IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
JONESBORO DIVISION

IN RE: JIMMY H. HARRIS, JR. CASE NO. 99-31282M (CHAPTER 7)

Debtor.

AGRO DISTRIBUTION, LLC PLAINTIFF

VS. AP NO. 00-3010

JIMMY H. HARRIS, JR. DEFENDANT

MEMORANDUM OPINION

On October, 20, 1999, Jimmy H. Harris, Jr. ("Debtor") filed a voluntary petition for relief under the provisions of chapter 7. On March 8, 2000, Agro Distribution, LLC ("Agro") filed a complaint objecting to the dischargeability of various debts owed to Agro. Agro alleged the debts were nondischargeable because the Debtor committed actual fraud pursuant to 11 U.S.C. § 523(a)(2)(A) and submitted a false financial statement pursuant to 11 U.S.C. § 523(a)(2)(B).[1]

[1]An amended complaint filed October 13, 2000, added the allegations of embezzlement under 11 U.S.C. § 523(a)(4) and willful and malicious injury under 11 U.S.C. § 523(a)(6).

Trial on the merits was held in Jonesboro, Arkansas, on June 8, 2001, and at the conclusion of the presentation of evidence, the Court made oral findings of fact and conclusions of law in accordance with Bankruptcy Rule of Procedure 7052 regarding two specific accounts. Pursuant to these oral findings of fact and conclusions of law, judgment was entered regarding Account Number 0841015800 in the principal sum of $70,639.72, plus interest, and Account Number 0842609149 in the principal sum of $16,114.31, plus interest. The Court determined these debts to be nondischargeable on the grounds of actual fraud. The Court took under advisement the issues remaining in regard to Agro's claim related to Account Numbers 08410-15348 and 08410-15340.

The proceeding before the Court is a core proceeding under 28 U.S.C. § 157(b)(2)(I)(1994), and the Court may enter a final judgment in the case. The following shall constitute findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052(a).

FACTS

The Debtor is a farmer and has residences in both

Memphis, Tennessee, and West Memphis, Arkansas. He testified that he currently is employed as a farmhand for his younger brother, Ricky Harris, and has worked in that capacity for the preceding two years. While in college, the Debtor began farming with his father and in 1990 he started his own farming operation.

On January 7, 1998, in connection with his farming operation, the Debtor submitted a financial statement to Terra International, Inc. ("Terra")[2] which reflected total assets of $827,900.00 and liabilities of $354,500.00. The statement indicated a net worth of $473,400.00.

After analyzing the statement, Eugene Michalski, Terra's credit and collection manager, and Milton Floyd, Michalski's superior, approved an operating loan to the Debtor for the 1998 farming year. Terra dealt with the Debtor through accounts labeled "Jimmy H. Harris, Jr." (Account Number 08410-15348) and "Midsouth Farms, Inc." (Account Number 08410-15340).

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[2]For clarity, Agro will be referred to hereafter as "Terra,"
Agro's predecessor in interest. Terra supplied the Debtor
with farm financing and with credit to purchase farm products such as seed, fertilizer, and other chemicals.

By 1999, the Debtor was in financial trouble and was indebted to Terra for a carry-over debt from 1998 in the amount of $372,275.49. This debt included obligations incurred in 1998 on the two accounts listed above and debts incurred in the course of the Debtor's cultivation of a winter wheat crop in 1998-99.

In 1999, the Debtor entered into a restructuring agreement with Terra. The agreement simply transferred the unpaid indebtedness from the 1998 accounts to a promissory note payable to Terra and dated March 10, 1999. The Debtor signed the note in his individual capacity. The note recites that the principal sum comprises $45,000.00 in fertilizer inputs on the wheat crop, plus $71,823.75 on account number 08410-15340 (Midsouth Farms, Inc.) and $255,451.74 on account number 08410-15348 (Jimmy H. Harris, Jr.). (Pl.'s Ex. 26.)

Michaelski testified that no approval sheet for the 1999 transaction was needed because the March 10, 1999 note was entered into as part of a "workout" of the existing 1998 debt. (Tr. at 196.) It was unnecessary for Terra to repeat the loan approval process of January 1998 because

the 1999 restructure agreement involved carry-over debt related to the 1998 operating loan.

The Debtor made very few payments on the note before he filed for relief under chapter 7 on October 20, 1999. The Debtor's bankruptcy schedules reflect liabilities of $1.6 million as of October 20, 1999, as compared with liabilities of $354,500.00 listed on the financial statement dated January 7, 1998. Terra's claim is scheduled at $412,203.31.

Terra urges the Court to find the financial statement submitted by the Debtor in January 1998 to be materially false and fraudulent in regard to assets and liabilities listed by the Debtor. Further, Terra asks the Court to find that Terra reasonably relied on the financial statement when it extended credit to the Debtor on the Jimmy H. Harris, Jr., and Midsouth Farms, Inc. accounts. Terra states that for these reasons, the Court should conclude the debts accruing to the Jimmy H. Harris, Jr., and Midsouth Farms accounts should be held nondischargeable.

