

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

IN RE:

JACKY EARAL GOFF,

Debtor.

BK #92-20460-WHB
Chapter 7

LYNN T. SHAW,

Plaintiff,

v.

Adversary Proceeding
No. 92-0352

JACKY EARAL GOFF,

Defendant.

MEMORANDUM OPINION AND ORDER ON COMPLAINT
TO DETERMINE DISCHARGEABILITY

After trial on this complaint on November 22, 1993, the Court took under advisement the issues to permit review of the testimony, documentary exhibits and depositions. The complaint and trial raise issues concerning the dischargeability of this debt under 11 U.S.C. §523(a)(2)(B), a proceeding over which this Court may exercise core jurisdiction. 28 U.S.C. §157(b)(2)(I). The following contains findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

DISCUSSION

The plaintiff alleges that the debt to him is nondischargeable pursuant to 11 U.S.C. §523(a)(2)(B), which provides as follows:

- (a) A discharge under §727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt -
 - (2) for money, property, services, or 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 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; or

. . .

It is clear that it is the plaintiff's burden to prove each of the elements of the statutory exception from discharge by a preponderance of the evidence. Grogan v. Garner, 111 S. Ct. 654 (1991). From a review of the evidence, the Court must make a factual determination as to whether each of the statutory elements are satisfied. See, e.g., In re Woolum, 979 F. 2d 71 (6th Cir. 1992), cert. den. 113 S. Ct. 1645 (1993).

Prior to the debtor's Chapter 7 bankruptcy, a trial had been conducted in the Circuit Court of Shelby County, Tennessee, in October, 1991, and a judgment had been entered in favor of the plaintiff in the amount of \$163,440.68. See Tr. Ex. 6. This judgment is final and the amount of the debt is therefore established by the preclusive effect given to that monetary judgment. See Grogan

v. Garner, 111 S. Ct. 654 (1991); Spillman v. Harley, 656 F. 2d 224 (6th Cir. 1981). Of course, the state court did not have before it the issue of whether the debt was nondischargeable.

The plaintiff relies upon the financial statement introduced as Tr. Ex. 1, dated July 7, 1986. It is not disputed that this statement is in writing and that it respects the debtor's financial condition. Thus, portions of the statutory elements are satisfied. The issues remaining are whether the statement is materially false, whether the plaintiff reasonably relied upon that statement in extending credit to the debtor, and whether the statement was given or published by the debtor with intent to deceive the plaintiff.

Both the plaintiff and the debtor were and are sophisticated in financial transactions and in certain business transactions. In July, 1986, these parties entered into an agreement for the sale of a self service car wash located at 5295 Winchester Road, Memphis, Tennessee (hereinafter "the business") from Lynn T. Shaw to Jacky E. Goff. See Asset Purchase Agreement, Ex. 2. The sale involved the execution of a monthly installment note (Ex. 3), a security agreement (Ex. 4) and a sub-lease of the real estate (Ex. 5). The testimony established that the parties met and looked at the car wash, and that during their negotiations Mr. Goff asked about seller financing. Mr. Shaw requested Mr. Goff's financial statement and was provided with the one marked as Exhibit 1. Mr. Shaw testified that after his review of the financial statement he was willing to accept \$30,000.00 in down payment and a \$140,000.00 note payable over ten years. Mr. Shaw further testified that he confirmed Mr. Goff's employment as an auditor at Federal Express. The sales transaction was closed on August 21, 1986, and Mr. Goff proceeded to operate the business and to make payments under his note obligation. The down payment was obviously made. However, Mr. Goff became dissatisfied with the business; he felt that its financial capacity had been misrepresented to him; he

ceased making payments after approximately two years; and he surrendered the business assets to the secured creditor, Mr. Shaw. Mr. Shaw then conducted a sale, resulting in a deficiency.

Mr. Shaw testified that he relied upon the debtor's financial statement in making his credit decision to extend financing to the debtor. He testified that he had no reason to question the accuracy of the statement and that a value shown on the statement of \$125,000.00 for Bartlett Car Wash was consistent with the sales price of the business being sold by Mr. Shaw to Mr. Goff.

The plaintiff produced proof that the financial statement contained inaccuracies concerning the valuation on the statement of the Riverland Corporation, valued at \$50,000.00, and The Works, valued at \$60,000.00. Mr. Alexander Ivy, a business valuation expert, testified that The Works would have had no value, merely speculative value, in July, 1986.

The testimony of the debtor established that he based the \$60,000.00 value for The Works on a projected annual earnings multiplied three times, and he based the earnings projection on the representations made to him when he acquired the business. However, the debtor only owned the business for one month. He showed on his 1986 tax return that The Works was disposed of on July 26, 1986, with a cost or other basis of \$1,408.00.

There was also some proof that the Riverland Corporation was overvalued in that a \$50,000.00 value was shown but no separate bank account existed for the Riverland Corporation. The debtor testified that he formed Riverland Corporation as a holding company to take advantage of tax laws, but that the tax laws were changed so as to take away the advantage of so using the Riverland Corporation. He had originally intended to place some of his businesses into Riverland but he did not do so. He further testified that he allocated a portion of the cash available to him to be placed into Riverland Corporation and that this cash availability was his basis for the market value

placed on Riverland Corporation. The Court is not persuaded by this testimony from the debtor, as there was no separate bank account for Riverland Corporation and the debtor's financial statement showed only \$50,000.00 in the bank. Apparently the debtor did in fact have at least \$50,000.00 in the bank at that time but the proof has not shown sufficient cash in the bank to justify both \$50,000.00 in the bank and \$50,000.00 value for the Riverland Corporation.

