983); *First Nat'l City Bank v. Latono*,

(continued...)

The determination of the reasonableness of a creditor's reliance on a debtor's false statement in writing is judged in light of the totality of the circumstances, taking into consideration:

1) The creditor's standard practices in evaluating credit worthiness, and whether they were followed;

2) The standards or customs of the creditor's industry in evaluating credit worthiness; and whether a commercially reasonable investigation of the information supplied by the Debtor was undertaken; and

3) The surrounding circumstances existing at the time of the Debtor's application for credit, including such factors as A) whether there existed a "red flag" that would have alerted an ordinally prudent lender to the possibility that the information that was furnished was inaccurate; B) whether there existed previous business dealings that gave rise to a relationship of trust; or C) whether even minimal investigation would have revealed the inaccuracy of the Debtor's representations. *In re Cohn* at 1117.

The actual reliance requirement discussed here is distinct from the reliance concept that affects the element of materiality previously discussed, as the former is a factual determination while the latter is a question of law.

Intent to deceive is the final required element in the § 523(a)(2)(B) case. In this respect

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[2](...continued)
260 F.2d 264 (2d Cir. 1958); *Kansas Fed. Credit Union v. Niemeir,* 227 F.2d 287, 290 (10th Cir. 1955); *Morris Plan Indus. Bank. v. Parker,* 143 F.2d 665 (D.C. Cir. 1944); *In re Walther*, 48 F.Supp. 959 (E.D. N.Y. 1943); *In re Keller,* 86 F.2d 90, 91 (2d Cir. 1936)

the plaintiff must show 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.[3] With respect to the latter, a creditor can establish intent to deceive by proving reckless indifference to, or reckless disregard of, the accuracy of the information in the financial statement of the Debtor when the totality of the circumstances supports such an inference. *In re Cohn* at 1118.

IV

Against the above backdrop, the Court turns to a more detailed examination of the parties' competing contentions. Mellon, as noted, seeks to have the entire amount owed to it declared non-dischargeable. In this respect, it is Mellon's position that there is but a single loan obligation outstanding, and that the entirety of it may be found non-dischargeable if the elements of § 523(a)(2)(A) or (B) are established with respect to any of the four advances that together comprise the aggregate amount owed. This point is critical to Mellon's case, as the evidence which Mellon offered at trial dealt almost exclusively with events and circumstances that arose only in connection with the final $150,000 extension of credit to Advantage in May 1999. Unsurprisingly, the Debtor conversely insists that, at a minimum, the previous three advances made to Advantage; i.e., those in October 1996, March 1998 and February 1999, must be held dischargeable, as no evidence pointing to false representations, actual fraud or the use of a false financial statement was introduced by Mellon in connection with those particular extensions of credit. Before determining this important question, the Court will first review the evidence

[3] *In re Batie*, 995 F.2d 85, 90 (6th Cir. 1993); *Bank One Lexington v. Woolum (In re Wooolum)* 979 F.2d 71, 73 (6th Cir. 1992), *cert. denied*, 507 U.S. 1005, 113 S. Ct. 1645, 123 L. Ed.2d 267 (1993); *Driggs v. Black (In re Black)*, 787 F.2d 503, 14 C.B.C.2d 1215 (10th Cir. 1986) abrogated by *Grogan v. Gorner, supra*; *Matter of Ostrer*, 393 F.2d 646 (2 Cir. 1968).

which was presented.

The first principal bank witness was an individual named Shawn Niles. Mr. Niles was the Mellon representative assigned to the Advantage account following the February 1999 loan. The Advantage account was apparently transferred to Niles' supervision after the third loan to Advantage had been approved, because with that approval the Advantage loan balance had passed the threshold level of $250,000. Mr. Niles met Ms. Diener in February 1999 during the transition of responsibility, however his dealings with her for present purposes effectively began in April 1999 when she began the process of applying for a further $150,000 advance under Advantage's existing line of credit. In connection with this request, the Debtor provided Niles with three pertinent items of information:

A) An April 1999 aged accounts receivable report

B) A financial statement for Advantage as of 12-31-98.

C) A completed business loan application.