DISCUSSION

The Bankruptcy Code provides that:

a discharge under section 727 . . . of this title does not discharge an individual debtor from any debt-

(2) for . . . an extension, renewal or refinancing of credit, to the extent obtained by-

(B) use of a statement in writing-

(i) that is materially false;

(ii) respecting the debtor's . . .financial condition

(iii) on which the creditor to whom the debtor is liable for such . . 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)(B)(1994).

In other words, the following factors must be established: (1) the existence of a statement in writing; (2) the writing is materially false; (3) the writing concerns the debtor's financial condition; (4) the creditor reasonably relied on the statement; and (5) the statement was made with intent to deceive. First Interstate Bank of Nevada v. Greene (In re Greene), 96 B.R. 279, 282 (B.A.P. 9th Cir. 1989)(citing Regency Nat'l Bank v. Blatz, 67 B.R. 88, 90 (E.D. Wis. 1986); In re Furimsky, 40 B.R. 350, 353

(Bankr. D.Ariz. 1984)). Each of the elements of 11 U.S.C. § 523(a)(2)(B) must be proved by a preponderance of the evidence. Grogan v. Garner, 498 U.S. 279, 286 (1991).

There is no dispute that a statement in writing regarding the Debtor's financial condition was submitted to Terra. A copy of the financial statement, signed by the Debtor, was admitted into evidence as Plaintiff's Exhibit 23.

Moreover, Terra has established by a preponderance of the evidence that the Debtor did not truthfully state his assets and liabilities on his financial statement and that the statement is materially false. The evidence demonstrates that the Debtor omitted the following liabilities from his financial statement:

1. $3,787.00 owed to Barton Equipment Company for uninsured damage to rented equipment. A lawsuit on the debt was filed in 1997.

2. $41,000.00 owed to James A. Taylor & Sons Construction Co. for a judgment on a counterclaim in a lawsuit filed by the Debtor in 1997. The Debtor omitted the contingent debt owed to James A. Taylor & Sons from his financial statement, but listed $117,000.00 allegedly owed

him by his corporation that would only be paid if he recovered against James A. Taylor & Sons. The Debtor eventually abandoned his suit.

3. $169,000.00 owed to Taylor Seed Company. The company sued the Debtor on the debt in 1997.

4. $19,900.00 owed to Regions Bank. The loan was made in connection with a crashed airplane in which the insurance proceeds resulted in a deficiency. Although the note to Regions probably did not exist in 1997, the deficiency arose in 1997.

These omitted liabilities total $233,687.00. The Debtor stated that he omitted them because they were contingent on the outcome of various lawsuits. However, he listed all of these liabilities as debts in his schedules filed in connection with his bankruptcy.

Additionally, the Debtor overstated the value of his airplane by $62,000.00 to $75,000.00 in his listing of assets on his financial statement. He stated the airplane had a value of $100,000.00 when he had previously only paid $38,000.00 for it. The Debtor eventually sold the plane for $25,000.00. Had the Debtor noted his assets and liabilities more accurately, his net worth would have been in the range

of $175,000.00 to $178,000.00, not $473,400.00 as calculated on the financial statement.

A financial statement is materially false if it "paints a substantially untruthful picture of a financial condition by a misrepresentation of the type which would normally affect the decision to grant credit." Meyer v. Dygert (In re Dygert), 2000 WL 630833, at *8 (Bankr. D.Minn. May 11, 2000) (citations omitted). See also Borg Warner Cent. Envtl. Sys., Inc. v. Nance (In re Nance), 70 B.R. 318, 321 (Bankr. N.D. Tex. 1987), (quoting In re Denenberg, 37 B.R. 267, 271 (Bankr. D.Mass 1987)(citing In re Hunt, 30 B.R. 425, 440 (Bankr. M.D. Tenn. 1983)). Material falsity may be supported by the inclusion of false information or the omission of information about a debtor's financial condition. In re Greene, 96 B.R. at 283 (citing In re Anzma, 73 B.R. 156, 163 (Bankr. D.Colo. 1986)).

In this case, the omission of $233,687.00 in liabilities and the inclusion of an overstated value on a primary asset substantially distorted the picture of the Debtor's financial condition. Had the Debtor accurately completed his financial statement, the net worth calculation would have been reduced by more than half.

The numbers on the financial statement reflecting net worth and total debt were material because Terra used them to calculate the Debtor's credit-worthiness. The Debtor passed two of Terra's criteria that were based on the ratios of net worth to debt and debt to net worth. Had the more accurate figures been employed in the calculation, the Debtor would not have met either criterion. Thus, the Court concludes that the statement was materially false.

The fourth factor, reasonable reliance, is judged by an objective standard. Peoples Thrift Savs. Bank v. Larrieu (In re Larrieu),230 B.R. 256, 265 (Bankr. E.D. Pa. 1999). Reliance must be both actual and reasonable. Agribank v. Webb (In re Webb), 256 B.R. 292,296 (Bankr. E.D. Ark. 2000).

