IN THE UNITED STATES BANKRUPTCY COURT FOR THE SOUTHERN DISTRICT OF MISSISSIPPI
JACKSON DIVISION

IN THE MATTER OF:

DAVID L. ROSS AND
VERONICA M. ROSS — CASE NO. 8502045JC

FINANCIAL ENTERPRISES, LTD. — PLAINTIFF

vs. — ADV. NO. 860039JC

DAVID L. ROSS AND
VERONICA M. ROSS — DEFENDANTS

GREAT SOUTHERN NATIONAL BANK — PLAINTIFF

vs. — ADV. NO. 860042JC

DAVID L. ROSS AND
VERONICA M. ROSS — DEFENDANTS

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Edward Ellington, Bankruptcy Judge

DECISIONS ON COMPLAINTS FILED TO OBTAIN DETERMINATIONS OF THE DISCHARGEABILITY OF PARTICULAR DEBTS

An Order for Relief under 11 U.S.C. Chapter 11 was entered on a petition filed on December 17, 1985, by David L. Ross and Veronica M. Ross.

On March 10, 1986, Financial Enterprises, Ltd. commenced the above styled Adversary Proceeding No. 860039JC against the debtors pursuant to Bankruptcy Rule 4007 to obtain a determination as to whether an indebtedness owed to it by the debtors was excepted from discharge by the provisions of 11 U.S.C. §523(a)(2)(B).

On March 14, 1986, Great Southern National Bank commenced the above styled Adversary Proceeding No. 860042JC against the debtors seeking a similar determination as to certain indebtednesses owed to it by the debtors.

The defendants filed answers denying the material allegations of the complaints.

The issues thus raised came on to be heard on July 9, 1986. By agreement of all parties, the two adversaries were consolidated for purposes of the trial.

Part of the delay in the rendering of this written opinion was at the request of the attorneys for

the parties. Part of the delay is the fault of this Court. After the trial the attorneys and their clients engaged in protracted settlement negotiations and they requested that the Court delay any decisions. In May of 1987 this Court entered an order approving a settlement between the debtor and Financial Enterprises, Ltd. However, the settlement was never consummated. Briefing was then finally completed in September 1988. Additional settlement negotiations have ensued with no results.

The matters are now before the Court for final determination.

BACKGROUND

In the beginning, David L. Ross and John Deddens were longtime friends from college. Mr. Ross was in the travel agency business in Jackson, Mississippi. He knew nothing about the restaurant business. Mr. Deddens had experience in the restaurant business, and he had been with a well know fried chicken franchise for several years.

In 1977 Mr. Deddens approached Mr. Ross with a proposal for them to buy a pizza store franchise for the state of Mississippi. The name of the franchise operation was "Mr. Gatti's." They decided to go into the business and established a corporation, "Pizza,

Inc." which acquired the "Mr. Gatti's" franchise and operated the business. Fifty percent (50%) of the stock was owned by Mr. Ross and fifty percent (50%) by John and/or Cherry Deddens.

During the early years, their efforts were highly successful. At one point, the company was operating eight stores located in several different towns. During the successful period, Mr. Ross continued to operate his travel business and Mr. Deddens was responsible for the operation of the restaurants.

From the beginning, the equipment in the restaurants was leased through Financial Enterprises, Inc., whose sole stockholder and executive officer was Kenneth E. Boggs. The leases were between Financial Enterprises, Inc. and Pizza, Inc., but Mr. Boggs required Mr. and Mrs. Ross and Mr. and Mrs. Deddens to sign personal guarantees for the leases. He also obtained four financial statements from Mr. Ross and one financial statement from both Mr. and Mrs. Ross as set out in detail in other parts of this opinion.

Initially, the source of credit for Pizza, Inc. was the First Mississippi National Bank. In November, 1980, the business started obtaining credit from the bank which is the plaintiff in this case. Eventually, it became the chief source of bank credit

for the business. At that time the bank was known as the Bank of Jackson, N.A. Later the name was changed to the Great Southern National Bank.

During the period of growth over about three years, the pattern was for the bank to make loans to Pizza, Inc. in the $50,000.00 to $75,000.00 range to open the restaurants. When the construction was completed and operation commenced, the particular note would then be amortized over a five or ten year period. This caused the business to have a lot of debt on a relatively short repayment period. The total of the payments was $13,000.00 or $14,000.00 per month, which caused a serious cash flow problem. In early 1984 the bank agreed to consolidate all of the business debt into one note amortized over ten years, with a balloon payment in a year. To facilitate this arrangement Pizza, Inc. executed one note dated February 27, 1984 in the principal amount of $391,040.00.

The business was having problems at the time. It continued to go down hill. In late September or October 1984, John Deddens left and David Ross had to assume the active management of the business.

At that time the business was overdrawn at the bank in the amount of approximately $40,000.00; it could not get food and related items from its main

supplier because the supplier was holding $15,000.00 in bad checks; and it had not paid $20,000.00 in sales tax and the State Tax Commission was not going to renew its beer permit.