According to Niles, the Debtor's request for additional funds in April 1999 was based on an expressed need for additional working capital to finance business growth. Niles contends that in April/May 1999 the Debtor portrayed her company to him as being robust and profitable, but nevertheless restricted in its ability to expand because of delays in the collection of its Medicare receivables, the latter stemming from the installation of new computer software by Medicare. All of this, says Mellon, was false.

A) **Accounts Receivable**

To begin, Mellon contends that the April, 1999 accounts receivable report given to it significantly overstated the actual sums owed to Advantage from Medicare and Aetna U.S.

Healthcare, the Company's largest account debtors. In support of this charge, Mellon points to various things. Included here is evidence which established that in late 1998 Medicare received a complaint about Advantage that led to an investigation into alleged improprieties in the manner in which Advantage had prepared certain claims submitted to Medicare for payment. One result of this was that on May 19, 1999, Medicare issued a notification to Advantage that it would be assessed $61,140.71 as an over payment. Mellon strongly implies that this charge back was but the "tip of an iceberg," and that a substantial portion of Advantage's Medicare receivables were of dubious quality at or about the time of the May 19, 1999 loan transaction, because the sales on which they were based were improperly solicited and/or documented. To buttress this insinuation, Mellon offered testimony from an individual named Marcus Rosario. Mr. Rosario was hired by Advantage in February 1999 based on his prior experience handling Medicare Equipment claims. He was brought on specifically to assist in expediting the collection of Advantage's Medicare claims. Rosario testified to his sense that there were certain irregularities in Advantage's procedures, and in fact, he himself later contacted Medicare as "whistle blower" in that regard. This contact occurred in April 2000, at or about the same time as Rosario's employment with Advantage was terminated, leading the Debtor to naturally suggest that the contact and Rosario's testimony herein are retaliatory.

Mellon also offered ostensibly corroborative testimony from Gregory Stratoti, CPA. Mr. Stratoti was retained by Mellon after Advantage ceased doing business to assist it in collecting the Company's outstanding accounts receivable. The thrust of Stratoti's testimony was that he has had little success in collecting any of Advantage's accounts receivable, including specifically those owed by Medicare. Of the latter, he testified that as of October 17, 2000, when the

Bankruptcy cases were commenced, almost 80% of the Company's outstanding Medicare receivables had been initially denied by Medicare and were pending in various stages of appeal or review. Mellon infers from this that the Medicare receivables of Advantage were for the most part never valid to begin with, and it charges the Debtor with knowledge of that fact and with the intentional inclusion of many illegitimate Medicare receivables in the April 1999 report submitted to Mellon in order to induce an extension of credit at that time.

Mellon makes basically the same argument as to monies allegedly owed to Advantage by Aetna. Here again, says Mellon, there were serious collectability problems in existence prior to the May 1999 loan closing which the Debtor knew of but failed to disclose. In particular, Mellon stresses that in late 1998, Aetna, a traditionally slow pay customer, had simply ceased processing Advantage claims. Advantage apparently thereafter contacted various elderly, infirm individuals who were actually in possession of the pumps purchased through Aetna insurance and threatened to repossess the pumps because of Aetna's failure to pay. This, in turn, led to litigation between Advantage and Aetna, which litigation was eventually settled through an agreement under which Advantage agreed to reduce its billing rate to Aetna to 55% of the National Medicare ceiling rate. Mellon claims that neither the seriousness of the poor relationship between Advantage and Aetna, nor the particulars of the aforesaid litigation were brought to its attention prior to May 1999. These facts, it argues, reflected so adversely on the purported value of the Aetna receivables presented to it in connection with the May 1999 loan transaction as to render the submission of the unadorned book value of those accounts receivable, without explanation, actionable under 11 U.S.C. §523(a)(2)(A)and(B).

The Debtor, for her part, paints a decidedly different picture of Advantage's accounts receivable. As to Medicare, the Debtor testified that this particular region of the country is among the most difficult within which to navigate the Medicare reimbursement channels. Audits, she insists, are routine, and it is typical in the industry, she claims, for reimbursement claims to be repeatedly denied for minor deficiencies in paperwork. The Debtor argues that eventually the vast majority of Advantage's Medicare claims would have been paid, although it might have required prosecuting numerous and successive appeals. This point of view was confirmed generally by the testimony of other Debtor witnesses, including (1) Paul Comishock, a former Medicare employee and self-described "trouble shooter" for Medicare subcontractors, (2) Michael Steinberg, a Medicare claims "fair hearing" officer, and (3) Dan Dulnikowski, a former Advantage sale representative.

