IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION

IN RE:	§	
	§	
MANOJ K. PATEL,	§	
Debtor.	§	CASE NO. 01-48528-DML-7
	§	

HOWARD JOHNSON	§	
INTERNATIONAL, INC.,	§	
Plaintiff,	§	
	§	
vs.	§	ADV. NO. 02-4021
	§	
MANOJ K. PATEL,	§	
Defendant	§	

MEMORANDUM ORDER

Came for consideration the complaint (the "Complaint") by Howard Johnson International, Inc. ("HJI") for a non-dischargeable judgment against Manoj K. Patel ("Debtor") in the amount of $750,000. This memorandum constitutes the Court's findings of fact and conclusions of law pursuant to FED. R. BANKR. P. 7052 and 9014. This matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(I) and (J), and the Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1334.

I. Background

In 1992, Debtor (and other individuals)[1] formed Yogi Development Co., Ltd., LLC ("Yogi") for the purposes of distributing petroleum products on a wholesale basis and developing convenience stores and hotels. In a typical hotel development transaction, Debtor (through Yogi) would coordinate a project by procuring start-up financing, hiring architects, engineers, and construction personnel, and attracting investors who would

[1] At the time Debtor sought relief under the Bankruptcy Code, and at all times since, Debtor owned 100% of Yogi's stock

assume ownership of the project upon completion. The parties offered evidence that Debtor achieved above average results in conducting Yogi's business in this manner, and that Debtor was one of HJI's preferred developers.

In 1997, Yogi and HJI entered into an agreement whereby Yogi undertook to develop approximately twelve Howard Johnson facilities throughout the Fort Worth/Dallas area. Soon after entering into the development agreement, Yogi began work on the first few projects for HJI. While there is some dispute over the degree and disclosure of difficulties encountered, Yogi suffered a series of setbacks soon after starting its work for HJI In one such instance, a general contractor failed to pay subcontractors and apparently absconded with funds needed to complete a project. To remedy the situation, Debtor expended his own monies, funds borrowed on his account, funds from other projects, and proceeds from Yogi's wholesale petroleum business to pay the subcontractors.

During Fall 1999, Debtor and HJI engaged in discussions regarding development of three Howard Johnson Plaza locations (the "Plazas"), which are upscale Howard Johnson hotels. One of the Plazas was to have been located in Frisco, Texas (the "Frisco Plaza"); another was to have been located in Grapevine, Texas (the "Grapevine Plaza"); and the third was to have been located in Irving, Texas (the "Irving Plaza").

During the discussions regarding the Plazas, HJI agreed to, and ultimately did on December 30, 1999, advance $750,000 (the "Advance") to Debtor. Purportedly pertinent to HJI's decision-making process was Debtor's 1998 personal financial statement.[2] The Advance was memorialized in the form of three "incentive advance notes", each executed

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[2] The parties dispute when or whether Debtor provided the financial statement to HJI, and how much or if HJI relied on the financial statement in deciding to make the Advance

by Yogi and Debtor (in his individual capacity). The Advance is the subject of the instant controversy.

A. HJI's Position

HJI contends that it was the parties' understanding that the Advance would be used solely to facilitate the development of the Plazas. It further contends that the entire Advance was used for purposes other than developing the Plazas; a contention not disputed or denied by Debtor. It is HJI's position that Debtor, through a failure to disclose the true extent of his and Yogi's financial woes and through material misrepresentations on his financial statement, fraudulently induced HJI to make the Advance with knowledge that HJI would not have done so if it had known the true state of Debtor's and Yogi's affairs. Finally, HJI contends that Debtor and Yogi procured the Advance by nefarious devices with no intention of completing the Plazas or ever repaying the obligation. It is on these bases that HJI seeks this Court's declaration that Debtor's indebtedness on the Advance is a nondischargeable obligation.

B. Debtor's Position

In response to HJI's allegations, Debtor avers that HJI had full knowledge of his and Yogi's precarious position when it made the Advance, and that the parties both understood that the Advance was to be used by Yogi for whatever purpose Yogi deemed appropriate. Further, Debtor professes no knowledge of how or when the disputed financial statements came into HJI's possession but he affirmatively asserts that he did not provide the document to HJI for the purpose of securing the Advance and neither knew nor intended that HJI would use the statement as a basis for authorizing the

Advance. Finally, Debtor denies dishonest intent in accepting the Advance in that he fully intended that the Plazas would be built or the Advance would be repaid.