Mr. Ross discussed these problems with the officers at the bank. Great Southern decided to extend the business a line of credit in the initial amount of $100,000.00. The initial draw of $61,000.00 was made on September 28, 1984. This line of credit was the basis of the indebtedness later evidenced by a promissory note to the bank from Pizza, Inc. dated January 31, 1985, in the principal amount of $150,000.00.

During part of the time Pizza, Inc. was in business, Mr. and Mrs. Ross personally borrowed money from the bank to build a home. This was done by a series of short term notes and draws which began on May 25, 1981, and culminated in the permanent financing promissory note dated October 22, 1984, in the principal amount of $114,000.00.

During the course of this borrowing from the bank, Mr. Ross signed seven (7) guarantees for the debts of Pizza, Inc. Mrs. Ross did not sign any guarantees. Both of them did sign personally the note for $114,000.00 for their home. The bank also obtained three (3) financial statements during this time.

The efforts of Mr. Ross to save the business failed. On April 19, 1985, Pizza, Inc. filed its petition in bankruptcy pursuant to Chapter 11 of the Bankruptcy Code. On August 8, 1988, it converted to Chapter 7. On May 24, 1985, Cherry Deddens filed her petition pursuant to Chapter 11. She converted to Chapter 7 on January 27, 1987, and received her discharge on July 27, 1987. Mr. and Mrs. Ross filed pursuant to Chapter 11 on December 17, 1985. Finally, John Deddens filed his petition pursuant to Chapter 7 on January 15, 1986, and received his discharge on May 12, 1986.

There is a common thread which runs through both of the adversaries and gives rise to the charges that the debts should be excepted from discharge because Mr. and Mrs. Ross provided false financial statements. In all of the financial statements, a significant part of the assets was always shown to be composed of one or more trusts connected with Mrs. Ross. After the business failed and bankruptcy ensued, it developed that the largest trust contained a "spend-thrift" provision which kept it from being available for the benefit of creditors.

Financial Enterprises, Inc. also complains because the home loan of the debtors was left off of the last financial statement which it received.

TRUSTS

The debtor, Mrs. Veronica Mounger Ross, has a beneficial interest in three separate trusts. The Deposit Guaranty National Bank is the trustee for each of the trusts. Copies of the trust instruments and details of the trust were introduced into evidence by the use of a deposition taken on March 5, 1986, of a Senior Vice President and Trust Officer of the Deposit Guaranty National Bank, Mr. William H. Mounger, Jr.

The details of the three trusts are as follows:

1. W. M. Mounger Residuary Trust:

This trust is a testamentary trust established under the Will of W. M. Mounger, deceased, who was the father of Mrs. Ross. The current beneficiaries are Mrs. Ross and her two sisters. At the time of the deposition its assets had a market value of $3,148,956.79 and accumulated income of $11,100.58. The bank had been distributing to Mrs. Ross her share of the income each year. The trust instrument contained the following "spendthrift" provision, to-wit:

> The beneficiaries of the trusts herein created shall not transfer, encumber or anticipate their interest in the trust estates, or either of them, or any part thereof, and any effort so to do shall be null and void and shall not be binding upon the trust or the

beneficiaries. Prior to final disposition thereof, no part of the trust estates shall be subject to the debts, obligations or liabilities of the beneficiaries thereof, and the same shall not be subject to execution, attachment or any legal process to enforce a judgment of any court against the 2.

2. Veronica R. Mounger Trust:

This is an irrevocable trust established by Veronica R. Mounger, deceased, who was the mother of Mrs. Ross, by a declaration dated April 1, 1946. The beneficiaries are Mrs. Ross and her two sisters and two brothers. Its assets had a market value of $39,306.71 and accumulated income of $301.74.

The trust instrument contained a "spendthrift" provision similar to the one contained in the W. M. Mounger Trust. However, under the terms of the trust, the youngest beneficiary was now over twenty-five years of age and the trust could now be distributed. Thus, Mrs. Ross's share of the trust is available for the benefit of creditors.

3. Veronica M. Ross Trust:

This is a revocable trust established by the debtor, Mrs. Ross, by a trust agreement dated January 26, 1963. Mrs. Ross is the sole beneficiary of the trust. The assets of the trust had a market value of $77,760.75 and accumulated income of $53,622.14. The trust contained no "spendthrift" provision and it is available for the benefit of creditors.

LOAN DOCUMENTS, FINANCIAL STATEMENTS AND RELATED DOCUMENTS

The following is an itemization of the relevant documents and amounts relating to the indebtednesses to Great Southern National Bank and to Financial Enterprises, Inc.

GREAT SOUTHERN NATIONAL BANK

Promissory Notes:

1. Promissory Note dated February 27, 1984, from Pizza, Inc. to Great Southern National Bank in the principal amount of $391,040.00. (Exhibit 6).

