UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW JERSEY

IN RE:	:	
WILLIAM R. SCHROEDER. JR. and KATHLEEN A. SCHROEDER,	:	CHAPTER 7
Debtors.	:	CASE NO. 01-14748 (GMB)
SALES AND PEOPLE, INC., PENSCO PENSION SERVICE, INC., and THOMAS V. YARNALL,	:	ADVERSARY NO. 01-1270 (GMB)
Plaintiffs,	:	
v.	:	MEMORANDUM OPINION
WILLIAM R. SCHROEDER, JR. and KATHLEEN A. SCHROEDER,	:	
Defendants.	:	

APPEARANCES:

Thomas V. Yarnall, Pro Se
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Appearing for Plaintiffs

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I. INTRODUCTION

The matter was brought before the Court upon the filing of an adversary complaint by Plaintiff, Thomas V. Yarnall, Jr. on September 26, 2001, appearing pro se against Debtors/Defendants William and Kathleen Schroeder (the "Debtors" or "Defendants") seeking nondischargeability of a debt in the principal amount of $40,000 pursuant to 11 U.S.C. §§ 523(a)(2)(A) and 523(a)(4). The debt stems from a check to an entity known as Ki-Digital ("Ki-Digital") in the amount of $40,000 written on behalf of the Plaintiff Thomas V. Yarnall by an entity known as PENSCO Pension Services, San Francisco, California ("PENSCO") dated 3/10/98 with respect to a self-directed Investment Retirement Account Mr. Yarnall maintained with PENSCO identified as YA008.

Mr. Yarnall originally sought recovery on behalf of Sales and People, Inc. and PENSCO Pension Services. Because those entities were corporations and were not represented by attorneys, he amended his complaint on December 4, 2001 to bring the complaint only for his individual claims. On December 26, 2001, he further amended the complaint. On January 2, 2002, the Court entered an order denying a Motion to Dismiss filed by the Defendants. An answer was then filed by the Debtors on January 26, 2002. After the filing of Pre-Trial Memoranda, and the narrowing of the allegations in this case at a pre-trial hearing, the Court conducted a trial of this matter on 6/12/02, 6/20/02 and 7/17/02, after which time it reserved decision.

II. JURISDICTION

Matters concerning the dischargeability of a debt are core proceedings pursuant to 28 U.S.C. section 157(b)(2)(I). The within Opinion constitutes this Court's findings of fact and conclusions of law pursuant to Fed. R. Bankr. P. 7052.

III. FINDINGS OF FACT

A. Factual Background Concerning Charles McCormick Mata Factoring and Ki-Digital Six Percent Notes

Prior to rendering its specific factual findings in this case, the Court notes for the record that the within matter is in fact the second in a series of three nondischargeability actions filed and tried by various creditors of Debtors William and Kathleen Schroeder relating to the sale of promissory notes in the late 1990's, by the Debtors.[1]

The Court rendered its first Opinion orally in the matter of Robert G. Stevens, Esq. v. William Schroeder, et al., Adv. Pro No. 01-1112, on 4/18/02.[2] At the outset, it is important to note that this Court has repeatedly indicated in the course of these independent adversary proceedings that the evidence presented in one proceeding has no direct bearing on the factual record in the other two proceedings, except as an aid to the Court in its general understanding of the basic background facts common to all three proceedings involving the Debtors.

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[1] For purposes of accuracy, the Court notes the existence of a fourth adversary complaint Hai T. Nguyen v. William Schroeder, Adv. No. 01-1192 filed on 8/10/01 pursuant to section 727 of the Bankruptcy Code. A Stipulation to Dismiss with Prejudice was filed on 10/30/02.

[2] Adversary Complaint No. 01-1112 was filed on 5/17/01.

Since certain of the factual findings as to background in the Stevens matter are relevant to the case *sub judice,* they are specifically incorporated by reference as noted herein. The parties to this proceeding however, are left to their proofs with respect to establishing a record regarding the section 523 claims and affirmative defenses asserted herein and as argued at trial.

On May 4, 2001, the Debtors William and Kathleen Schroeder filed a voluntary petition for relief under Chapter 7 of the Bankruptcy Code.[3] As recognized by the Court in the Stevens proceeding, during the fall of 1996, the debtors became involved in a financial deal with an individual identified as Charles McCormick, a high school friend of the Debtors. Mr. McCormick, who had previously worked as an exterminator and had no college background, advised the Schroeders that he had bought computers at a discount and had an agreement to sell them for a profit, however, he needed financing to complete the transaction and would pay interest for a short term loan.

