
In the United States Bankruptcy Court

for the
Southern District of Georgia
Brunswick Division

In the matter of:)	
)	Adversary Proceeding
I. FARNELL O'QUINN)	
(Chapter 7 Case <u>91-20701</u>))	Number <u>92-2080</u>
)	
<i>Debtor</i>)	
)	
)	
CITIZENS BANK & TRUST)	
COMPANY)	
)	
<i>Plaintiff</i>)	
)	
)	
v.)	
)	
I. FARNELL O'QUINN)	
)	
<i>Defendant</i>)	

MEMORANDUM AND ORDER

Plaintiff, Citizens Bank & Trust Company, initiated the above-captioned adversary proceeding seeking a declaration that a debt owed to it by Defendant, I. Farnell

O'Quinn, is excepted from any discharge which Defendant may receive in his Chapter 7 bankruptcy case presently pending in this court. After an Entry of Default was set aside, Defendant filed an Answer denying the debt's non-dischargeability and a Counterclaim seeking sanctions under Bankruptcy Rule 9011. By Pre-Trial Stipulation, the parties agreed that Defendant's Counterclaim would be tried separately from CB&T's dischargeability action. Accordingly, the dischargeability action was tried in Brunswick, Georgia, on June 8, 1995, after which the court took the matter under advisement. Based upon the Findings of Fact and Conclusions of Law set forth below in accordance with Bankruptcy Rule 7052, the court finds that Defendant is entitled to judgment declaring the loan to be a dischargeable debt in his Chapter 7 bankruptcy case.

FINDINGS OF FACT

On September 6, 1991, Defendant filed a voluntary petition under Chapter 11 of the Bankruptcy Code. Plaintiff, Citizens Bank & Trust Company ("CB&T"), filed a proof of claim in Defendant's case indicating that it holds an unsecured claim against Defendant in the amount of \$87,406.76. On June 29, 1992, this court converted Defendant's Chapter 11 case to one under Chapter 7 of the Bankruptcy Code, and CB&T subsequently initiated the instant adversary proceeding on September 28, 1992. CB&T seeks a judgment in its favor and against Defendant for the amount of its claim, plus interest, attorney's fees and costs, as well as a declaration that the judgment is excepted under section 523(a)(2)(B) of the Bankruptcy Code from any discharge that Defendant receives in his Chapter 7 case.

CB&T's claim is based upon Defendant's guarantee of a series of promissory notes that an Eastman, Georgia business known as Hardy Distributing made in CB&T's favor during 1990 and 1991. Hardy Distributing executed the original note in the principal amount of \$105,000.00 on January 2, 1990, with Defendant and another individual named Philip Hardy signing the note as guarantors. *See* Plaintiff's Exh. 1, stipulated into evidence as "P-1". CB&T subsequently permitted Hardy Distributing to renew the note four times, with Defendant and Mr. Hardy signing each of the four renewal notes as guarantors. The first renewal note was executed on June 5, 1990, the second on October 11, 1990, the third on February 6, 1991, and the fourth and final note on June 24, 1991. *See* Plaintiff's Exhs. 2, 3, 4 and 5, stipulated into evidence as "P-2, P-3, P-4 and P-5". At some point after execution of the final renewal note, Hardy Distributing failed. A balance of \$87,406.76 remains owing under the note, which CB&T seeks to collect, together with interest, costs and attorney's fees, from Defendant under his guarantee.

In support of its claim of non-dischargeability under section 523(a)(2)(B), CB&T alleges that Defendant submitted three "materially false" financial statements to it in order to enhance the value of his guarantee and thereby increase the chances of Hardy Distributing receiving a loan from CB&T. Thus, according to CB&T, because it relied upon Defendant's "materially false" financial statements in its decision to make the loan to Hardy Distributing, its claim of \$87,406.76 should, under section 523(a)(2)(B), be excepted from

any discharge that Defendant receives in his Chapter 7 case. In support of these allegations, CB&T introduced into evidence copies of three financial statements which it alleges are "materially false." The documents were stipulated into evidence as Plaintiff's Exhs. 6, 7 and 8, and, for ease of reference, will be referred to hereinafter as "P-6, "P-7" and "P-8".