2. Promissory Note dated October 22, 1984, from David L. Ross and Veronica M. Ross in the principal amount of $114,000.00. (Exhibit 5).

3. Promissory Note dated January 31, 1985, from Pizza, Inc. to Great Southern National Bank in the principal amount of $150,000.00. (Exhibit 7).

At the time of the trial, $366,292.54 principal plus accumulated interest was owing on the first note; $111,624.51 principal plus accumulated interest was owing on the second note; and, $5,000.00 principal plus accumulated interest was owing on the third note.

Continuing Guarantees:

David L. Ross gave a series of seven (7) continuing guarantees to Great Southern National Bank

to personally guarantee indebtednesses of Pizza, Inc. The dates and amounts of the guarantees are as follows:

Date	Amount
November 10, 1980	$ 50,000.00
April 17, 1981	200,000.00
March 30, 1983	55,000.00
July 23, 1983	87,273.44
February 27, 1984	391,040.00
September 28, 1984	100,000.00
January 31, 1985	150,000.00

Financial Statements

The Great Southern National Bank received three (3) written financial statetments relating to the indebtedness herein. They are as follows:

1. Financial Statement dated October 1, 1980, signed by David Ross. (Exhibit 11).

2. Financial Statement dated June 30, 1981, signed by David L. Ross and Veronica M. Ross. (Exhibit 10).

3. Financial Statement dated December 31, 1982, signed by David Ross and Veronica M. Ross. (Exhibit 9).

Loan Applications and Related Documents

Exhibits 17 through 29 are numerous new loan applications, renewal applications and commercial loan worksheets pertaining to the various loans to Pizza, Inc. that were finally consolidated into the promissory note dated February 27, 1984, in the principal amount of $391,040.00. The earliest document is a commercial loan worksheet dated November 10, 1980, which pertains

to the initial loan to Pizza, Inc. in the amount of $50,000.00. It is a part of Exhibit 19. The last document is a renewal application dated October 18, 1983, which pertains to a loan in the original amount of $45,000.00 that was used to start a restaurant in Vicksburg, Mississippi. It is part of Exhibit 29.

Exhibit 30 is the new loan application for the consolidation of all of the Pizza, Inc. debt into the $391,040.00 note.

Exhibits 33 through 49 are numerous new loan applications, renewal applications, "dummy notes" and similar documents which relate to the construction financing and permanent financing of the home of Mr. and Mrs. Ross. The earliest document is a new loan application dated May 25, 1981. It is a part of Exhibit 33. The last document is dated October 22, 1984 and is Exhibit 49. It is an application for permanent financing on the home of Mr. and Mrs. Ross. These exhibits are related to the promissory note dated October 22, 1984, in the amount of $114,000.00 signed by Mr. and Mrs. Ross.

Exhibits 31 and 32 are the new loan applications and renewal applications which pertain to the line of credit extended to Pizza, Inc. after the departure of John Deddens in September or October, 1984. The initial application is dated September 28,

1984, and it is part of Exhibit 31. The last application, which is Exhibit 32, is dated January 31, 1985, and it relates to the promissory note of the same date in the amount of $150,000.00.

FINANCIAL ENTERPRISES, INC.

Equipment Leases and Guarantees:

It was stipulated that as of January 20, 1986, David L. Ross and Veronica M. Ross were indebted to Financial Enteprises, Inc. in the amount of $125,712.81. This indebtedness resulted from written equipment leases from Financial Enterprises, Inc. to Pizza, Inc. Mr. and Mrs. Ross had signed personal guarantees for the leases. The written leases and guarantees were not introducted into evidence, but there was no dispute about this point.

Financial Statements:

Financial Enterprises, Inc. received five (5) written financial sttements relating to the indebtednesses herein. They are as follows:

1. Financial Statement dated January 28, 1977, signed by David Ross. (Exhibit 12).

2. Financial Statement dated April 11, 1979, signed by David Ross. (Exhibit 13).

3. Financial Statement dated January 23, 1980, signed by David Ross. (Exhibit 14).

4. Financial Statement dated October 1, 1980, signed by David Ross. (Exhibit 15).

5. Financial Statement dated June 30, 1982, signed by David L. Ross and Veronica M. Ross. (Exhibit 16).

OVERVIEW OF THE LAW

An overview of the law is appropriate prior to consideration of the separate adversaries.

The applicable statute is Section 523(a)(2)(B) of the Bankruptcy Code. It provides in relevant part that:

> (a) A discharge under section 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;

11 U.S.C. §523(a)(2)(B).

The predecessor of §523(a)(2)(B) of the Code was Section 17(a) of the Bankruptcy Act, 11 U.S.C.

§35(a)(2).