The Schroeders took an advance on their credit card, loaned the money to McCormick and were repaid with interest. After that transaction was completed, they entered into another. They saw no documentation and had no information regarding the buyers or sellers of the computer equipment. They told others of the return on their investments and subsequently began handling the collection of funds from investors in return for promissory notes and with respect to which, the Schroeders were paid commissions. The debtors referred to these transactions as "factoring," and to the promissory notes as "factoring notes."

Mrs. Schroeder, who had been working at a hospital at the time of the first McCormick transaction in 1996, left her job in January 1997 in order to work full time handling the

[3] The docket reveals that the Debtors received a discharge on June 18, 2003.

investments. The Court found in the Stevens case, that neither of the Debtors had any type of education or training in financial management. Neither were licensed security brokers nor investment advisors.

Originally, the investment transactions were arranged through Mata Services, Inc. ("Mata") which was an entity controlled by McCormick, and later through Ki-Digital, another entity of McCormick. In this case, Mr. Schroeder has admitted in paragraph 6 of the debtors' Amended Answer to being an "unregistered agent in the sale of promissory notes issued by Mata." The Court finds this admission further supported by Plaintiff's Exhibit P-1 which is a Mata business card with the name "Bill Schroeder," and the title "Investment Manager," printed on the top left hand corner.

As in the Stevens matter, the Court finds that the number of people investing and the amounts of the transactions grew.[4] Mrs. Schroeder would collect money and turn it over to McCormick despite a lack of documentation. After McCormick advised her that the transaction was completed, she would give him a list of the investors who wanted their investment returned with interest. The others would "roll-over" their money to another transaction. The Court found in Stevens that McCormick never returned all of the profits to the Schroeders, nor did the Schroeders return the profits to all individuals who had invested, only those who requested that their investment and/or interest be returned to them. The Court has previously found that most investors chose to roll-over their investments, and that only a small percentage of the total number of investors requested their investment or interest returned to them.

[4] Exhibit P-4 is a list of list of investors. Mr. Yarnall is indicated therein as investor number 532.

Significantly, as it relates to the matter *sub judice*, in addition to the factoring notes, the Court finds that in 1997 the debtors began collecting investments in Ki-Digital which notes were to pay interest to investors at a rate of six percent per month ("Ki-Digital Six Percent Notes" or "permanent notes"). These notes were issued to the various investors beginning in June of 1997.

Mr. Yarnall testified that in May and June of 1997, the Debtors, continuing to represent themselves as authorized agents of Mata "solicited" him directly to roll-over funds originally invested in "factoring notes" into Ki-Digital Six Percent Notes. Mr. Yarnall asserts that their purpose as described to him was to preserve his right to an option to purchase stock in Ki-Digital in an imminent and lucrative private stock offering. It is undisputed that the debt in question to Mr. Yarnall, did not however arise out of an earlier "roll-over" transaction *per se,* but rather out of Mr. Yarnall's eighth and final investment of $40,000 in January of 1998 relating to the purchase of a Ki-Digital Six Percent Note.[5]

B. The Civil Enforcement Action, The Courier Post Article and McCormick's Guilty Criminal Plea to Securities Fraud

Because of its relevance to the matter at hand, the Court further repeats its findings in Stevens that the Attorney General of New Jersey filed a civil enforcement action on behalf of the Chief of the State Bureau of Securities against Ki-Digital, Mata, and Charles McCormick ("the Civil Enforcement Action"). Exhibit P-18 is the June 19, 1998 Consent Order Appointing a

[5] Exhibit P-27 is a copy of Check Number 31712 payable to the order of Ki-Digital (Attn: Bill Schroeder") in the amount of $40,000. The handwritten notation on P-27 indicates as follows: "New check from PENSCO for Tom Yarnall. 1st Ck #30388 never got cashed. 1st ck recv'd late 1/12/98 but lost. This ck deposited 3/16/98. Interest pd from 1/12/98." Exhibit P-13 is the related Promissory Note dated January 2, 1998 signed by Charles McCormick as President of Mata."

Receiver, Robert G. Stevens Esq., in the Civil Action (Docket No. C-158-98) which was pending in the Superior Court of New Jersey - Chancery Division - General Equity in the County of Essex, before the Honorable Benjamin Cohen.

