Not For Publication

UNITED STATES BANKRUPTCY COURT
DISTRICT OF CONNECTICUT

IN RE:	CASE NO.	03-30947 (LMW)
KATALINA IRENE RIEGELMANN a/k/a KATALINA FERRARO,	CHAPTER	7
DEBTOR.		
JOY BERSHTEIN,	ADV. PRO. NO.	03-3126
PLAINTIFF	DOC. I.D. NO.	1
vs.		
KATALINA IRENE RIEGELMANN a/k/a KATALINA FERRARO,		
DEFENDANT.		

JOY BERSHTEIN,	ADV. PRO. NO.	03-3127
PLAINTIFF	DOC. I.D. NO.	1
vs.		
KATALINA IRENE RIEGELMANN a/k/a KATALINA FERRARO,		
DEFENDANT.		

APPEARANCES

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MEMORANDUM OF DECISION

Lorraine Murphy Weil, United States Bankruptcy Judge

The matters before the court are the above-referenced plaintiff's (the "Plaintiff") (1) complaint (Section 727 A.P. Doc. I.D. No. 1, the "Section 727 Complaint")[1] which seeks denial of the above-captioned debtor's (the "Debtor") discharge pursuant to 11 U.S.C. §§ 727(a)(2)(A) (among other subsections); and (2) complaint (Section 523 A.P. Doc. I.D. No. 1, the "Section 523 Complaint") which seeks a determination that a certain alleged debt owing to the Plaintiff is not dischargeable in this chapter 7 case pursuant to 11 U.S.C. § 523(a)(2)(A). The court has jurisdiction over these proceedings as "core proceeding[s]" pursuant to 28 U.S.C. §§ 1334(b) and 157(b) and that

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* Mr. Khorozian appeared pursuant to Rule 83.9 (Law Student Internship Rules) of the District of Connecticut Local Civil Rules.

[1] Citations herein to the docket of adversary proceeding No. 03-3126 (the "Section 727 Adversary") are in the following form: "Section 727 A.P. Doc. I.D. No. ___." Citations herein to the docket of adversary proceeding No. 03-3127 (the "Section 523 Adversary") are in the following form: "Section 523 A.P. Doc. I.D. No. ___." Citations herein to the docket of this chapter 7 case are in the following form: "Case Doc. I.D. No. ___." The Section 727 Adversary and the Section 523 Adversary together constitute the "Proceedings."

certain Order dated September 21, 1984 of the District Court (Daly, C.J.).[2] This memorandum constitutes the findings of fact and conclusions of law mandated by Rule 7052 of the Federal Rules of Bankruptcy Procedure.

I. PROCEDURAL BACKGROUND

A. Chapter 7 Case

The Debtor commenced the underlying bankruptcy case by the filing of a chapter 7 petition (included in Case Doc. I.D. No. 1, the "Petition") on February 27, 2003. Together with the Petition, the Debtor filed a complete set of schedules and a statement of financial affairs. (*See* Case Doc. I.D. No. 1.)[3] Copies of the Petition and Schedules appear in the record as Plaintiff's Trial Exhibits B and C.

As of the petition date, the Schedules reflected the following pertinent information. The Debtor owned no real property (*see* Schedules (Schedules A. Real Property)). She scheduled personal property in the aggregate amount of $33,000.00, including an interest in "Salt & Light, LLC ["S&L"] d/b/a The Coffee Pot Coffee Shop [the "Coffee Pot"], [k]itchen [e]quipment, [c]hairs & [m]iscellaneous [r]estaurant [f]urniture"[4] valued at $27,500.00 and an "IRS Refund" of $3,800.00. (*See* Schedules (Schedule B. Personal Property, items 12, 17).) Pursuant to 11 U.S.C. § 522(d), the Debtor exempted $0.00 in S&L and the full amount of the IRS Refund. (*See* Schedules (Schedule

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[2] That order referred to the "Bankruptcy Judges for this District" *inter alia* "all proceedings arising under Title 11, U.S.C. . . . ."