The burden of proving the elements set forth in §523(a)(2)(B) is entirely on the party seeking to have the debt found nondischargeable. All of the elements must be proved by clear and convincing evidence, a burden of proof more stringent than the standard burden in civil cases of a preponderance of the evidence. IFG Leasing Company v. Vavra (In Re Harms), 53 B.R. 134, 140 (Bkrtcy.D.Minn. 1985); Springfield Institution for Savings v. King (In Re King), 96 B.R. 413, 415 (D.Mass. 1989); Caspers v. Van Horne (Matter of Van Horne), 823 F.2d 1285, 1287 (8th Cir. 1987); Matter of Bogstad, 779 F.2d 370, 372 (7th Cir. 1985); Martin v. Bank of Germantown (In Re Martin) 761 F.2d 1163, 1165 (6th Cir. 1985).

The purpose of bankruptcy laws and the intended scope of exceptions to discharge as viewed by the Fifth Circuit were stated in the case of Murphy & Robinson Investment Company v. Cross (Matter of Cross) 666 F.2d 873 (5th Cir. 1982). Although Cross dealt with an exception contained in the Bankruptcy Act, the principals are the same. The Fifth Circuit stated:

> As a general rule, a discharge in bankruptcy will release the bankrupt from all provable debts with the exception of a few narrowly defined types of obligations.
>
> . . .

> The overriding purpose of the bankruptcy laws is to provide the bankrupt with comprehensive, much needed relief from the burden of his indebtedness by releasing him from virtually all his debts. Perez v. Campbell, 402 U.S. 637, 648, 91 S.Ct. 1704, 1710, 29 L.Ed.2d 233 (1971); Hartman v. Utley (In re Schroeder & Co.), 335 F.2d 558, 560 (9th Cir. 1964); Hardie v.Swafford Brothers Dry Goods Co., 165 F. 588, 590-91 (5th Cir. 1908).To this end, the courts have narrowly construed exceptions to discharge against the creditor and in favor of the bankrupt. Gleason v. Thaw, 236 U.S. 558, 562, 35 S.Ct. 287, 289, 59 L.Ed. 717 (1915); In re Vickers, 577 F.2d 683, 687 (10th Cir. 1978); Davison-Paxon Co. v. Caldwell, 115 F.2d 189, 191 (5th Cir. 1940); In re Knight, 421 F.Supp. 1387, 1391 (M.D.La. 1976), **aff'd without opinion,** 551 F.2d 862 (5th Cir. 1977). Accordingly, the burden of proof lies with the creditor to demonstrate that the particular debt falls within one of the statutory exceptions. Danns v. Household Finance Corp., 558 F.2d 114, 116 (2d Cir. 1977); Kelley v. Conwed Corp., 429 F.Supp. 969, 972-73 (E.D.Va. 1977); Bankruptcy Rule 407; 1A W.Collier, Bankruptcy, ¶17.24[5] (14th rev.ed. ;978). The exceptions to discharge found in §17(a)(4) were designed to prevent the bankrupt from avoiding through bankruptcy the consequences of certain wrongful acts by providing protectiion to a certain preferred classs of creditors. The exceptions to discharge were not intended and must not be allowed to swallow the general rule favoring discharge. (Footnotes omitted).
>
> 666 F.2d at 879-880.

For this Court to find the debts of Mr. and Mrs. Ross to be nondischargeable pursuant to §523(a)(2)

(B), all of the following elements must be established:

1. The existence of a statement in writing;

2. The writing must be materially false;

3. It must concern the debtor's financial condition;

4. The creditor must have reasonably relied on the statements; and

5. The statement must be made or published with the intent to deceive.

See: W.A.F.B. Federal Credit Union v. Furimsky (In re Furimsky), 40 B.R. 350, 353 (Bkrtcy. D.Ariz. 1984); First Interstate Bank of Nevada v. Greene (In re Greene), 96 B.R. 279, 282 (Bkrtcy.Cir. 1989).

In the cases at bar, there is no dispute that the statements were in writing and that they were in respect to the debtor's financial condition.

Thus, the issues remaining for this Court to determine are whether Great Southern National Bank and Financial Enterprises, Inc. proved by clear and convincing evidence that (1) the financial statements were materially false; (2) the creditors' reasonably relied on the statements; and (3) Mr. and Mrs. Ross caused the statements to be made or published with an intent to deceive.

Section 523(a)(2)(B) is frequently litigated. The cases dealing with it and its predecessor in the

Bankruptcy Act are legion. There appear to be no absolute, precise definitions or standards that are accepted by every court because the cases are so fact intensive.