It is undisputed and admitted by the debtors that on or about March 30, 2000 the debtors were found to have participated in the sale of unregistered securities in violation of N.J.S.A. 49:3-52(b) and N.J.S.A. 49:3-56(h) by Judge Cohen due to the omission of material facts in dealing with investors and not being properly registered to sell and issue securities. These findings were made despite the fact that during the period in question the Schroeders hired two CPA's, Brian Lynn, and Joel Penn, and later retained attorney David Rubin, Esquire, with respect to a lawsuit in a similar transaction. The Debtors strenuously argue that they had placed their reliance on the McCormick representations and were unaware that their actions violated state law. No criminal charges relating to these transactions were ever brought against the Debtors.

At some time after June 25, 1998, Mrs. Schroeder became aware of an article which had been published in the Camden *Courier Post* newspaper stating that the State of New Jersey was investigating McCormick regarding fraud allegations. The defendants contend that the Schroeders first became aware of the appointment of the Receiver of Ki-Digital from the *Courier Post* article which was sent to them in June 1998 by Mr. Yarnall.

The Court further notes for the record that it has reviewed the *Courier Post* article as contained within Plaintiff's Exhibit P-20, along with the following note to the Schroeders from the Yarnalls dated 6/25/98 as repeated verbatim below:

> Kathy and Bill:
>
> The above article was in the Courier Post on Tuesday. Since we haven't heard from you, we thought you might not know about the article or you are calling your clients (in alphabetical order) to reassure them or you are sending an explanation in the mail. I guess the best thing for us is to be told the complete facts directly from you because sometimes the press does not have all the facts.
>
> Are you folks (as agents) registered? I never thought to ask that when we first met.
>
> Has the lawyer for Ki-Digital composed a letter for distribution to the brokers and investors as was discussed at the brokers' meeting?
>
> Does this mean the amounts that my IRA ($40,000), Polly ($10,000) and Sales and People ($17,000) have invested in Ki-Digital are in jeopardy? Notice I am not even including the accrued interest values.
>
> Is this suit tied in to the factoring notes in any way?
>
> Tom and Polly

It is undisputed that this review of the *Courier Post* article was after the appointment of the Receiver in the Civil Enforcement Action, and also subsequent to the investment which is the basis for Thomas Yarnall's present claim.

On October 19, 2000, Charles McCormick waived indictment and pled guilty to criminal charges arising from the issuance of the promissory notes including securities fraud. This Court has previously found that the Schroeders acted as agents in connection with the sale of at least 1,567 promissory notes. In the Stevens case, the parties stipulated that the debtors realized an aggregate amount of $565,514 from the issuance of factoring notes and $171,281 from the issuance of permanent notes. The record reflects that not until September 1998 when

McCormick failed to pay the money due on an outstanding note and the Schroeders were being questioned by State of New Jersey investigators, did they contact an attorney to represent them.

C. The Yarnall Investment(s)

The *pro se* testimony of the Plaintiff Tom Yarnall establishes that on or about October of 1996, Mr. Yarnall was retired and seeking to invest some funds he had transferred from his 401K Plan into an IRA. He indicated that he wanted to both maximize his potential returns and maintain the safety of his investment. He stated that he believed that these two goals were incompatible until he met the defendant William Schroeder and learned of the sale of Mata factoring notes with a return greater than any investment opportunity that he was aware of at that time. Mr. Yarnall testified on several occasions that his clear understanding was that Mr. Schroeder was an "investment manager" for Mata. After a series of initial factoring note purchases beginning in October of 1996 resulted in a good return on his investment in a relatively short period of time, Mr. Yarnall indicated that a trust developed between himself and Mr. Schroeder.[6]

In December 1996, Mr. Yarnall opened his "self-directed IRA" with PENSCO, a company specializing in such investment vehicles. Mr. Yarnall testified that this type of IRA was a necessary prerequisite to his doing business with Mr. Schroeder as other types of IRAs required SEC approval of the investment.

[6] Exhibit P-5 is a copy of Mr. Yarnall's original investment in Mata in the amount of $4,000 written on check number 5436 dated 10/10/96.