As to the specific Medicare charge back, the Debtor states that notice of Medicare's final determination was first detailed to the company in correspondence dated May 19, 1999, and that this correspondence was not even received by the Company until after the May 24, 1999 loan closing. Accordingly, says the Debtor, this is not a matter which she is fairly charged with failing to disclose.

As to the Aetna receivables, the Debtor maintains that the problem of prompt payment from Aetna, and the need to resort to litigation, were matters which she specifically discussed with Mellon's representative Niles, and not matters that she ever concealed.

Finally, the Debtor asks the Court to discount the testimony of Mellon's accountant Gregory Stratoti, pointing out that he has had, by his own admission, no prior experience in resolving disputed Medicare reimbursement claims, a particular type of account debt which, the Debtor insists, requires an intimate familiarity with the often byzantine rules of a large bureaucratic governmental agency.

B) **False Financial Statements**

Apart from the question of Advantage's accounts receivable, Mellon has also emphasized herein the December 31, 1998 financial statements which were prepared by Advantage's outside accountant, Stephen D'Angelo, CPA, and which were submitted to Mellon in connection with the May 1999 loan transaction. The December 31, 1998 income statement, in particular, reflected a net profit of $105,465 for the calendar year. Although arguably consistent with a portrait of profitability, Mellon contends that such representation was materially false, because by May 1999, if not much earlier, Advantage was losing money and was struggling desperately to keep its doors open. In support, Mellon points to another financial statement prepared by Advantage's accountant, D'Angelo, for the first five calendar months of 1999. This income statement, for the period ended May 31, 1999, reflected a net loss of approximately $28,000. Evidence established that the May, 1999 statement was in fact used by Advantage in an effort to demonstrate to Medicare that the Company was at that time laboring under extreme financial hardship, so as to persuade Medicare to permit the abatement of the $61,140.71 charge back against the Company over an extended period of time. Mellon argues that this is irrefutable proof that at or about the time of the May 1999 loan transaction, the Debtor was simultaneously portraying her company as thriving and prosperous on the one hand, and cash starved and beset with financial difficulties on the other.

Mellon offered other evidence to buttress the foregoing contention. There was, in the first instance, testimony from D'Angelo that Advantage indeed lost money for the first months of 1999, along with testimony from both D'Angelo and the Debtor's own expert accounting witness, James Douglas, CPA, that, contrary to the published 1998 year end financial statement, Advantage no more than broke even for calendar year 1998. More importantly, however, there was evidence which confirmed that significant other loans had been made to the company throughout the relevant time prior in order to defray operating expenses. These loans were extended either directly from the Debtor herself, or through the Debtor's father. The detail of the loans, which exceeded in total $400,000, is completely missing from either of the financial statements described above. The loans were, however, reflected on tax returns which the Debtor used to report S-Corporation losses and claim personal income tax refunds.

The Debtor's response to the foregoing was weak to say the least. The Debtor reiterates that the Medicare charge back took effect after the May 19, 1999 loan closing, and she therefore maintains that most anything to do with it is essentially irrelevant. The Debtor likewise stands by her contention that Advantage was growing its business in the first half of 1999. As to the shareholder loans, the Debtor testified that all of the loans in question were personal to her from her father, although she admits to using certain of the monies she received to finance business operations of Advantage. The Debtor for the most part, however, disavowed intimate acquaintance with the particulars of Advantage's financial statements and tax returns, claiming only that if mistakes or omissions were made they were inadvertent and the fault of professionals she had retained and on whom she relied.

C) **Undisclosed lawsuits.**

As a part of the May 1999 loan application the Debtor executed a document entitled "Business Credit Application." According to the Debtor this single page document (Exhibit P-3) was completed by Mellon Bank personnel in advance of the closing and was perfunctorily presented to her for signature. The testimony of Shawn Niles and Mellon Bank workout officer, Marion Cirello, confirmed that under Mellon's "stream lined" approach to the processing of small business loans, associated paperwork, such as the credit application, might typically be prepared and reviewed in Pittsburgh, Pennsylvania.