P-6 is dated March 31, 1989, and is entitled "Organizers, Proposed Directors, Executive Officers and Principal Shareholders." Defendant testified that the document is a comprehensive statement of his financial affairs and business interests prepared by his in-house accountant, Mr. Ed Hancock, as part of Defendant's successful application to the Comptroller of the Currency to charter Wayne National Bank in Jesup, Georgia. The statement indicates that Defendant owned a substantial amount of real estate and held significant interests in a number of businesses, including radio stations, cable television systems, and electronic paging companies. The statement fixes Defendant's net worth on March 31, 1989, at \$8,796,201.00, based upon total assets of \$11,268,205.00, total liabilities of \$2,472,004.00, and contingent liabilities, which were not included in the net worth calculation, of \$1,420,000.00.

P-7 and P-8 are both entitled "PERSONAL FINANCIAL STATEMENT TO I. Farnell O'Quinn," and they reflect Defendant's financial situation as of March 31, 1990, and March 31, 1991, respectively. P-7 indicates that Defendant's net worth as of March 31, 1990 was \$8,102,099.00, based upon assets totalling \$9,189,329.00, liabilities totalling

\$1,087,230.00, and contingent liabilities, not included in the net worth calculation, of \$1,020,000.00. P-8 indicates that Defendant's net worth had dropped to \$5,431,448.00 as of March 31, 1991, based upon total assets of \$6,710,189.00, and total liabilities of \$1,278,746.00.

Although Defendant admits that P-6 is an accurate copy of the document prepared for his application to the Comptroller of the Currency, he denies that he submitted the document to CB&T in connection with the loan application of Hardy Distributing. In fact, Defendant denies ever having any relationship whatsoever with CB&T, testifying that he has never been in the offices of CB&T or spoken with any of its representatives. As to P-7 and P-8, Defendant not only denies delivering the documents to CB&T, he also claims that neither he, his accountant nor anyone else within his organization prepared P-7 or P-8 for CB&T or any other institution. He did admit, however, that his in-house accountant, Ed Hancock, routinely prepared financial statements on his behalf and may have delivered them from time to time to various financial institutions.

Notwithstanding Defendant's testimony that he did not deliver P-6 to CB&T, CB&T presented uncontradicted evidence that it had P-6 in its possession at the time it made the initial loan to Hardy Distributing. CB&T's President, Mr. James Robert Williams, Jr., testified that, because Hardy Distributing was a fledgling business, CB&T's loan committee, upon which Mr. Williams sits, would not have made the loan to Hardy Distributing absent

a guarantee from an individual, such as Defendant, with a strong financial position. Thus, as part of its loan-approval process, CB&T sought a comprehensive financial statement from Defendant so that it could determine whether his guarantee would provide it with sufficient security to make the loan. According to Mr. Williams, P-6 contained the necessary financial information and demonstrated to CB&T's loan committee that Defendant had ample resources to satisfy the debt in the event that Hardy Distributing could not. Mr. Williams could not, however, testify as to how CB&T obtained P-6. He could only state that CB&T's loan committee had the document in its possession during the time it was considering the loan to Hardy Distributing.

CB&T's evidence as to P-7 and P-8, on the other hand, was far less compelling. CB&T contends that it received P-7 and P-8 as annual updates of Defendant's financial condition and that it relied upon them when Hardy Distributing's loan was periodically up for renewal. Thus, according to CB&T, P-7 was delivered to it for the purpose of aiding it in its decision of whether to proceed with the June 5, 1990, the October 11, 1990, and February 6, 1991, renewals, while P-8 aided it in proceeding with the final renewal on June 24, 1991. However, CB&T's only witness, Mr. Williams, testified forthrightly that, because he was not the officer in charge of Hardy Distributing's loan, he could not say precisely how, or when in relation to the renewals, CB&T obtained possession of P-7 and P-8. All that he could say was that CB&T's normal practice was to update financial statements annually when a borrower seeks to renew a loan. Moreover, the

exhibits contain no file-stamped date or any other indication of when they might have been placed in the CB&T files. Thus, as to the critical issue of precisely when, in the loan renewal process, CB&T obtained P-7 and P-8, CB&T presented no direct evidence to the court.