Mr. Yarnall testified that in December 1997, a year after opening his self-directed IRA, his account manager at PENSCO advised him that for "account reconciliation" purposes, all funds had to be returned to PENSCO on their anniversary date, and that therefore it was necessary for Mr. Yarnall to "get out of the program." Mr. Yarnall testified that he complied with this requirement by withdrawing all of his money from the investment cycle, which at that time amounted to $71,000, and depositing these funds back into his PENSCO self-directed IRA. Thereafter, at the end of 1997, Mr. Yarnall had received back all of his principal investments and returns on his investments of $38,386.00.[7]

Mr. Yarnall further stated that once withdrawn, there was a policy or "rule" that prohibited re-entry into the investment program.[8] He indicated that despite this policy, Mr. Schroeder undertook to work out a means by which Mr. Yarnall could re-invest with Ki-Digital. In this regard, Mr. Yarnall testified that because the PENSCO Account Manager was unfamiliar with Ki-Digital as an investment opportunity, prior to re-investing in January 1998, a loan servicing agreement was required by PENSCO, between Mr. Schroeder as "Loan Servicing Agent," Ki-Digital as the Borrower, and Mr. Yarnall as the Lender. This Loan Servicing Agreement was faxed to Mr. Schroeder by the Account Manager on or about January 6, 1998, at approximately the same time as re-entry or re-investment by Mr. Yarnall into Ki-Digital.[9]

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[7] Exhibits D-1 through D-9.

[8] Exhibit P-8 is correspondence to investors on Mata letterhead indicating "All invested funds will be available to each investor at any time. Money will never be held back at any time if a refund is requested. Once funds are withdrawn from the investment cycle, they WILL NOT be allowed to be re-entered into the process again (NO EXCEPTIONS)."

[9] Exhibit P-12 is the Loan Servicing Agreement.

With respect to Mr. Yarnall's $40,000 investment, on or about January 2, 1998, PENSCO issued a check on Mr. Yarnall's behalf to Ki-Digital in order to purchase a Ki-Digital Six Percent Note. The defendants contend that these funds were deposited into a bank account of Ki-Digital, and never received by either of the Schroeders or their business Macrophage. Mr. Yarnall alleges that Mr. Schroeder omitted telling him of an alleged "lateness" or delay of these funds from PENSCO, and that Mr. Schroeder indicated falsely that he had in fact received the $40,000 check from PENSCO in time to meet a deadline of January 15, 1998 with respect to participation in the January offering. The record at Exhibits P-14 and P-27 reflects that a second apparent "replacement check" was issued by PENSCO to Ki-Digital dated 3/10/98 in the amount of $40,000 with interest due from January 12, 1998. Mr. Yarnall further alleges that with respect to this investment, after issuance of Ki-Digital Six Percent Notes in January and April 1998, Exhibits P-13 and P-16 respectively, the Debtors continued to reiterate the security of the investments with the alleged intention of persuading Mr. Yarnall not to withdraw his money.

In addition to the above, upon an "automatic roll-over" of his January 1998 investment into the April 1998 Ki- Digital Six Percent Note, Mr. Yarnall testified that he was unable to withdraw any of his investment because certain information was falsely represented to him. Specifically, he alleges that he was told that the SEC had frozen all funds in March of 1998 until an audit was completed by the SEC in preparation for an alleged promised private stock offering. In addition, Mr. Yarnall advises that it was his understanding that visits to the business offices to observe operations were forbidden because he was told, it would be disruptive to the business operations which involved confidential contracts.

By April of 1998 it had become apparent to Mr. Yarnall that there was a serious problem with respect to his January 1998 investment. This concern was heightened upon his reading of the *Courier Post* article in the early summer of 1998, approximately six months after his January investment. It is undisputed that, despite his prior seven successful transactions, Mr. Yarnall ultimately did not receive any return on his last investment, the January 1998 Ki- Digital Six Percent Note.

D. The Defendants' Position

Much of the cross-examination of Mr. Yarnall in this case by counsel for the Debtors focused upon "suspicions" allegedly held by Mr. Yarnall with respect to his investments. The record substantiates that these alleged "suspicions" were both articulated and unarticulated in various circumstances during the investment period of October 1996 through January 1998. The Court finds that at some point early on in the investment period, Mr. Yarnall questioned Mr. Schroeder at the Schroeders' home, as to how he might be able to obtain the names of the buyers and sellers of the computer equipment involved in the factoring transactions. Mr. Yarnall testified that Mr. Schroeder replied that "he didn't know and that he didn't want to know." He indicated that he was told by Mr. Schroeder that Charles McCormick, the person responsible for the factoring transactions, whom Mr. Schroeder trusted, did not in turn trust Mr. Schroeder enough to provide this information to him for fear of risking the establishment of a competing business by Mr. Schroeder.