[3] Subsequently, the Debtor filed an Amended Schedule I (Case Doc. I.D. No. 6), an Amended Petition (Case Doc. I.D. No. 7) and Amended Schedules (Case Doc. I.D. No. 8). The initial schedules and statement of financial affairs together with the foregoing amended filings collectively constitute the "Schedules."

[4] All such tangible items are hereafter referred to, collectively, as the "Equipment."

C. Property Claimed as Exempt).) The Debtor scheduled secured debts of $67,800.00, including two July, 2002 "[b]usiness [l]oan[s]" in the amounts of $20,000.00 and $35,000.00 owing to the City of New Haven (the "City"). (*See* Schedules (Schedule D. Creditors Holding Secured Claims).) The Debtor listed unsecured debts in the aggregate amount of $37,295.24, including a loan from the Plaintiff for $16,700.00. (*See* Schedules (Schedule F. Creditors Holding Unsecured Nonpriority Claims).) The Debtor is the mother of a six year old son, was an instructor at In-Shape, a fitness facility, and had been so employed for three years. (*See* Schedule (Schedule I. Current Income of Individual(s)).) She listed a combined net monthly income of $1,128.82 which was comprised of $528.82 from In-Shape and $600.00 from the Coffee Pot. (*See id.*) The Debtor listed monthly expenses of $1,577.00. (*See* Schedules (Schedule J. Current Expenditures of Individual Debtor(s)).) The Plaintiff commenced a "contracts-collection" action in the New Haven Superior Court with respect to the above-referenced loan which resulted in a stipulated judgment (the "Judgment") of $15,822.00 (the "Judgment Debt") which entered on April 8, 2002. (*See* Schedules (Statement of Financial Affairs, item 4).)

On April 12, 2003, the chapter 7 trustee filed that certain Trustee's Report of No Distribution (Case Doc. I.D. No. 9). Pursuant to that certain Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines (Case Doc. I.D. No. 2), the bar date (the "Bar Date") for filing complaints objecting to discharge or seeking a determination of nondischargeability was May 27, 2003. Upon motions by the Plaintiff (*see* Case Doc. I.D. Nos. 17, 34), the Bar Date was extended to August 25, 2003 (*see* Case Doc. I.D. No. 38).

B. Adversary Proceedings

The Section 727 Adversary was commenced by the timely-filed Section 727 Complaint seeking denial of discharge pursuant to Bankruptcy Code § 727(a)(2)(A) (among other subsections).[5] On November 6, 2003, the Debtor filed her Answer (Section 727 A.P. Doc. I.D. No. 12). In that answer, the Debtor admitted receipt of the funds, entry of the Judgment and her failure to make payment pursuant to the Judgment but denied any violation of Bankruptcy Code § 727(a).

The Section 523 Adversary was commenced by the timely-filed Section 523 Complaint seeking a determination of nondischargeability under Bankruptcy Code § 523(a)(2) with respect to the Judgment Debt. On November 7, 2003, the Debtor filed her Answer (Section 523 A.P. Doc. I.D. No. 13). In that answer, the Debtor admitted receipt of the funds, entry of the Judgment in respect of such funds and her failure to make payment pursuant to the Judgment but denied any allegations of fraud.

The Proceedings were consolidated for trial (the "Trial").[6] At the Trial, the Plaintiff and the Debtor testified and Plaintiffs Exhibits A through L were admitted as full exhibits. At the conclusion

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[5] The Section 727 Complaint also sought denial of discharge pursuant to Bankruptcy Code §§ 727(a)(3), (a)(4)(A) and (a)(6)(A). However, because the Plaintiff did not address denial of discharge on those grounds in her post-trial brief (Section 727 A.P. Doc. I.D. No. 40, the "Plaintiff's Brief"), the court deems those counts to be abandoned. *Cf. Linc Finance Corp. v. Onwuteaka,* 129 F.3d 917, 921 (7th Cir. 1997) ("[T]he failure to cite authorities in support of a particular argument constitutes a waiver of the issue.").