In exceedingly small print, the Business Credit Application contains the following question. "Is your business a party to any claim or lawsuit?" The Debtor states that the "No" box next to the question was already checked when she signed the form in May 1999, and that she paid scant attention to it in any event. Mellon alleges a discrepancy in the reply given, and contends that it was misled into making the May 1999 loan to Advantage because at the time there were in fact several lawsuits to which Advantage was a party: specifically, an unpaid commission claim by former employee Daniel Dulnikowski; a suit commenced by Advantage against certain discharged salespersons to enforce the provisions of non-competition agreements; and the Aetna/Advantage litigation described earlier. Mellon emphasizes the non-disclosure of these "pending" actions as yet further instances of the Debtor's misrepresentations and fraud.

The Debtor's response here was notably more convincing than in other areas. The Dulnikowski "lawsuit", for instance, was commenced by writ of summons months before the May 1999 loan closing, but no complaint was ever filed. The Debtor testified, credibly, that she believed the matter to have been discontinued or abandoned. The salespersons litigation, on the other hand, was an action commenced <u>by</u> Advantage, not an action commenced <u>against</u> it. (Although a successful counter claim was eventually asserted by one defendant in this litigation, the counter claim was not filed until June 1999, after the May 1999 loan transaction had closed.) In the opinion of the Court, the most reasonable and common sense interpretation of the Business

Credit Application is that it seeks information concerning lawsuits in which claims are asserted against the applicant not by it. Hence, the Court finds little amiss with this alleged non-disclosure. Finally with respect to the Aetna litigation, the Court notes that although that case remained open as a technical matter in May 1999, the dispute had effectively been settled for all practical purposes by the time of the May 1999 loan closing. Again, therefore, this non-disclosure appears to be no more than a "makeweight" argument.

V

The foregoing summarizes, in brief, a plethora of evidence offered by the parties on the question of false representations, actual fraud, and the use of a false financial statement. As previously noted, Mellon contends as a threshold matter that success in establishing the non-dischargeability of the May 1999 loan in the amount of $150,000 will dictate that its entire indebtedness is non-dischargeable. As will be discussed *infra*, the Court finds the May 1999 loan to be indeed non-dischargeable. Before elaborating on that determination, however, the Court pauses here to reject, as a matter of law and fact, Mellon's theory of aggregation.

Mellon's legal theory proceeds from the premise that for present purposes there are not four separate loans to Advantage; rather, there is only one loan. In this respect Mellon understandably emphasizes that in connection with the May 1999 loan transaction the Debtor executed a $400,000 promissory note, along with other pertinent loan and collateral documentation all of which purport to apply to a single debt. And of course the Debtor's personal guarantee extends to the entirety of the obligation. There is no escaping the fact, however, that in May 1999 Mellon actually loaned Advantage only the sum of $150,000. The remaining $250,000 of the principal balance claimed by Mellon was advanced in three other transactions; the first in October 1996 ($50,000), the second in March, 1998 ($150,000), and the last in February 1999 ($50,000). The fact that the parties re-documented the transaction in May 1999 does not change the substance of it. The May 1999 loan transaction was an extension on an existing line of credit. The Business Credit Application on which Mellon so heavily relies describes the transaction in that very way. Mellon has cited no authority for its proposition that, without more, a preexisting indebtedness can automatically be rolled into a new loan that is tainted with some indicia of non-dischargeability and thereby "boot strapped" into a non-dischargeable posture itself. Mellon's argument in this respect is conclusory, elevates form over substance, and does violence to the well established legal tenant that the discharge provisions of the Bankruptcy Code are to be strictly construed against Creditors and liberally construed in favor of Debtors. Cohn. supra @ 1113. As Collier notes, if property or services are obtained before the making of any false representation, subsequent misrepresentations will have no effect on dischargeability. *See generally* 4 COLLIER ON BANKRUPTCY ¶ 523.08 (1)(d) (Matthew Bender 15th Ed. Revised 2001).

The Court therefore holds that as a matter of law for Mellon to prevail on its Complaint to have its three previous loans to Advantage declared non-dischargeable, it must establish by a preponderance of the evidence each requisite element of its cause of action with respect to each individual loan. The Court, in turn, finds as a matter of fact, that Mellon has failed to meet that burden of proof.