Mr. Yarnall indicated upon cross-examination that after this inquiry he kept investing, believing in a developing friendship between himself and the Schroeders. The testimony

establishes that this developing friendship included up to as many as a dozen visits by Mr. Yarnall to the Schroeders' home, as well as golf outings with Mr. Schroeder. Also, with his knowledge of computers, Mr. Yarnall assisted the Schroeders with their "PC operation" and helped develop elaborate "spread sheets" to document the investments.

Testimony was elicited regarding a "Presentation" that was held on May 16, 1997 in Mt. Laurel, New Jersey for what was described as "Kinetic Images, Inc., a division of Mata Services, Inc."[10]

Exhibit P-7 is the Invitation to this presentation as received by Mr. Yarnall. Mr. Yarnall attended this meeting and, and as he arrived late, was later given further investment materials. Those investment materials are set forth at Exhibit P-8. Mr. Yarnall admitted on cross-examination that after the meeting he described the presentation by the Kinetic Images' representative to Mr. Schroeder as being "crappy." Mr. Yarnall indicated that he continued to invest after this meeting because of the promise by Mr. Schroeder of a high yield for his investment. He indicated that he "accepted" the representation of his friend, Mr. Schroeder, that such high yields were possible due to the tremendous mark up of the equipment and that therefore, being a trusting person, his suspicions were "quelled."

He further testified that he feared that he would be dropped from the program if he pursued an independent inquiry. The Court notes that various forms of investor correspondence in this case, including correspondence on Mata letterhead represented by Exhibits P-6, P-9 as well as a "Ki-Digital Newsletter," Exhibit P-10, specifically direct all questions to the investor's representative. The Ki-Digital Newsletter advises on page 2, ". . . please make sure all your calls

[10] The record reflects that the name "Kinetic Images" was later changed to "Ki-Digital."

and questions are placed directly to your rep. Do not call the office for information or questions."

Mr. Yarnall was also cross-examined by Debtor's counsel regarding his December 1997 withdrawal of all of his money prior to re-investing a portion of it in January 1998 which he testified was required by his pension service. Again, Mr. Yarnall indicated that he was "cautious" in deciding to reinvest $40,000 and not the entire amount of $71,000 as had been previously invested by him, because he "did not want the exposure." In his cross-examination, Mr. Yarnall repeatedly admitted that he was interested in what Debtors' counsel described as "non-traditional investments" because of their potential for high interest returns, but having had at least seven successful prior investments through the Schroeders and Mata and Ki-Digital, as well as what he earnestly believed to be a genuine friendship with the Schroeders, he believed that nothing could go wrong.

It was not until April of 1998, when he failed to receive a return on his January 1998 Ki-Digital Six Percent Note, and later his reading of the *Courier Post* Article in June 1998 that Mr. Yarnall realized that the factoring notes as well as the Ki-Digital Six Percent Notes were part of a broad based scheme involving investment fraud.

IV. DISCUSSION

The issues before the Court are first, whether the Debtors obtained money from the Plaintiff by false representations within the meaning of 11 U.S.C. § 523(a)(2)(A)[11]; and/or

[11] 11 U.S.C. section 523(a)(2)(A) provides in relevant part:

(a) A discharge under section 727. . . of this title does not discharge

whether the discharge exception for fiduciary debts pursuant to 11 U.S.C. section 523(a)(4)[12] applies.

As to section 523(a)(2)(A), in order to prevail under this section, the creditor must show:

> (1) the debtor *obtained* money through a *material misrepresentation*;
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> (2) the Debtor, at the time, knew the representation was *false* or made with *gross recklessness* as to its truth;
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> (3) the debtor *intended* to deceive the creditor;
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> (4) the creditor *justifiably relied* on the debtor's false representations; and
>
> (5) the creditor sustained a loss and damages as a *proximate result* of the debtor's material false representations.

(Emphasis added). In re Cohen, 191 BR 599, 604 (D.N.J. 1996)(citing In re Poskanzer, 143 B.R. 991, 999 (Bankr. D.N.J. 1992), affirmed, 106 F.3d 52 (3rd Cir. 1997), affirmed 118 S.Ct. 1212 (1998); see also In re Trombadore, 201 B.R. 710, 713 (D.N.J. 1996).

The creditor bears the burden of proving each of the elements by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 287, 288 (1991).