[6] The Trial was held on October 18, 2004 and November 22, 2004. Transcripts of the Trial appear in the record of the Section 727 Adversary as Section 727 A.P. Doc. I.D. Nos. 34 and 35. References herein to the transcript of the October 18, 2004 appear in the following form: "10/18/04 Transcript at ____." References herein to the transcript of the November 22, 2004 transcript appear in the following form: "11/22/04 Transcript at ____."

of the Trial, the court took the Proceedings under advisement subject to post-trial briefing. Briefing is complete and the Proceedings are now ripe for decision.

II. FACTUAL BACKGROUND

Based upon the entire record of the Proceedings and the chapter 7 case, the court finds the following facts.

The Plaintiff and the Debtor met at a fitness club in 1997 and became friends. The Plaintiff is a practicing attorney (although not in the financial area). The Debtor is a college graduate and had run previously a successful coffee shop business. (*See* 10/18/04 Transcript at 11, 20 (Testimony of Plaintiff).) Subsequently, the Plaintiff hired the Debtor to provide child care services for the Plaintiff's children. In or about either October, 2000 or July, 2001,[7] the Debtor formed S&L for the purpose of purchasing the Coffee Pot. (11/22/04 Transcript at 30 (Testimony of Debtor).) The Debtor is the sole member of S&L. (*Id.*) The Debtor applied for business loans (the "NH Loans") from the City with respect to starting up a coffee shop.[8] Because a problem arose with respect to the proposed rental space for the business (which resulted in the Debtor's having to find an alternative

[7] The Debtor testified to both dates with respect to the formation of S&L. (*See* 10/18/04 Transcript at 40 (7/01) and 11/22/04 Transcript at 31 (10/00).)

[8] Plaintiff's Trial Exhibit F consists of documents from the City pertaining to the NH Loans. However, while Exhibit F contains documents relevant to the $35,000.00 loan, there is no documentation relating to the $20,000.00 loan (apart from a cover letter enclosing the loan documents and making reference to the $20,000.00 loan). However, it is undisputed that the aggregate amount of the NH Loans was $55,000.00.

The parties to the loan agreement (dated June 4, 2002, the "Agreement") were the City, S&L as borrower, and the Debtor as guarantor. (*See* Plaintiff's Trial Exhibit F.) The NH Loans were funded by the New Haven Small Business Initiative Loan Fund . (*See id.*) The $35,000.00 sum was comprised of $25,000.00 "for the purchase of furniture, fixture and equipment and $10,000.00 for leasehold improvements." (*Id.* ¶ 1C.) The NH Loans were secured by a "first security interest in all of the assets, tangible and intangible for the Coffee House [sic]." (*Id.* ¶ 1.03; *see also* 11/22/04 Transcript at 35 (Testimony of Debtor).)

site for the business), the loan was delayed. (10/18/04 Transcript at 53 (Testimony of Debtor).) The Debtor was "very stressed" about the delay in the closing of the NH Loans and complained to the Plaintiff about not having enough money for certain startup costs for the business. (10/18/04 Transcript at 16 (Testimony of Plaintiff).)

In or about December, 2000, the Debtor approached the Plaintiff about a "bridge" loan[9] (the "Bershtein Loan") of $15,000.00 for startup costs associated with the Coffee Pot pending receipt of funds from the NH Loans. (10/18/04 Transcript at 18 (Testimony of Plaintiff).) The Bershtein Loan was intended to be short term, to be used for startup costs for the business and was to be repaid by the Debtor upon receipt of the proceeds of the NH Loans (to the extent that such proceeds could be used for such purpose). The Plaintiff agreed to give the Debtor the loan, which loan was to be repaid without interest. The parties did not reduce the Bershtein Loan to a writing. At the time of the Bershtein Loan, in addition to being a care giver to the Plaintiff's children, the Debtor held part-time employment as a fitness instructor and as a part-time baker at a coffee shop.

In January, 2001, the Plaintiff gave the Debtor a personal check dated January 19, 2001 in the amount of $7,500.00. (*See* Plaintiff's Trial Exhibit A.) The Plaintiff issued a second check dated January 25, 2001 to the Debtor for $7,500.00. (*See id.*) Those payments constituted the Bershtein Loan.