II. Discussion

In this matter, HJI relies on section 523(a)(2) to support its contention that Debtor's actions gave rise to a non-dischargeable obligation to repay the Advance. In relevant part, section 523(a)(2) provides that the debt of an individual is not discharged if the debt is:

> 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;
>
> (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.[3]

The party objecting to discharge under section 523(a)(2) has the burden of proof to satisfy the elements of either section 523(a)(2)(A) or (B) by a preponderance of evidence.[4]

A. 523(a)(2)(A)

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[3] 11 U S C. §§ 523(a)(2)(A) & (B).

[4] *See* FED R. BANKR. P. 4005; Grogan v Garner, 498 U S. 279, 286, 111 S Ct 654, 659 (1991); Recoveredge, L.P , v. Pentecost, 44 F.3d 1284, 1292 (5th Cir 1995)

As a general matter, section 523(a)(2)(A) "contemplates fraud involving 'moral turpitude or intentional wrong; fraud implied in law which may exist without imputation of bad faith or immorality, is insufficient.'"[5]

When defining the elements of nondischargeability under section 523(a)(2)(A), the Fifth Circuit has distinguished between actual fraud and false pretenses or representations.[6] In order to establish nondischargeability pursuant to an "actual fraud" theory under section 523(a)(2)(A), the objecting party must prove by a preponderance of the evidence that: 1) the debtor made representations; 2) at a time when the debtor knew such representations to be false; 3) with the intention or purpose to deceive the creditor; 4) the creditor must have relied on the representations; and 5) the creditor must have sustained losses as a proximate result of the representations.[7] In order for a "false representation" or "false pretense" to give rise to a nondischargeable debt under section 523(a)(2)(A), the representation or pretense must have been: 1) a knowing and fraudulent falsehood; 2) describing past or current facts; 3) that was relied upon by the creditor.[8] In either case, the creditor must show that his reliance was both *actual* and *justifiable*.[9]

The Court concludes that HJI failed to prove by a preponderance of the evidence the requirements of section 523(a)(2)(A) for either "actual fraud" or

[5] Allison v. Roberts, 960 F.2d 481, 483 (5th Cir. 1992) (quoting 3 COLLIER ON BANKRUPTCY ¶ 523.08[4] 15th ed. 1989).

[6] *See* Recoveredge, 44 F.3d at 1292 (5th Cir. 1995).

[7] *See* Id at 1293

[8] *See* Id

[9] *See* Field v Mans, 116 S Ct 437, 445-46 (1995); *In re* Rich, 249 B R 709, 715 (Bankr. N.D Tex 2000)

"false pretenses or representations". Assuming, *arguendo*, that Debtor did make a representation (either overt or implied), Debtor did not have the requisite intent or purpose to deceive HJI. Further, given the information available to HJI at the time of the Advance, any reliance by HJI on debtor's representations about project status or ability to complete the Plazas was not *justifiable*. Finally, the witness and evidence proffered by HJI failed to establish by a preponderance of the evidence that HJI *actually relied* on any representation made by Debtor. Rather, it appears that HJI relied solely on Debtor's previously pristine track record of developing hotels for HJI.

B. 523(a)(2)(B)

In order to establish nondischargeability under section 523(a)(2)(B), the creditor must prove by a preponderance of the evidence that: 1) the debtor made a written statement; 2) respecting the debtor's or an insider's financial condition; 3) which statement was materially false; and 4) was made with an intent to deceive. Unlike the justifiable reliance requirement of section 523(a)(2)(A), section 523(a)(2)(B) specifically calls for *reasonable* reliance on the statement by the creditor.

The Court concludes that HJI failed to prove by a preponderance of the evidence the requirements of section 523(a)(2)(B). Although HJI apparently was in possession of Debtor's financial statement at the time of the Advance, HJI failed to establish when, under what circumstances, or even if, Debtor provided the statement. Absent such information, the Court is unable to find that Debtor "used" the statement (as contemplated by the language of section 523(a)(2)(B)) to procure the Advance. Further, the financial statement was nearly a year out of date at the time of the Advance. As a result, the Court is unable to find that HJI's reliance (if any) thereon was reasonable.

III. Conclusion

As HJI was not able to establish by a preponderance of the evidence all of the elements of either section 523(a)(2)(A) or section 523(a)(2)(B), the Court will not except from Debtor's discharge his obligation to repay the Advance. The Court would note that this appears to be a case of two parties who acted in good faith, but who, through unavoidable hardships and unforeseen consequences, came to a bad end. Where such a confluence of innocents occurs, the Bankruptcy Code requires the nondebtor to bear the brunt of the loss.

Accordingly, it is

ORDERED that Debtor's obligation to repay the Advance is not excepted from discharge in Debtor's chapter 7 case.

Signed this 15 day of October, 2002

Dennis Michael Lynn
United States Bankruptcy Judge