> an individual debtor from any debt
> (2) for money. . . , to the extent obtained by-
> (A) false pretenses, a false representation or actual fraud.

[12] 11 U.S.C. section 523(a)(4) provides in relevant part:

> (A) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt
>
> (4) for fraud or defalcation while acting in a fiduciary capacity, embezzlement, or larceny.

A. Nondischargeability Pursuant to 11 U.S.C. § 523(a)(2)(A)

With respect to the first element of obtaining money or property by false representation, it has been recognized that it is not necessary that the property actually be gained for the direct benefit of the debtor. Even an indirect benefit to the debtor may constitute "obtaining property" within the meaning of section 523(a)(2)(A). *Collier on Bankruptcy*, section 523.08 [1]{a} (citing Brady v. McAllister (In re Brady), 101 F.3d 1165 (6th Cir. 1996); Hssn#7 Limited Partnership v. Bilzerian (In re Bilzerian), 100 F.3d 886 (11th Cir. 1990).

As applied to the facts herein, the Court rejects the threshold defense of the Debtors' counsel that as a result of the January 1998 transaction, the Schroeders received "nothing" from the transaction. First, the debtors did receive the investment from Mr. Yarnall and they directed its distribution. Although some funds were turned over to Charles McCormick and some were deposited into the account of the corporation they set up, Macrophage, Inc., the debtors received the funds and transmitted them. Mr. Yarnall merely delivered the funds to them, as directed. Moreover, the Court finds that there was, at a minimum, an indirect benefit to the Debtors stemming from the final Yarnall investment, as part of an overall investment scheme through which the Schroeders obtained hundreds of thousands of dollars in commissions. In this regard, the Court accepts Mr. Yarnall's proposition that the Debtors' argument regarding a lack of direct benefit stemming from this particular transaction, under which Ki-Digital undeniably defaulted, is not enough to defeat the Plaintiff's §523(a)(2)(A) claim. By his own representations (Exhibit P-1), Mr. Schroeder was acting as an "investment manager" for Mata Services and later as a "Marketing Director and Licensed Agent" of Ki-Digital. Both of these entities obtained millions of investor dollars from which they and their "agents," specifically the Schroeders, gained. The

Court finds that whether or not a commission was actually received on this particular transaction is immaterial because the debtors made the representations intending to receive commissions from the investments which they received.

As to the second element of the section 523(a)(2)(A) claim, to except a debt from discharge, the false representations giving rise to the debt must have been knowingly and fraudulently made. Century 21 Balfour Real Estate (In re Menna), 16 F.3d 7 (1994). This Court has previously recognized that in this Circuit, reckless representations may in some cases be sufficient to meet this element. In re Cohn, 54 F.3d 1108 (3rd Cir. 1995). A material fact is one touching upon the essence of the transaction. *Collier,* Section 523.08 [d]. It is basically undisputed herein, that a litany of factual representations too numerous to recount in detail made by the Schroeders to Mr. Yarnall ultimately proved to be false. Like the Bankruptcy Court in In re Wholly, 145 B.R. 830, 834 (Bankr. E.D. Va. 1991), the Court finds that the statements and actions of the Debtors were "reckless and in conscious indifference to the consequences." As in Stevens, the Court finds that the Schroeders had an obligation to satisfy themselves and the investors that they had made a reasonable investigation into the legitimacy of the enterprise regarding which they were collecting from the investing public, millions of dollars, and from whom they were reaping significant financial gain. The fact that they hired professionals who did not reveal these problems, is of little weight when balanced against the fact that they undertook this enterprise without training, education or license and had the potential to inflict devastating harm to individuals and their retirement income.

With respect to the element of intent, the debtors defense, as in Stevens, is that they did not know that the representations were false when they passed them on to their clients and that

they did not intend to deceive them. They assert here once again that they were misled by Charles McCormick just like the creditors of their estate. They point to the fact that some of the client/investors were sophisticated business people and if they could be deceived, so could the debtors. This Court has previously rejected this defense stating that the problem with it is that while the creditors only invested their own funds into a risky investment, the debtors made a business of soliciting investors and collecting funds to invest in these entities based on the false representations they were passing on to the public. It is uncontested that they earned hundreds of thousands of dollars based on these false representations. The losses they claim are merely the lost commissions they thought they would earn as part of the fraudulent McCormick scheme.