In March 2001, the Plaintiff demanded payment of the Bershtein Loan; the Debtor could not and/or did not comply. On or about March 11, 2001, the Plaintiff terminated the Debtor's services as care giver to the Plaintiff's children. Some time thereafter, the Debtor was evicted from her home

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[9] The term "bridge loan" appears only in the testimony of the Plaintiff (*see* 10/18/04 Transcript at 18, line 17) and the court attaches no particular significance to its use.

for failure to pay rent. (10/18/04 Transcript at 59 (Testimony of Debtor).) In her move to a new residence, the Debtor lost documents (including some relating to the Coffee Pot). (*Id.*) She subsequently had to move to another residence and lost more documents (including some related to the Coffee Pot) and items. Approximately $3,500.00 of the Bershtein Loan was used for business purposes (such as architectural services related to the proposed space for the business, insurance, deposits and cooking equipment). (*See* Section 727 A.P. Doc. I.D. No. 39 (Defendant's Proposed Findings of Fact and Conclusions of Law ¶ 9).)[10] The remainder of the Bershtein Loan was used for personal and living expenses of the Debtor during the summer of 2001. By July, 2001, the Bershtein Loan was exhausted. (10/18/04 Transcript at 46 (Testimony of Debtor).) In or about September, 2001, either the Debtor's sister or the Debtor's sister's company (if such existed) contributed $25,000.00 to S&L as a "gift" (the "Gift").

Between March, 2001 and April, 2002, the Plaintiff made numerous demands for repayment on the Debtor. Thereafter, the Judgment in respect of the Judgment Debt entered and the Debtor agreed to make weekly payments (she defaulted on that agreement). The NH Loans were funded in or about June, 2002. The Debtor did not make any subsequent payments with respect to the Judgment Debt. The Coffee Pot opened for business in July, 2002. As noted, the Debtor filed the Petition on February 27, 2003. The Schedules did not list the Gift and the Debtor did not list either the Gift or the Bershtein Loan on her 2002 tax returns.[11]

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[10] The Debtor testified to a larger amount at the Trial. (*See* 10/18/04 Transcript at 55-57, 61 (Testimony of Debtor).)

[11] It has not been established that the Debtor was required to list the Gift or the Bershtein Loan on her tax returns. As discussed below, there is no evidence that the Gift did not go directly to S&L and, at least arguably, neither item was reportable income even if paid to the Debtor.

III. ANALYSIS

A. Bankruptcy Code § 727(a)(2)

> Appreciative that denial of a debtor's discharge "imposes an extreme penalty for wrongdoing," the United States Court of Appeals for the Second Circuit in *In re Chalasani*, 92 F.3d 1300, 1310 (2d Cir. 1996), has instructed that Section 727 "must be construed strictly against those who object to the debtor's discharge and 'liberally in favor of the bankrupt.'" *Id.* Nevertheless, the relief of a bankruptcy discharge is not an absolute right, but rather, a privilege accorded honest debtors who provide full and honest disclosure to creditors and otherwise satisfy bankruptcy statutory obligations.

Casa Investments Co. v. Brenes (In re Brenes), 261 B.R. 322, 329 (Bankr. D. Conn. 2001) (Dabrowski, J.). Bankruptcy Code § 727(a)(2)(A) provides in relevant part:

> (a) The court shall grant the debtor a discharge, unless—
>
> . . .
>
> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed—
>
> (A) property of the debtor, within one year before the date of the filing of the petition . . . .

11 U.S.C.A. § 727(a)(2)(A) (West 2005). The provision "is intended to prevent the discharge of a debtor who attempts to avoid payment to creditors by concealing or otherwise disposing of assets." 6 Alan N. Resnick and Henry J. Sommer, *Collier on Bankruptcy* ¶ 727.02 [1], at 727-13 (15 ed. rev. 2005). To prevail under the provision, the Plaintiff must prove that (1) the Debtor; (2) transferred or concealed; (3) property of the Debtor; (4) with the intent to hinder, delay or defraud a creditor; (5) within one year of the date of the bankruptcy filing. *See In re Kontrick*, 295 F.3d 724, 736 (7th Cir. 2002), *aff'd*, 540 U.S. 443 (2003). *See also In re Brenes*, 261 B.R. at 341; *Montey Corp. v. Maletta (In re Maletta)*, 159 B.R. 108, 115-16 (Bankr. D. Conn. 1993) (Shiff, J.). Once the Plaintiff