The court is thus faced with two very different versions of the facts with respect to the origins and timing of delivery of P-7 and P-8. Defendant's testimony that neither he nor anyone in his organization produced the statements is not particularly credible in light of the fact that his signature appears on the first page of P-7 and the second page of P-8, and the fact that both statements contain attachments of Defendant's personal documents, including account statements from his mutual funds and schedules outlining in detail the assets which Defendant owned on the date of each statement. Nevertheless, CB&T clearly bears the burden of proof on this issue, and it did not present any evidence beyond Mr. Williams' testimony as to "bank policy" which tended to prove that it had P-7 in its possession when it proceeded with the June 5, 1990, the October 11, 1990, and February 6, 1991 renewals, and P-8 when it proceeded with the final renewal on June 24, 1991. Moreover, Defendant's testimony as to the general nature of his relationship with CB&T was fairly credible: Taken as a whole, the evidence supported Defendant's testimony that he had no direct relationship with CB&T and that he had never personally delivered P-7

and P-8 to CB&T.¹ The burden, therefore, rested squarely with CB&T to produce evidence of how and, most importantly, when, it received P-7 and P-8. This it did not do.

As to the material falsity of P-6, P-7 and P-8, Defendant stipulated that P-8, as introduced into evidence by CB&T, is "materially false" in that it omits a potentially large liability arising from his sale of his cable television systems to Bresnen Communications Company Limited Partnership. Bresnan, in a suit ultimately transferred to this court, alleges that Defendant misrepresented the condition of the cable systems and violated certain express warranties contained in the sales contracts under which the systems were sold. The Chapter 7 Trustee has recently settled, pending approval by this Court, the claim for approximately \$1.5 million. P-8, therefore, overstates Defendant's net worth by at least the value of Bresnan's claim against Defendant at the time P-8 was prepared.

Defendant has not, however, stipulated that either P-6 or P-7 is materially false. CB&T therefore sought to prove that P-6 and P-7 are "materially false" by comparing them to Defendant's bankruptcy schedules. Defendant filed his bankruptcy schedules on September 23, 1991, and they indicate that his net worth on the date he filed his Chapter 11

¹ Because neither party introduced any evidence on the point, the court is left to speculate as to who was the moving force behind CB&T's loans to Hardy Distributing. The most likely candidate would appear to be Philip Hardy, the person apparently running Hardy Distributing at the time of the loans. Mr. Hardy was subpoenaed as a witness in the trial of this action by CB&T, but he did not appear. When asked by this court if CB&T required a continuance to secure Mr. Hardy's presence (and Defendant's accountant, Ed Hancock, who also failed to appear at trial after being subpoenaed by CB&T), CB&T's counsel answered in the negative, stating that he was prepared to proceed with trial.

petition was negative <\$7,295,916.77>, based upon assets totalling \$2,995,727.25 and liabilities totalling \$10,291,644.02. CB&T points out that, when compared to Defendant's bankruptcy schedules, P-6 suggests that Defendant's net worth declined by over \$16,000,000.00 in just under 30 months; from \$8,796,201.00 as of March 31, 1989, to <\$7,295,916.77> as of September 23, 1991. Likewise, P-7 suggests that Defendant's net worth declined by over \$15,000,000.00 in less than 18 months; from \$8,102,099.00, as of March 31, 1990, to <\$7,295,916.77> as of September 23, 1991. Thus, CB&T's underlying premise is that the only plausible explanation for the dramatic decline in Defendant's net worth in such a short period of time is that he omitted certain of his debts and overstated the value of certain assets in P-6 and P-7 in order to enhance the value of his guarantee.