As previously noted, literally all of the evidence adduced by Mellon relates exclusively to the facts and circumstances surrounding the May 1999 loan transaction. There is no evidence of any kind whatsoever which supports a dischargeability cause of action with respect to the pre-

May 1999 extensions of credit. As a consequence, judgment will be entered in favor of the Debtor and against Mellon with respect to this aspect of Mellon's complaint.

Passing beyond this, however, the Court finds that Mellon has met its burden of proof with respect to the May 1999 loan. All indebtedness associated with this obligation will therefore be excepted from the Debtor's discharge.

VI

On this score, the Court observes at the outset that while the parties presented a great deal of evidence, it varied widely in probative value. As noted, the Court attaches little weight to alleged fraud and misrepresentation in the completion of the Business Credit Application. The "missing" litigations are all of dubious materiality. The evidence furthermore indicated that the form was indeed "pre-completed" by Mellon's own personnel in Pittsburgh. Taking nothing away from Mellon's argument that it is the borrower's ultimate responsibility to correct the application where necessary, there is no evidence to suggest that the credit application was even reviewed with the Debtor in May 1999. To the contrary, it appears to have been simply presented for perfunctory signature at closing. The Court finds the procedures followed by Mellon in this respect to have been so commercially unreasonable as to defeat any claim on the part of Mellon to have justifiably relied on this aspect of the Credit Application.

The Court likewise discredits the testimony of Mellon's accountant, which was apparently offered, in part, to quantify the actual value of the Debtor' accounts receivable in May 1999 based on analysis and collection activity that took place in the year 2000 and thereafter. In the first place, no clear picture was ever presented as to the portion of the outstanding accounts receivable reviewed by Niles which pre-dated and post-dated the May 1999 loan closing. The accountant's testimony thus lacked context. There was, moreover, no basis to discern what alleged misrepresentations occurred with respect to what accounts, and what reliance was placed on what alleged misrepresentations. Here again, the testimony was unhelpful. Even were this not the case, however, the very premise of the testimony seems seriously flawed. Mellon's accountant was called as a fact witness, but ended up offering hindsight opinions (without objection) as to the "quality" of Advantages' accounts receivable in May 1999. Mellon invites the Court to draw inferences as to the value and collectibility of Advantage's accounts receivable in May 1999 based on the opinion proffered by its accountant two years after the fact. The Court declines to do so, and views such opinion testimony as having little probative value, particularly since it was wholly unsupported by evidence of any reliable methodology.

The above shortcomings notwithstanding, there is nevertheless abundant evidence in the record which is fatal to the Debtor with respect to the May 1999 loan. The Court here will focus on only the more salient examples. It is clear, for instance, that the Debtor had knowledge of the impending Medicare charge back before the May 1999 loan, even if formal notice of it post-dated the loan closing by approximately one week. The Debtor's failure to give any effect to this in Advantage's April 1999 accounts receivable report, or to disclose the situation to Mellon in the context of an application for an additional extension of credit was fraudulent. The Court furthermore discredits the Debtor's testimony that she shared with Niles the particulars of the very serious difficulties the Company was experiencing with Aetna at or about the time of the May 1999 loan closing.

It is clear, moreover, that the December 31, 1998 financial statements submitted to Mellon significantly misstated Advantage's financial position: Specifically, they overstated net income and understated liabilities owed with respect to shareholder loans. It is clear that the Debtor was intimately aware of this in May 1999, and was depicting her company as healthy and growing to Mellon, while simultaneously depicting it as struggling and unprofitable to Medicare. The latter picture appears to have been the more accurate, and the Court finds the Debtor's conduct in creating and furthering this deception to have been fraudulent.

The inaccuracies as the Medicare charge back, the Company's poor relationship with Aetna, the mistatements of the Company's 1998 income, its overall profitability, and the status of shareholder loans, all involved material information, as that term has been construed in the context of actions brought under 11 U.S.C. § 523(a)(2)(A) and (B). The Court finds that the Debtor intentionally acted to conceal the true facts concerning these matters, and that Mellon's reliance on the information that was provided to it was justified and reasonable. In short, the Court is convinced that had it been in possession of the true picture of the Debtor's financial condition, Mellon would not have loaned the Debtor an additional $150,000 in May 1999. This portion of the Mellon indebtedness will therefore be held non-dischargeable.

An appropriate Order follows.

By the Court:

____
Stephen Raslavich
United States Bankruptcy Judge

Dated: September 27, 2002