establishes a prima facie case under Section 727(a)(2)(A), the burden shifts to the Debtor to refute the evidence. *Jones v. Herbert (In re Herbert)*, 304 B.R. 67, 74 (Bankr. E.D.N.Y. 2004), *aff'd*, 321 B.R. 628 (E.D.N.Y. 2004). *See also Clark v. Hammeken (In re Hammeken)*, 316 B.R. 723, 728 (Bankr. D. Ariz. 2004). However, the Plaintiff "bears the ultimate burden of persuasion by a preponderance of the evidence." *The Cadle Co. v. Ogalin (In re Ogalin)*, 303 B.R. 552, 557 (Bankr. D. Conn. 2004) (Dabrowski, J.). *Cf.* Fed. R. Bankr. P. 4005.

Section 727(a)(2)(A) requires a showing of *actual* intent to hinder, delay or defraud; a showing of constructive intent is insufficient. *The Cadle Co. v. DiFabio (In re DiFabio)*, 314 B.R. 281, 285 (Bankr. D. Conn. 2004) (Krechevsky, J.). Because a debtor ordinarily will not admit to intentionally hindering, delaying or defrauding creditors, "fraudulent intent may be established by circumstantial evidence, or by inference drawn from a course of conduct." *Id.* As discussed below, the court determines that the Plaintiff has failed to satisfy the elements of Bankruptcy Code § 727(a)(2).

The Plaintiff argues that the Debtor fraudulently transferred (or concealed) property of the Debtor within the statutory one-year period. The Plaintiff asserts that claim with respect to (1) the proceeds of the NH Loans, (2) the Gift and (3) the Bershtein Loan proceeds.[12] The court will discuss each of the foregoing below.

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[12] To the extent that the Plaintiff argues that the Debtor fraudulently failed to schedule her interest in S&L, that claim is unpersuasive. As noted above, the Debtor amended the Schedules to reflect her interest in S&L (and the Equipment) and the value of the foregoing. (*See* Case Doc. I.D. No. 8.) Further, the court is not persuaded that the ascribed value ($25,700.00) of S&L and the Equipment is unreasonable (at least on a net basis given the debt that encumbered both S&L and the Equipment).

1. The Proceeds of the NH Loans

Section 727(a)(2)(A) requires that the property transferred (or concealed) shall have been "property of the debtor." The court is unpersuaded that the proceeds of the NH Loans were "property of the debtor." That is because the court is unpersuaded that the NH Loans were made to the Debtor rather than to S&L. The parties to the $35,000.00 NH Loan were S&L, as borrower, and the City, as lender. The Debtor signed the Agreement as a guarantor. (*See* Plaintiff's Trial Exhibit F.) There is no evidence that the structure of the $20,000.00 NH Loan was any different. While the Debtor is the sole principal of S&L, the court is not persuaded on this record that S&L was the alter ego of the Debtor.[13] *Cf. Toshiba America Medical Systems, Inc. v. Mobile Medical Systems, Inc.*, 53 Conn. App. 484, 489, *cert. denied*, 249 Conn. 930 (1999) ("[T]he corporate shield should not be lightly disregarded . . . even when . . . there is but one stockholder."). Accordingly, the Plaintiff has failed to prove that the proceeds of the NH Loans were "property of the debtor" within the purview of Section 727(a)(2)(A). *Cf. Thompson v. Eck*, 149 F.2d 631, 633 (2d Cir. 1945) ("[T]he bankrupt must have some legal interest in the property before he can be charged with its concealment." (citations and internal quotation marks omitted)). Because the court is unpersuaded that the proceeds of the NH Loans were property of the Debtor, it is unnecessary to address the remaining elements of Bankruptcy Code § 727(a)(2) with respect to the NH Loans.[14]

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[13] The court does not deem the Debtor's scheduling of the Equipment, or the Debtor's scheduling of the NH Loans as secured debts (versus unsecured guaranty debts), to be sufficiently unambiguous so as to constitute an admission of alter ego status between herself and S&L.