CB&T attempted to flesh out this premise by cross examining Defendant on particular debts that are listed in his bankruptcy schedules but do not appear in P-6 or P-7. Counsel for CB&T questioned Defendant about a \$100,000.00 contingent unsecured debt to Alma Exchange Bank, a \$1,000,000.00 contingent unsecured debt to American Pioneer Bank, a \$100,000.00 contingent unsecured debt to the National Bank of Waterloo, a \$238,000.00 secured debt to Patterson Bank, and a secured claim of \$400,000.00 to Janet Hoffman, as trustee for an unspecified entity. Counsel asserted in his questions that, although each of these debts appear in Defendant's bankruptcy schedules, none of them appear in P-6 or P-7. Additionally, Counsel asked Defendant to explain why the nature and amount of his debt to Barnett Bank had changed so dramatically from the dates of P-6 and

P-7 to the date of his bankruptcy: Defendant's bankruptcy schedules reflect a secured debt of \$4,159,762.00 owing to Barnett Bank, while P-6 and P-7 reflect that Defendant had only a contingent unsecured (i.e., guarantee) liability to Barnett of \$1,200,000.00.

Defendant was generally unable or unwilling to explain the circumstances surrounding these debts. He stated that, because of his advanced age and poor health, he simply could not remember the details of these debts, particularly when they had been incurred. Defendant did indicate that he and his accountant had taken particular care in preparing P-6 because they were aware that the Comptroller of the Currency was meticulous in reviewing these sorts of documents and would deny a charter application if the document contained any material inaccuracies. Thus, Defendant testified that, although he had no personal recollection of most of the matters in P-6, he felt certain that the document was a true and accurate statement of his financial position at that time.

Counsel for CB&T also cross-examined Defendant about the value of certain assets, including his interest in a company called Americom of Florida, and a radio station called WEUFF Radio. CB&T's counsel pointed out that Americom had been valued in P-6 at \$532,180.00, in P-7 at \$650,000.00, and in P-8 at \$700,000.00, but was not listed as an asset in Defendant's bankruptcy schedules. Likewise, counsel pointed out that, although WEUFF Radio had been valued in both P-6 and P-7 at \$600,000.00, and in P-8 at \$650,000.00, it had been valued Defendant's bankruptcy schedules at \$0.00. Counsel also

questioned Defendant about three notes receivable listed in P-6: one from an individual named Al Graham, with a balance owing of \$126,252.00, another from Queen City Broadcasting, having a balance of \$325,000.00, and finally one from Metrolink, Inc., with a balance of \$1,192,992.00.

Defendant was again extremely vague in his answers, indicating that his inability to provide detailed information was due to his poor memory. He did testify, however, that his interest in both Americom and WEUFF Radio were transferred to his now-ex-wife as part of or in anticipation of a settlement of their divorce. As to the notes receivable, Defendant testified that the notes from Al Graham and Queen City Broadcasting were worthless and uncollectible, Queen City Broadcasting having filed bankruptcy, and that the note from Metrolink had been valued at \$5,000.00 in his bankruptcy schedules, versus \$1,192,992.00 in P-6, because the business value of Metrolink had rapidly declined between March and September of 1991.

On direct examination, Defendant pointed out that, contrary to CB&T's counsel's assertions on cross-examination, page 10 of P-6 and page 2 of P-7 did indeed reflect a contingent liability of \$120,000.00 to Alma Exchange Bank, arising from Defendant's guarantee of a debt owed to the bank by one of his businesses. Furthermore, although Defendant was still unable to provide the court with details of the debts not listed in P-6 and P-7, he did testify that many of these debts were debts of his businesses that he

had guaranteed, and as a result, it was likely that his accountant had "netted out" these debts against the value placed upon these businesses in P-6 and P-7. Finally, on both cross and direct examination, Defendant offered, as a general reason for the rapid decline in his net worth, the fact that many of his businesses were technology sensitive and experienced a rapid and dramatic decline in the early 1990s. In particular, Defendant testified that his paging companies were valued in P-6 by multiplying the number of pagers that a company had rented times \$1,000.00 per pager; whereas today, because of increased competition, the appropriate value would be \$200.00 per pager. According to Defendant, then, the decrease in the value and number of rented pagers, in combination with the decrease in value of his low-power radio stations, explains most if not all of the decline in his net worth.