Nevertheless, the courts have generally concluded that in determining whether a financial statement is "materially false" it is not sufficient simply to show that the statement is factually incorrect. "An incorrect or erroneous financial statement is not necessarily materially false." Merchants National Bank v. Denenberg (In re Denenberg), 37 B.R. 267, 271 (Bkrtcy. D. Mass. 1983). The courts have generally accepted the proposition that a materially false financial statement is one which paints a substantially untrue picture of the debtor's financial condition by misrepresenting information of the type which would normally effect a decision to grant credit. "Material falsity" in a financial statement can be founded upon the inclusion of false information or upon omission of information about a debtor's financial condition. Omission, concealment or understatement of material liabilities can constitute a materially false statement and may lead to nondischargeability of debt. First Interstate Bank of Nevada v. Greene (In re Greene), 96 B.R. 279 (Bkrtcy. Cir. 1989); John Deere Co. v. Iverson (In re Iverson), 66 B.R. 219 (Bkrtcy.D.Utah 1986); IFG Leasing Co. v.

Vavra (Harms), 53 B.R. 134, 140 (Bkrtcy.D.Minn. 1985).

In considering whether the creditors relied upon the financial statements and whether they were reasonable in so doing, an awareness of the Congressional action is helpful. This is set forth in Telco Leasing, Inc. v. Patch, (Matter of Patch), 24 B.R. 563, 565 (D.Md. 1982) where it is stated:

> Section 523(a)(2) of the Code is the successor to section 17a(2) of the Bankruptcy Act, 11 U.S.C. §35(a)(2) (1976). In enacting the Code, Congress modified the statutory language of this provision by inserting the word "reasonably" before the word "relied", making it "explicit that the creditor must not only have relied on a false statement in writing, but the reliance must have been reasonable." 3 Collier on Bankruptcy ¶523.09[4] at 523-59 (15th ed. 1981).
>
> In so doing, however, Congress apparently did not intend to add a new element to the creditor's burden in proving nondischargeability. The committee reports of both the House and Senate state that the reasonableness requirement now made express in section 523(a)(2)(B) was a codification of the trend in the caselaw implying a reasonableness requirement under section 17a(2) of the Act. (Citations Omitted).

One of the first Circuit Court opinions after the enactment of the Bankruptcy Code was the case of Northern Trust Co. v. Garman (Matter of Garman), 643 F.2d 1252 (7th Cir. 1980). The opinion was very much originated toward the creditor. It held that

reasonable reliance was lacking when "a creditor's reliance on the financial statement would be so unreasonable as not to be actual reliance at all." Therefore, virtually any reliance by the creditor was enough. The Garman decision has not been generally followed outside of the Seventh Circuit. See: Kentucky Bank and Trust v. Duncan (In re Duncan), 35 B.R. 323, 325 (Bkrptcy.W.D.Ky. 1983); W.A.F.B. Federal Credit Union v. Furimsky (In re Furimsky), 40 B.R. 350, 354 (Bkrtcy.D.Ariz. 1984).

Over the period of time since Garman at least four general categories of "unreasonable reliance" based on different factual situations have emerged. John Deere Co. v. Iverson (In re Iverson), 66 B.R. 219 (Bkrtcy.D.Utah 1986); Green River Production Credit Association v. Bridges (In re Bridges), 51 B.R. 85, 88 (Bkrtcy.W.D.Ky. 1985); Kentucky Bank and Trust Company v. Duncan (In re Duncan), 35 B.R. 323, 325 (Bkrtcy.W.D. Ky. 1983); Telco Leasing, Inc. v. Patch (Matter of Patch), 24 B.R. 563, 566 (D.Md. 1982); IFG Leasing Company v. Vavra (In re Harms), 53 B.R. 134, 140 (Bkrtcy.D.Minn. 1985).

The four general categories where courts have concluded that the creditor's reliance on the financial statements was unreasonable are:

1. When the creditor knows at the outset that the information listed on the financial statement

is not accurate. See, e.g., Swint v. Robins Federal Credit Union, 415 F.2d 179, 184 (5th Cir. 1969); First National Bank v. Houk (In re Houk), 17 B.R. 192, 195-96 (Bkrtcy.D.S.D. 1982).

2. When the financial statement does not contain sufficient information to portray realistically the debtor's financial status. See, e.g., Waterbury Community Federal Credit Union v. Magnusson (In re Magnusson, 14 B.R. 662, 668-69 & n. 1 (Bkrtcy.N.D.N.Y. 1981).

3. When the creditor's investigation suggest that the financial statement is false or incomplete, reliance thereon is held to be unreasonable. See, e.g., Nationwide Financial Corp. v.Smith (In re Smith), 2 B.R. 276, 279 (Bkrtcy.E.D.Va. 1982).

4. When, under certain circumstances, the creditor's failure to verify any of the information contained in the financial statement renders reliance on the statement unreasonable. See, e.g., First National Bank v. Breen (In re Breen), 13 B.R. 965 (Bkrtcy.S.D.Ohio 1981); Belcher Oil Co. v. Price (In re Price), 48 B.R. 211, 213 (Bkrtcy.S.D.Fla. 1985).

In regard to this fourth category of cases, this court is of the opinion that creditors are not under an affirmative duty in all cases to investigate a debtor's financial condition in order for creditor's

reliance to be reasonable. Sovran Bank v. Allen (In re Allen), 65 B.R. 752, 758-763 (E.D.Va. 1986).