The evidence demonstrates that Terra actually relied on the information supplied in the financial statement. The numbers the Debtor supplied with regard to his liabilities and net worth were employed by Terra employees to calculate whether the Debtor satisfied some of Terra's criteria for financing the Debtor. (See, Terra's Worksheet to screen Debtor for credit-worthiness, Pl.'s Ex. 30.)

To determine reasonable reliance, three factors are

considered: (1) the creditor's standard practices in evaluating credit-worthiness; (2) industry standards or customs in evaluating credit-worthiness; and (3) the circumstances existing at the time of the debtor's application for credit. In re Cohn, 54 F.3d 1108, 1117 (3d Cir. 1995)(citing Coston v. Bank of Malvern (In re Coston), 991 F.2d 257, 261 (5th Cir. 1993) (en banc); Lisman v. Mitchell (In re Mitchell), 70 B.R. 524, 527-28 (Bankr. N.D. Ill. 1987); Landmark Leasing, Inc. v. Martz (In re Martz), 88 B.R. 663, 673-74 (Bankr. E.D. Pa. 1988)).

If the creditor follows its usual business practices, reliance is reasonable, absent other circumstances. In re Larrieu, 230 B.R. at 265. In the instant case, Terra employees entered data derived from the financial statement and the Debtor's income projections into a computer, applied Terra's standard numerical criteria, and decided, based on these calculations, to extend operating financing to the Debtor.

After reviewing the numbers, at least three Terra employees concluded that the Debtor should receive financing. The evidence clearly demonstrates Terra acted in conformity with its own established procedures.

Neither party presented evidence as to industry standards; therefore, the Court cannot evaluate this factor. As to circumstances present at the time of the transaction, these support a finding of reasonable reliance. See generally In re Larrieu, 230 B.R. at 266 (listing special circumstances to consider) (citing In re Eckert, 221 B.R. 40, 45 (Bankr. S.D. Fla. 1998)(citing In re Kahler, 187 B.R. 508, 514-15 (Bankr. E.D.Va. 1995)).

Terra and the Debtor had an established, stable business relationship, Terra having extended credit to the Debtor the year before and the Debtor having "paid out" under the terms of the parties' agreement. (Tr. at 188.) This circumstance also supports the conclusion that there were no red flags indicating the need for further investigation of the Debtor's financial condition when the parties transacted the 1998 agreement.

Furthermore, both parties were sophisticated in the specialized area of farm financing, the Debtor having conducted his individual and corporate farming operations for at least seven years previously. He was fully aware of how Terra used the numbers he supplied to calculate Terra's risk in extending the Debtor credit. Thus, Terra has

established it reasonably relied on the Debtor's financial statement.

The evidence also demonstrates that the Debtor prepared the financial statement with intent to deceive. Intent to deceive does not require a "malignant heart" but rather is indicated by objective facts and circumstances. Texas Am. Bank v. Barron (In re Barron), 126 B.R. 255, 260 (Bankr. E.D.Tex. 1991). Knowledge of the falsity of the statement or reckless disregard for the truth satisfies the element of intent. In re Dygert, 2000 W.L. 630833 at *9 (citations omitted); Shaw Steel, Inc. v. Morris (In re Morris), 230 B.R. 352, 260 (Bankr. N.D. Ill. 1999) (citing In re Sheridan, 57 F.3d 627, 633 (7th Cir. 1995); Phillips v. Napier (In re Napier), 205 B.R. 900, 907 (Bankr. N.D.Ill. 1997)) *aff'd*, 240 B.R. 553 (N.D. Ill. 1999) *aff'd*, 223 F.3d 548 (7th Cir. 2000).

In the instant case, the magnitude of the Debtor's omitted liabilities, coupled with a gross exaggeration of the value of his airplane, establishes that the Debtor knew of the falsity of his financial statement. Furthermore, the Debtor's bankruptcy schedules clearly demonstrate that he was aware of the omitted obligations

some three years after they were incurred, when he carefully listed them in order to discharge them. Because the Debtor knew of the falsity of the information when he supplied it, he had the requisite intent to deceive.

CONCLUSION

The Debtor submitted a materially false statement in writing regarding his financial condition. Terra reasonably relied on the information supplied, and the Debtor, knowing the information was false, acted with intent to deceive. For these reasons, the following debts incurred by the Debtor are nondischargeable: obligations incurred by the Debtor in production of the 1998-99 winter wheat crop and under Account Number 08410-15340 (Midsouth Farms) in the total principal sum of $116,823.75, plus interest, and under Account Number 08410-15348 in the principal sum of $255,451.74, plus interest.

IT IS SO ORDERED.

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HON. JAMES G. MIXON
U. S. BANKRUPTCY JUDGE

DATE:_____

cc: A. Jan Thomas, Jr., Esq.
Joseph A. Strode, Esq.
Debtor