Thus, the evidence on the issue of whether P-6, P-7 and P-8 are "materially false" can be summarized as follows: P-8 is stipulated to be "materially false." The evidence presented to the court with respect to P-6 and P-7 essentially consisted of CB&T's counsel asking Defendant about debts found in his bankruptcy schedule but not in P-6 and P-7, as well as assets found in P-6 and P-7 but not in his schedules, and Defendant responding with an "I don't know" or "I don't remember." CB&T presented no direct evidence to prove that any of these allegedly omitted debts were actually outstanding on the date of either P-6 or P-7. Nor did it present any other evidence of what the correct value of Defendant's assets should have been in P-6 and P-7. In other words, CB&T introduced no evidence showing that Defendant actually owed more than he represented in P-6 and P-7.

Likewise, it did not present, for example, appraisals or appraisal testimony showing that the values placed upon Defendant's assets in P-6 and P-7 were inaccurate.

CONCLUSIONS OF LAW

Section 523(a)(2)(B) provides:

(a) A discharge under section 727 . . . 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

11 U.S.C. § 523(a)(2)(B). Under this provision, "a debt is non-dischargeable in bankruptcy where it was obtained by a writing: (1) that is materially false; (2) respecting the debtor's or an insider's financial condition; (3) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and (4) that the debtor caused to be made or published with the intent to deceive." In re Miller, 39 F.3d 301, 304 (11th Cir.

1994). The burden is upon the complaining creditor to prove each of these elements by a preponderance of the evidence, and if the creditor fails to meet its burden with respect to any one of the elements, then the debt is dischargeable. *Id.* (citing Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed. 2d 755 (1991)). Moreover, 523(a)(2)(B), like each of the exceptions to discharge, should be narrowly construed:

[C]ourts generally construe the statutory exceptions to discharge in bankruptcy "liberally in favor of the debtor," and recognize that "[t]he reasons for denying a discharge . . . must be real and substantial, not merely technical and conjectural.'" In re Tully, 818 F.2d 106, 110 (1st Cir. 1987) (quoting Dilworth v. Boothe, 69 F.2d 621, 624 (5th Cir. 1934)); see also Boyle v. Abilene Lumber, Inc. (Matter of Boyle), 819 F.2d 583, 588 (5th Cir. 1987). This narrow construction insures that the "honest but unfortunate debtor is afforded a fresh start." Birmingham Trust Nat'l Bank v. Kase, 755 F.2d 1474, 1477 (11th Cir. 1985) . . .

Miller, 39 F.3d at 304.

Thus, in order to prove that its claim falls under the exception to discharge contained in section 523(a)(2)(B), CB&T must prove the presence of each of the four elements listed above with respect to at least one of the three financial statements at issue in this proceeding. For the reasons that follow, I conclude that it has not sustained this burden.

CB&T has not carried its burden of proving that P-6 and P-7 are "materially false" under element (1). Although the differences between P-6 and P-7 and Defendant's bankruptcy schedules cast significant doubt upon the accuracy of the statements, this doubt, in the absence of supporting evidence, is simply not sufficient to carry CB&T's burden under this element. The time difference between P-6 and Defendant's bankruptcy schedules is approximately 30 months, and while the time differential between P-7 and Defendant's schedules is 12 months shorter, it is still over a year and a half. As a result, the schedules do not, standing alone, prove the inaccuracy of P-6 and P-7. While it does constitute circumstantial evidence that there may have been some inaccuracies, the precise amount of any inaccuracy and therefore its materiality was not established.