In addition to the methods of inquiry used to determine reasonableness illustrated in the four general categories of cases enumerated above, there has emerged another approach sometimes referred to as the "business-practice-and-industry-custom inquiry." Telco Leasing, Inc. v. Patch (Matter of Patch), 24 B.R. 563, 567 (D.Md. 1982); Sovran Bank v. Allen (In re Allen), 65 B.R. 752, 763 (Bkrtcy.E.D.Va. 1986); John Deere Co. v. Iverson (In re Iverson), 66 B.R. 219, 229 (Bkrtcy.D. Utah 1986).

This emerging standard is summarized in In re Iverson as follows:

> In addition to the four categories of cases where a creditor's reliance on a false financial statement is not reasonable, a standard of reasonableness is emerging which requires the court to measure the creditor's actual conduct in the particular case against three different factors: (1) the creditor's standard practices in evaluating credit-worthiness; (2) the standards or customs of the creditor's industry in evaluating credit-worthiness; and (3) the surrounding circumstances existing at the time of the debtor's application for credit. In re Harms, supra, 53 B.R. at 141. Courts generally do not seek to prescribe procedures for the evaluation of credit-worthiness, but where a creditor's procedure does not comport with industry standards, or where warning signals suggest that independent investigation of a debtor's

> representations is appropriate, the court may suggest ways to improve the credit evaluation process. In re Hames, 53 B.R. 868, 872 (Bkrtcy.D.Minn. 1985).

66 B.R. at 229.

Courts have often denied the complaints of creditors seeking exceptions to discharge when the financial statements or other information which they had contained matters so obvious that any reasonably prudent lender would have made further investigation or inquiry. In these "red flag" cases the Courts have held that creditors who ignore available information that should have led them to protect themselves by making further inquiry cannot be heard to say that they reasonably relied on the financial statements of the debtors. See: Whitney National Bank v. Delano (In re Delano), 50 B.R. 613 (Bkrtcy.D.Mass. 1986); IFG Leasing Company v. Vavra (In re Harms), 53 B.R. 134 (Bkrtcy.D. Minn. 1985); Nisswa State Bank v. Eberle (In re Eberle), 61 B.R. 638 (Bkrtcy.D.Minn. 1985); W.A.F.B. Federal Credit Union v. Furimsky (In re Furimsky), 40 B.R. 350 (Bkrtcy.D.Ariz. 1984); Bank of Waynesboro v. Yeiser (In re Yeiser), 2 B.R. 98 (Bkrtcy.M.D.Tenn. 1979); U. S. Life Credit Corp. v. Ducote (In re Ducote), 4 B.C.D. 943 (Bkrtcy.W.D.La. 1978).

In considering the final element of whether the debtors made or published the financial statements with intent to deceive, the Sixth Circuit in the

case of Martin v. Bank of Germantown (In re Martin), 761 F.2d 1163, 1167 (6th Cir. 1985) stated the following:

> The standard, however, is that if the debtor either intended to deceive the Bank or acted with gross recklessness, full discharge will be denied. See In re Matera, 592 F.2d 378, 380 (7th Cir. 1979) (per curiam); In re Houtman, 568 F.2d 651, 655-56 (9th Cir. 1978). That is, the debtor must have been under some duty to provide the creditor with his financial statement; but full discharge may be disallowed if the debtor either intended the statement to be false, or the statement was grossly reckless as to its truth.

However, stating the standard is the simple part. Determining the proper standard of proof and whether it has been met is more difficult. This is illustrated in the case of IFG Leasing Company v. Vavra (In re Harms), 53 B.R. 134 (Bkrtcy.D.Minn. 1985) where the court says:

> Of course, proof of a debtor's subjective intent to deceive is difficult. In the absence of the rare actual statement of intent, the Court is left with a pattern of circumstantial evidence. In re Brown, 32 B.R. 554, 557 (Bankr.E.D. Tenn. 1983). Some Courts have held that proof of the first three elements of a false financial statement under §523(a)(2)(B) creates a presumption that the debtor made the statement with intent to deceive. Under this approach, once the plaintiff makes a prima facie case of the first three elements, the burden of production shifts to the debtor. If the debtor does not produce evidence of a lack of intent, the plaintiff may rely upon the presumption. If the debtor produces

evidence of lack of intent, the presumption is rebutted and, under operation of FED.R.EVID. 301, it "disappears". In re Tomeo, supra, at 677; In re Magnusson, supra, at 669.