[14] The City was notified of the commencement of this chapter 7 case. (*See* Case Doc. I.D. No. 4.) The Debtor testified that the City foreclosed upon its security interest in the Equipment presumably upon default on the NH Loans. (*See* 11/22/04 Transcript at 35 (Testimony of Debtor).) It is unclear when such foreclosure occurred (although the Debtor's scheduling of the Equipment suggests that foreclosure was postpetition). No mention of the foreclosure is made in the Schedules

2. The Gift

Similarly, the court is unpersuaded that the Gift was "property of the debtor" within the purview of Section 727(a)(2)(A). A copy of the check was made a part of the record as Plaintiff's Trial Exhibit H. The payor of the check was "Coffeee & Creamery", the business of the Debtor's sister, and the check was made payable to "Salt and Light LLC." There is no evidence of subsequent negotiation of that check and the court cannot assume that the proceeds of that check went to any person other than S&L. For the reasons discussed in the previous section, the court is unpersuaded that the Gift was property of the Debtor. Because the court is unpersuaded that the Gift was property of the Debtor, it is unnecessary to address the remaining elements of Bankruptcy Code § 727(a)(2) with respect to the Gift.

3. The Bershtein Loan

The court concludes that no transfer of the proceeds of the Bershtein Loan occurred within the one year period required by Bankruptcy Code § 727(a)(2). The Plaintiff argues that the subject "acts consisted of transferring money intended as a business loan to [the Debtor's] . . . personal expenses and she actively concealed this fact from [the Plaintiff]. . . . (Plaintiff's Brief at 13-14.)

The evidence establishes that the Debtor obtained the proceeds of the Bershtein Loan in January, 2001 and such proceeds were exhausted by July, 2001. (*See* 10/18/04 Transcript at 46 (Testimony of Debtor).) As noted above, this case was commenced on February 27, 2003. Because the proceeds of the Bershtein Loan were exhausted by July, 2001, the Debtor could not have transferred any such proceeds in or after February, 2002. Accordingly, any transfers of the Bershtein

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(*see* Schedules (Statement of Financial Affairs)) and the City did not deem it necessary to obtain relief from stay in this case to foreclose its security interest.

Loan occurred outside the statutory one-year period, and the Plaintiff has failed to satisfy a necessary element of Section 727(a)(2).

To the extent that the Plaintiff argues that the Debtor engaged in conduct which resulted in the continuing concealment of any property of the Debtor, the court is not persuaded. Plaintiff asserts that the Debtor "actively concealed" her use of the Bershtein Loan. That allegation is immaterial. The statute requires concealment of the existence of the Debtor's *interest* in extant property, not the *circumstances* of its transfer. As noted, the Plaintiff has failed to prove that either the Gift or the NH Loans proceeds were property of the Debtor. Accordingly, each such property is outside the purview of Section 727(a)(2) even on a "continuing concealment" theory. Moreover, as noted above, the proceeds of the Bershtein Loan were exhausted before the commencement of the statutory one-year period. Accordingly, during the statutory period the Debtor could not have concealed what did not exist. *Cf. Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237 (9th Cir. 1997) (holding that where debtor transferred real property to her mother to avoid paying on a judgment but retained an interest in such property by continuing to live on the premises and subordinating her mother's interest to a subsequent lender's deed of trust such conduct constituted a continuing concealment in violation of Bankruptcy Code § 727(a)(2)). For that reason, the court concludes that the Plaintiff failed to sustain her burden under Bankruptcy Code § 727(a)(2) in respect of the Bershtein Loan and the remaining elements of Section 727(a)(2) need not be considered.