The debtor also stated that he had a portfolio investment management account at First Tennessee Bank in 1986 that had \$50,000.00 to \$100,000.00 in it from the sale of Federal Express stock that is shown on his 1986 tax return. Once again, this testimony is not consistent with what is shown on the financial statement. It is true that the debtor's 1986 tax return shows a sale of approximately \$217,000.00 of Federal Express stock, primarily before the date on the financial statement. Yet, there is nothing on the financial statement to indicate that much stock or cash resulting from the sale of that much stock.

The debtor also testified that he continued to hold in 1986 \$50,000.00 to \$100,000.00 in Federal Express stock in a portfolio account and that he had other stock in a Merrill Lynch account. However, those stocks do not appear on the financial statement, which in fact shows no stock.

The Court finds that the debtor exaggerated the value of the Riverland Corporation which had only been chartered on May 23, 1986. Ex. 12. Further, the debtor exaggerated the value of The Works, an auto detailing business that he had only purchased approximately one month before the date on the financial statement. The debtor testified that the financial statement fairly and accurately stated his financial condition. However, it did not do so, because of the inaccurate estimates of value for Riverland Corporation and The Works and because of the omission of stock or cash from sales of stock.

The debtor's credibility was somewhat undermined by the debtor's testimony that three different sellers of businesses had defrauded him. He included in that accusation the sellers of The Works, the Bartlett Car Wash and the business at issue in this complaint. For a sophisticated auditor and business person, it is doubtful that the debtor would be defrauded three times in a short time span.

The debtor's credibility was also attacked when the debtor could not remember certain details about the purchase of The Works. For example, he could not recall exactly how much he paid for that business and he was vague as to the liabilities of that business. He testified that the liabilities were reflected in his net valuation of \$60,000.00, but that testimony does not appear to be consistent with his other statement that his market value was a multiple of three times the net earnings.

Notwithstanding that the debtor and Mr. Shaw have been in litigation in this Court and in state court for approximately five years, Mr. Goff had little documentary evidence to support his testimony or his financial statement. This is not an indication that the burden of proof shifted to the debtor; rather, the debtor failed to go forward with persuasive proof that would overcome the plaintiff's evidence.

From all of the proof, the Court finds that the written financial statement was materially false in its representation of the debtor's financial condition on July 7, 1986. As stated, it has been admitted that the statement reflected the debtor's financial condition and that it was in writing, signed by the debtor. The Court further finds that the debtor acted recklessly in preparing this financial statement and issuing it to Mr. Goff. Material falsity is found if a statement "paints a substantially untruthful picture of a financial condition by misrepresenting information of the type which would normally affect the decision to grant credit." In re Bailey, 145 B.R. 919, 930 (Bankr.

N.D. Ill. 1992), (quoting Matter of Jordan, 927 F. 2d 221, 223 (5th Cir. 1991)). As the debtor had requested financing from Mr. Goff, it should have been obvious to the debtor that Mr. Goff would review and rely upon the accuracy of that financial statement in making a credit decision. An "intent to deceive may be inferred from use of a false financial statement to obtain credit." Matter of Young, 995 F. 2d 547, 549 (5th Cir. 1993), (quoting In re Pryor, 93 B.R. 517, 518 (Bankr. S.D. Tex. 1988)). Certainly, an intent to deceive is satisfied by the debtor's reckless submission of a financial statement that he knew to be false. In re Batie, 995 F. 2d 85, 90 (6th Cir. 1993). Grossly reckless omissions of liabilities and misstatements of the values on a financial statement certainly satisfy the intent to deceive requirement of §523(a)(2)(B). See, e.g., Knoxville Teachers Credit Union v. Parkey, 790 F. 2d 490 (6th Cir. 1986).

The fact question remaining is whether the creditor relied upon the financial statement and if so was that reliance reasonable under all of the facts and circumstances of this particular adversary proceeding. First, the Court finds it to be clear that the creditor relied upon the financial statement in making a credit decision as to how much down payment to require and as to whether seller financing would be provided to Mr. Goff. Moreover, the Court finds this creditor's reliance to be reasonable under these facts and circumstances. The Sixth Circuit has recently reminded us that reasonable reliance is a factual question and that it is not a "rigorous requirement." See In re Woolum, 979 F. 2d 71 (6th Cir. 1992) and Knoxville Teachers Credit Union v. Parkey, 790 F. 2d 490, 492 (6th Cir. 1986). In other words, the reasonableness of a creditor's reliance is judged upon all of the facts and circumstances in a case by case analysis. In this particular proceeding, the Court should not substitute its view of whether credit should have been extended but should examine whether Mr. Shaw's actions in reliance upon the financial statement were reasonable. Mr. Shaw had before him a

financial statement issued by an auditor employed by the Federal Express Corporation, which statement indicated that Mr. Goff owned another business similar to the one being purchased from Mr. Shaw, with a value consistent with this sale. Further, the statement indicated that Mr. Goff owned two other business interests with significant value, along with real estate and \$50,000.00 in the bank or in cash. A total net worth of \$338,000.00 was reflected. Mr. Shaw verified the employment of Mr. Goff and relied upon his truthfulness as well as his professional status as an auditor. The Court cannot say that Mr. Shaw's reliance on this financial statement was unreasonable.

CONCLUSION

Based upon the foregoing findings and discussion, the Court concludes that the plaintiff has carried his burden of showing that the debt arising from the Circuit Court judgment is excepted from discharge under 11 U.S.C. §523(a)(2)(B).

IT IS SO ORDERED this 16th December, 1993.

WILLIAM HOUSTON BROWN
UNITED STATES BANKRUPTCY JUDGE

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