Other Courts have relied upon a somewhat less formulaic test, and have held that the Court may infer fraudulent intent "where the debtor knew or should have known of the falsity of his statement". In re Denenberg, supra, at 271; In re Mann, 40 B.R. 496, 500 (Bankr.D. Mass. 1984). Some Courts have allowed this inference to be made where a debtor made a false financial statement with actual knowledge of its truth or falsity, with reckless indifference to its falsity, or after disregarding actual facts suggesting its falsity. In re Brown, supra; In re Byrd, supra, at 563. This Court concludes that reliance on a presumption in a dischargeability action is a suspect practice where the presumption is not legislatively created, given the mandate to narrowly construe exceptions to discharge and the legislative goal of broadly affording the debtor his "fresh start". Gleason v. Thaw, 236 U.S. 558, 35 S.Ct. 287, 59 L.Ed. 717 (1915); In re Brown, supra, at 557. Therefore, it will adopt the test allowing it but not requiring it to make an inference of fraudulent intent, once the plaintiff has shown the first three elements and has produced some proof of actual knowledge of falsity or reckless disregard for the truth. (Footnote omitted).

53 B.R. at 141.

This Court is of the opinion that the test adopted by the Bankruptcy Court in Harms and stated at the end of the above quote is "reasonable and correct."

The most extensive and thoughtful consideration of the element of intent of which this Court is aware is found in the case of Heinold Commodities and Securities, Inc.v. Hunt (In re Hunt), 30 B.R. 425, 440 (Bkrtcy.M.D.Tenn. 1983).

REVIEW OF THE FINANCIAL STATEMENTS AND SUMMARY OF THE TESTIMONY

Great Southern National Bank

As previously noted, the Bank holds three separate financial statements dated October 1, 1980, June 30, 1981 and December 31, 1982. Each of them is a preprinted form consisting of two pages. The front page has separate sections to show assets, liabilities, source of income, contingent liabilities and personal information in a summarized fashion. On the back page are sections to give more detailed information concerning certain types of assets and liabilities. The typed names of both David Ross and Veronica Ross are shown on the front page of each of the forms.

On the front page of the statement dated October 1, 1980, total assets are shown to be $2,728,364.00; total liabilities are shown to be $150,695.00; and net worth is shown to be

$2,577,669.00. On the second page of the statement assets in the amount of $2,375,818.00 are identified as follows:

No. 4. Stocks and Securities Other Than Guaranteed U. S. Government Securities and Government Agencies.

Face Value (Bonds) No. of Shares (Stocks)	Description of Security	Registered in Name of	Cost	Present Market Value	Income Received Last Year	To Whom Pledged
	Werehauiser	V. Ross		381,000		
	VMR Trust	V. Ross		839,702		
	Pizza Inc.	D. Ross		1,000,000		
	Globescan Trvl	D. Ross		120,000		
	Other Stocks	V. Ross		35,116		

On the front page of the same financial statement total income is shown as $66,000.00 and the sources are identified as salary $35,000.00; dividends $6,000.00; and, other income $25,000.00.

On the front page of the statement dated June 30, 1981, total assets are shown to be $3,154,987.00; total liabilities are shown to be $143,944.00; and net worth is shown to be $3,011,043.00. On the second page of the statement assets in the amount of $2,495,910.00 are identified as follows:

SCHEDULE A - U.S. GOVERNMENTS & MARKETABLE SECURITIES

Number of Shares or Face Value (Bonds)	Description	In Name Of	Are These Pledged?	Market Value
	V. M. Ross Trust	V. Ross	NO	129,503
	Globescan , Inc.	D. Ross	NO	120,000
	Pizza, Inc. Mr. Gattis	D. Ross	NO	1,000,000
878 shrs	Weyerhaeuser Co.	V. Ross	NO	32,376
	Other Stocks	D. & V. Ross	NO	20,000

SCHEDULE B - NON-MARKETABLE SECURITIES

Number of Shares	Description	In Name Of	Are These Pledged?	Source of Value	Value
	W. M. Mounger Trust	V. Ross	NO	DGNB	1,194,031

On the front page of the same financial statement total income is shown as $76,468.00 and the sources are identified as salary $39,600.00 and dividends $36,868.00.

On the front page of the statement dated December 31, 1982, total assets are shown to be $3,117,091.00; total libilities are shown to be $194,000.00; and net worth is shown to be $2,923,091.00. On the second page of the statement assets in the amount of $2,439,335.00 are identified as follows:

SCHEDULE A - U.S. GOVERNMENTS & MARKETABLE SECURITIES

Number of Shares or Face Value (Bonds)	Description	In Name Of	Are These Pledged?	Market Value
	V.M. Ross TRUST	V. Ross	No	44,335
	Globescan, Inc.	D. Ross	No	120,000
	Pizza Inc. MR. Gatti's	D. Ross	No	4,000,000
	Weyerhaeuser Co	V. Ross	No	120,000
	OTHER STOCKS	D+V Ross	No	40,000

SCHEDULE B - NON-MARKETABLE SECURITIES

Number of Shares	Description	In Name Of	Are These Pledged?	Source of Value	Value
	W.M. Mounger TRUST	V. Ross	No	Deed	1,115,000

On the front page of the same financial statement total income is shown as $83,600.00 and the sources are identified as salary $39,600.00 and dividends $44,000.00.