B. Bankruptcy Code § 523(a)

Bankruptcy Code § 523(a)(2)(A) excepts from discharge "any debt— for money, property, services, or an extension, renewal, or refinancing of credit, *to the extent obtained by*— false pretenses, a false representation, or actual fraud . . . ." 11 U.S.C.A. § 523(a)(2) (West 2005)

(emphasis added). To prevail under Bankruptcy Code § 523(a)(2)(A), the Plaintiff must prove by a preponderance of the evidence the following elements: (1) the Debtor made representations; (2) knowing them to be false; (3) with the intent and purpose of deceiving the Plaintiff; (4) upon which representations the Plaintiff actually and justifiably relied; and (5) which proximately caused the alleged loss or damage sustained by the Plaintiff. *See AT&T Universal Card Services v. Mercer (In re Mercer)*, 246 F.3d 391, 403 (5th Cir. 2001) (*en banc*); *Rosenblit v. Kron (In re Kron)*, 240 B.R. 164, 165 (Bankr. D. Conn. 1999) (Krechevsky, J.). Exceptions to discharge must be strictly construed in favor of the Debtor in order to effectuate the fresh start policy of bankruptcy. *Kron*, 240 B.R. at 165. Furthermore, the "[D]ebtor's conduct must involve moral turpitude or intentional wrong; mere negligence, poor business judgment or fraud implied in law (which may exist without imputation of bad faith or immortality) is insufficient." *Id.* at 165-66 (citation and internal quotation marks omitted).

1. Misrepresentation of Intent To Use the Bershtein Loans for Business Purposes

The phrase "to the extent obtained by" "makes clear that the share of money . . . that is obtained by fraud gives rise to a nondischargeable debt." *Cohen v. de la Cruz*, 523 U.S. 213, 218 (1998). Therefore, the Plaintiff must make an initial showing that the alleged "fraud . . . existed at the time of, and been the methodology by which, the money, property or services were obtained." *Wilcoxon Construction, Inc. v. Woodall (In re Woodall)*, 177 B.R. 517, 523 (Bankr. D. Md. 1995). *See also Community Nat'l Bank v. Slominski (In re Slominski),* 229 B.R. 432, 435 (Bankr. D. ND. 1998) (The "funds themselves must have been obtained by fraud in the inception." (citation and internal quotation marks omitted)). Misrepresentations made subsequent to the creation of the debt

"have no effect upon the dischargeability of a debt, since the false representation could not have been the creditor's reason for the extension of credit." *In re Woodall*, *supra*, 177 B.R. at 524 (citation and internal quotation marks omitted). *See also Burbank v. Capelli (In re Capelli)*, 261 B.R. 81, 88 (Bankr. D. Conn. 2001) (Dabrowski, J.).

The Plaintiff argues that the Debtor misrepresented that she intended to use the proceeds of the Bershtein Loan for startup costs associated with the Coffee Pot when, in fact, she intended to use the funds to pay her personal debts. The court is unpersuaded that the Bershtein Loan was "obtained by" fraud.

The Debtor does not dispute that she represented to the Plaintiff that the loan would be used for business purposes. (*See* 10/18/04 Transcript at 35 (Testimony of Debtor).) Nor does she dispute that a substantial portion of the proceeds of the Bershtein Loan was used for personal living expenses. (*See id.*) However, the court is unpersuaded that, at the time the Bershtein Loan was made, the Debtor did not intend to use the Bershtein Loan for costs related to the startup of her business. Rather, the record supports a conclusion that a number of intervening factors contributed to the Debtor's failure to utilize the Bershtein Loan proceeds as intended.

The Debtor commenced the steps to obtain the NH Loans in or about the fall of 2000. The Bershtein Loan was made in January, 2001. At that time, the Debtor believed that the NH Loans would close soon. However, the closing of NH Loans was delayed. In fact, the NH Loans were not funded until June, 2002. Furthermore, after January 2001 the Debtor experienced additional financial distress. The Plaintiff terminated the Debtor's employment with the Plaintiff in March, 2001. Subsequently, the Debtor was evicted from her home for failure to pay rent. She had to quickly vacate her next residence. Under those circumstances, the Debtor "unfortunately . . . had to"