Bankruptcy schedules, moreover, serve a purpose quite different from that of financial statements. As Defendant's counsel correctly points out, a bankruptcy debtor has a strong incentive to schedule every possible debt, including debts that the debtor believes or knows he really doesn't owe, because failure to list a debt in one's bankruptcy schedules can result in that debt being excepted from discharge. *See* 11 U.S.C. § 523(a)(3). Quite obviously, then, the prudent practice for any debtor is to list any party that might possibly be considered a creditor, so that, in the event that such a party turns out to have a valid claim, the discharge of the claim cannot be contested under section 523(a)(3). Moreover, the bankruptcy schedules do not distinguish between debts upon which a debtor is only contingently liable (ie. as a guarantor), and debts upon which the debtor is primarily

liable. Therefore, while Defendant's net worth calculations in P-6, P-7 and P-8 do not include any of his contingent liability, the <\$7,295,916.77> net worth figure in Defendant's bankruptcy schedules does.

The bottom line is this: CB&T attempted to prove that P-6 and P-7 are materially false through cross examination of Defendant about the differences between P-6 and P-7 and his bankruptcy schedules, but it did not get the answers from Defendant that it needed to prove its case. Defendant's denials and stock answer of "I don't remember" were less than credible, and the stage was therefore set for CB&T to produce some, any, evidence other than the schedules which showed that debts had been omitted from P-6 and P-7 or assets overvalued. This it did not do. CB&T's only witness, Mr. Williams, testified that he could not say whether P-6 and P-7 were inaccurate. As a result, Defendant's explanation for the dramatic change in his financial fortunes, while certainly less than compelling, nevertheless stands unopposed in light of CB&T's failure to offer any evidence establishing the inaccuracy of P-6 and P-7. In sum, I conclude that the differences between Defendant's bankruptcy schedules and P-6 and P-7 are, in the absence of an admission by Defendant or other proof of omitted debts or overvalued assets, insufficient to prove that P-6 and P-7 are "materially false."

CB&T also failed to introduce any evidence showing when it obtained P-7, and as a result, it has not carried its burden under element (3) of proving that it relied upon

the statement when it proceeded with the renewal of Hardy Distributing's loan. It asserts that it had P-7 in its possession and relied upon the information therein when considering the June 5, 1990, October 11, 1990, and February 6, 1991 renewals; however, CB&T's only witness, Mr. Williams, testified that he did not know how or when CB&T obtained P-7, and could not, therefore, say for sure that CB&T had P-7 in its possession during its consideration of these renewals. And, although it is reasonable to presume that, because P-7 is dated March 31, 1990, CB&T had P-7 in its possession while it was considering the October 11, 1990 and February 6, 1991, renewals, such a presumption is clearly not sufficient to satisfy CB&T's burden of proof on this issue.

Similarly, although P-8 has been stipulated to be materially false under element (1), CB&T again failed to introduce evidence of when it received the statement. Thus, although CB&T asserts that it had and relied upon P-8 in allowing Hardy Distributing to proceed with the final renewal on June 24, 1991, it introduced absolutely no evidence supporting the assertion. Again, Mr. Williams testified that he did not know when or how CB&T obtained P-8 and could not say with any certainty that CB&T relied upon P-8 in approving the June 24, 1991 renewal. Moreover, given that the June 24, 1991, renewal occurred less than three months after the date appearing on P-8, March 31, 1991, it is not even reasonable to presume that it had P-8 in its possession when it was considering the renewal. I find, therefore, that CB&T has not proven that it reasonably relied upon P-8 in

proceeding with the final renewal of Hardy Distributing's loan because it has not proven that it had the document in its possession when the final renewal was under consideration.

Thus, although the court remains unconvinced that Defendant is the "honest but unfortunate debtor" that the Eleventh Circuit refers to in Miller, the court is certain that CB&T has not met its burden of proving that the four elements of section 523(a)(2)(B) apply to either P-6, P-7 or P-8. Accordingly, the court will order entry of judgment declaring CB&T's claim under Defendant's guarantee a dischargeable debt in Defendant's Chapter 7 bankruptcy case.

O R D E R

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that judgment be entered in favor of Defendant, I. Farnell O'Quinn, declaring that his debt to Plaintiff, Citizens Bank & Trust Company, is not excepted from any discharge that he may receive in his Chapter 7 bankruptcy case.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ____ day of July, 1995.