The Court has specifically found heretofore in Stevens, that by failing to take the appropriate steps to register the securities and be licensed, and failing to adequately investigate exactly what they were soliciting for their clients to invest in, the debtors were "grossly reckless." This reckless indifference to the truth is also sufficient to find that they intended to deceive the creditors of Mata Services and Ki-Digital, represented in the Stevens matter by the Receiver. In re Cohn, 191 B.R. 605 (determining that intent to deceive may be inferred from the totality of the circumstances which includes the debtor's reckless disregard of the truth.") Mr. Yarnall was likewise deceived.

As to the fourth element of justifiable reliance, In Field v. Mans, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed. 351 (1995), the Supreme Court settled a conflict among courts of appeals about the level of reliance that must be demonstrated for a false representation to be nondischargeable.

> The Supreme Court held that the other party's reliance on the false representation 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. Collier, section 523.08[d].

Mr. Yarnall testified that he believed the debtors and relied upon their representation which the Court has previously found in Stevens,[13] and finds again here, to be justified. In support of this finding the Court looks to several circumstances.

First, Mr. Yarnall developed a friendship with the Schroeders over a period of years, and therefore relied to his detriment on what he was told by them.

Second, the Court cites the various pieces of correspondence and corporate newsletters in this case entered as Exhibits and cited herein, that direct and require investors to rely on their representative, in this case Mr. Schroeder, for information. These same documents also discouraged independent inquiry by investors.

Finally, the Court looks to the circumstances surrounding the January 1998 investment itself wherein Mr. Schroeder directed Mr. Yarnall to let him "handle things" when the PENSCO Account Manager refused to allow the investment to go forward without the signing of the Loan Servicing Agreement. The Court finds that the interim lapse of several days between the issuance of the January 2, 1998 Promissory Note and the January 6, 1998 signing of the Loan Servicing Agreements by Mr. Schroeder does not discredit its value for purposes of finding justifiable reliance, insofar as the testimony supports that the investment would not have been authorized by PENSCO without it. In addition, Mr. Schroeder enticed Mr. Yarnall to make this

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[13] This Court's April 18, 2005 oral decision in Stevens, at page 10, lines six through eight.

January 1998 investment by representing to him that he (Schroeder) could arrange for this investment despite the "rule" that prohibited reinvestment into the program. Absent this enticement and Mr. Schroeder's assistance in structuring the loan servicing agreement, Mr. Yarnall would not have turned over funds to the debtors in January 1998. While the Court is mindful that the Plaintiff had his "suspicions" throughout the course of the investment period, the Court finds on balance, such cautious distrust is outweighed by the totality of the circumstances in this case specifically including the course of the parties dealings cited herein.

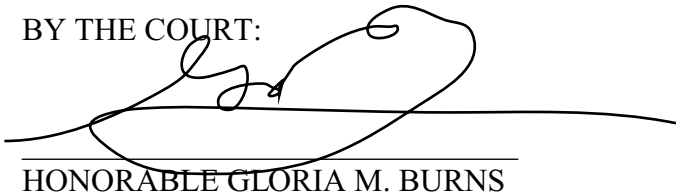
Therefore, for the reasons set forth herein, this Court finds that the Plaintiff Thomas Yarnall has satisfied each of the elements of Section 523(a)(2)(A) by a preponderance of the evidence and his debt is nondischargeable under 11 U.S.C. § 523(a)(2)(A). Having so found, this Court need not undertake an analysis of the elements of § 522(a)(4). However, the amount of his debt must still be determined.

In 1997 Mr. Yarnall made numerous investments with the Schroeders in amounts ranging from $40,000 to $60,000. He had also received additional amounts represented to be interest on his investment. While Mr. Yarnall believed he was receiving interest on his investment, he was in fact, receiving a portion of others' investments as part of a ponzi scheme. As the parties acknowledge, no profits were actually being earned on the funds he invested with the debtors.

At the end of 1997, Mr. Yarnall requested and received all of the funds the Schroeders owed him. That encompassed all of his principal investments plus $38,386 which had been characterized as interest. It would be inequitable for Mr. Yarnall to profit from these distributions in addition to return of his investment, and not credit those amounts to that which he did not recover. Having credited $38,386 received by Mr. Yarnall to the amount he lost, there

remains a balance of $1,614.00. This is the amount of the debt owed to him by the debtors and is the amount determined to be nondischargeable.

BY THE COURT:



HONORABLE GLORIA M. BURNS
United States Bankruptcy Judge