

Law Offices
James J. Falcone
520 Capitol Mall, Suite 600
Sacramento, California 95814-4717

916/442-4204

July 10, 2009

False financial statements are forever.

Long ago in law school a bankruptcy professor pointed out to us that, if you exaggerate your income on a credit card application, you might have a problem eliminating that card debt in bankruptcy. The bankruptcy code has a provision prohibiting discharge of debts to the extent they were obtained by use of statement in writing that is materially false, on which the creditor reasonably relied.

I'd be surprised if a credit card company could produce an original credit application from 10 years ago, but in other circumstances an exaggerated statement could seem to last forever, or so it may appear to the debtors in a recent decision. The 9th Circuit Court of Appeal, which governs Federal Courts in California, concluded in May 2009 that, even if the objecting creditor had not relied on the false statements, they could prevent the debt being wiped out in bankruptcy.

The case involved Blue Corporation, a commercial tenant. In signing a 1999 lease with the landlord, two corporate officers submitted personal financial statements and guaranteed the lease. The landlord sold its interest in the lease to Matsco in 2002. Blue Corp subsequently defaulted on the lease, and Matsco obtained a judgment for \$193,000 against the corporation & both officers. Matsco assigned the judgment to Stornawaye. In 2004 Stornawaye assigned the judgment to Blue Falls, and the two officers then filed for bankruptcy.

Blue Falls objected to discharge of the debt, claiming that the officers submitted false financial statements. The two corporate officers argued that Blue Falls had not relied on the statements- they were three parties removed from landlord and the lease negotiation that had occurred years prior.

The Court of Appeals considered that, under general principles of assignment law, an assignee steps into the shoes of the assignor. In this circumstance, there is nothing in the bankruptcy code to the contrary. The landlord, who relied on the false statements, had the right to object to a discharge, and assigned that right to Matsco, which assigned it to Stornawaye, who assigned it to Blue Falls.

Blue Falls has not won yet; it still has to go back to the trial court and prove that the financial statements (now ten years old) were materially false, with an intent to deceive the creditor. But you can expect that, whenever the value is high enough, the financial statements are in a file in a box in a storage unit somewhere and will last forever, or at least until the debt is paid off.

(In the matter of Boyajian, 9th Circ. 07-55716.)

James J. Falcone, practicing law in Sacramento, California for over 20 years, advises business and individual clients in real property and business transactions and litigation. JFalconeLaw.com