use a portion of the Bershtein Loan for living expenses. (10/18/04 Transcript at 44, line 5 (Testimony of Debtor).) Moreover, while the Debtor and the Plaintiff were friends when the Bershtein Loan was made, that friendship appears to have ended in March, 2001. That fact may have adversely affected the Debtor's motivation to repay the Bershtein Loan especially in light of her other problems.[15] While the Debtor may have breached a term or condition of the agreement, such breach does not indicate fraudulent intent for purposes of Bankruptcy Code § 523(a)(2). *See Palmacci v. Umpierrez*, 121 F.3d 781, 787 (1st Cir. 1997) ("A debtor's statement of future intention is not necessarily a misrepresentation if intervening events cause the debtor's future actions to deviate from previously expressed intentions." (citation and internal quotation marks omitted)); *McCallion v. Lane (In re Lane)*, 50 F.3d 1, 1995 WL 115751, at *3 (1st Cir. 1995) ("[M]ere failure to perform is not sufficient evidence of scienter nor is subsequent conduct contrary to the original representation necessarily indicative of fraudulent intent.") (unpublished decision).[16] For the foregoing reasons, the court is unpersuaded that when the Debtor obtained the Bershtein Loan, she did not intend to use those funds for business purposes. Therefore, the court determines that the Bershtein Loan was not "obtained by" fraud.

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[15] Discussions between the women on the subject of loan repayment apparently became quite heated. (*See* 10/18/04 Transcript at 23-24 (Testimony of Plaintiff).)

[16] [A] broken promise to repay a debt, without more, will not sustain a cause of action under § 523(a)(2)(A). Instead, central to the concept of fraud is the existence of scienter which, for purposes of § 523(a)(2)(A), requires that it be shown that at the time the debt was incurred, there existed no intent on the part of the debtor to repay the obligation."

Rust v. Tellam (In re Tellam), 323 B.R. 661, 664 (Bankr. N.D. Ohio 2005).

2. Misrepresentation of Intent To Repay the Plaintiff from the Proceeds of the NH Loans

The Plaintiff argues further that the Debtor misrepresented her intention to repay the Bershtein Loan from the NH Loans proceeds. If the Debtor made that representation to the Plaintiff at or before the time the Bershtein Loan was made, but knew (or should have known) that the proceeds of the NH Loans would not be available for such purpose, that would be a material fact. However, the court is unpersuaded that the Debtor made that representation.[17]

During her direct examination, the Plaintiff testified that the Debtor represented that the Bershtein Loan would be paid "off the top" of the NH Loans. (10/18/04 Transcript at 17, line 25 (Testimony of Plaintiff).) However, later in her examination the Plaintiff testified that the Debtor told her that the Debtor did not know if she would have "free reign [sic]" over the NH Loans proceeds to repay the Plaintiff in one lump sum and that the loan might have to be paid in "installments." (10/18/04 Transcript at 21, lines 6-13 (Testimony of Plaintiff).) Given the ambiguity in the Plaintiff's testimony, the court is unpersuaded that the Debtor misrepresented to the Plaintiff that the Bershtein Loan necessarily would be paid from the proceeds of the NH Loans. Accordingly, the court concludes that the Plaintiff failed to sustain her burden under Bankruptcy Code § 523(a)(2).[18]

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[17] It is more likely than not that the proceeds of the NH Loans could not have been used to repay the Bershtein Loan. (*See* Plaintiff's Trial Exhibit F ("Standby Agreement" dated June 4, 2002).) However, the record gives the court an insufficient basis to conclude that the Debtor knew or should have known that the NH Loans proceeds could not be used to repay the Bershtein Loan. For example, it is unclear from the record when the Debtor and the City agreed upon the final loan structure (i.e., S&L rather than the Debtor as borrower) and when the City first demanded the Standby Agreement.

[18] The court has considered the Plaintiff's other arguments in support of the Section 727 Complaint and the Section 523 Complaint and finds them to be unpersuasive.

IV. CONCLUSION

For the reasons discussed above, judgment will enter (1) in favor of the Debtor on the Section 727 Complaint and discharge shall enter; and (2) in favor of the Debtor on the Section 523 Complaint, the Judgment Debt shall be discharged and the Plaintiff shall take nothing on the Section 523 Complaint.

BY THE COURT

Dated: October 3, 2005