Although the names of both the debtors were typed on the first page of all three financial statements, only Mr. Ross signed the first statement. It was not signed by Mrs. Ross. The second and third statements dated June 30, 1981 and December 31, 1982, was signed by both of the debtors.

In regard to the indebtednesses to the Great Southern National Bank, during the course of the trial Mr. and Mrs. Ross were called as adverse witnesses and they also testified on direct examination. The sole witness for the Bank was Mr. James E. Shoemaker, Jr. Mr. Dennon Barron was called as a witness by the debtors.

The testimony of David L. Ross may be summarized as follows:

Mr. Ross testified that initially Pizza, Inc. had done its banking business with the First Mississippi National Bank. Mr. Deddens was involved in the active management of the business and he had most of the contact with the banks. At the time the original loan was made with Great Southern National Bank their stores were doing a big volume. Bill Hankins was the newly appointed president of Great Southern National Bank. Mr. Hankins was very aggressive and came after their business. Mr. Ross was told by Mr. Deddens that the bank had agreed to

loan them "X" amount of money without any personal guarantee. When Mr. Ross got to the bank, the bank required a personal guarantee originally for $50,000.00. The business was doing well so he gave the personal guarantee. Throughout the banking relationship, each time the corporation received new credit Mr. Ross signed a personal guarantee.

Mr. Ross testified that he did not personally deliver the financial statements to the bank nor did he ever remember discussing the statements with anyone at the bank. However, he knew that banks required financial statements. Mr. Deddens was dealing with the banks and from time to time Mr. Deddens would request financial statements from him which he would give to Mr. Deddens to be delivered to the banks. During 1980 and 1981, Mr. Ross was doing a lot of banking with the First National Bank and the Deposit Guaranty National Bank on matters unrelated to Pizza, Inc. Those banks required financial statements and when Mr. Deddens requested a statement he would give him copies of ones that he already had.

In reviewing the financial statement dated October 1, 1980, Mr. Ross said that the VMR Trust shown on page 2 as having a value of $839,702.00 was actually incorrectly identified. It should have been the W. M. Mounger Trust.

The statement dated June 10, 1981, had the V. M. Ross Trust listed under marketable securities and the W. M. Mounger Trust listed under nonmarketable securities. Mr. Ross testified that the reason he put the W. M. Mounger Trust under nonmarketable securities was because he knew that the trust contained provisions designed to prohibit creditors of his wife from gaining the trust assets and that he was trying to indicate that it was not a marketable security.

The preprinted form for the financial statement dated December 31, 1982, is identical to the one dated June 30, 1981. Mr. Ross testified that he knew the W. M. Mounger Trust could not be used to satisfy the claims of creditors and it could not be sold. For this reason he listed it under nonmarketable securities. His justification for listing the trust was to justify part of the income shown on the first page of the statements.

He testified that he put the trust under stocks and securities on the first financial statements because he did not see anywhere else to put it. When a different form was used at a later time to show nonmarketable securities, he then listed it in that section. He never claimed any title or interest in it; he never told anyone that he had authority to pledge it as an asset; and the bank never asked him or his wife any details concerning the trust.

In regard to the general financial condition of the business, Mr. Ross testified that after they started out in 1977 business was good through 1982. Pizza, Inc. was doing $2,500,000.00 worth of business and one of its stores was the number one store in the country some weeks. Things started to go bad in 1983, but Mr. Ross stated that he was not aware of how bad things were because he was misled by Mr. Deddens. At some point in time, Mr. Boggs contacted him about payments that were late to Financial Enterprises, Inc. and the accountants for Pizza, Inc. brought discrepancies to his attention. Finally he and two accountants confronted Mr. Deddens with the discrepancies, and Mr. Deddens left the business. At that time they were overdrawn approximately $40,000.00 with the bank; their main food supplier had cut them off because of bad checks; and they were about to loose their beer permit because they owed the State $20,000.00 in sales tax.

It was the testimony of Mr. Ross that at the time he did not fully know how bad things really were. He thought that by cutting back, trimming the budget and working real hard that he could get the business back in shape and pay off the debts. The bank was desperate when they found out the business was going down and it loaned him more money to keep the business from "bellying up." He was of the opinion that the bank

approved the line of credit which culminated in the $150,000.00 note, thinking that with him taking over the business that the matter would work out. The bank was in the situation where it either had to loan money and try to bail the business out or take a beating.

In regard to the personal loan on their home, Mr. Ross testified that he and his wife took out a construction loan with Great Southern National Bank, and that to secure the loan the bank took a deed of trust on some other property which they had. He did not remember anyone at the bank mentioning that he would be required to submit a financial statement. He was of the opinion that they probably already had a financial statement plus they were taking a deed of trust on a good piece of property.

The testimony of James E. Shoemaker, Jr. may be summarized as follows:

Mr. Shoemaker had started to work for Great Southern National Bank in November, 1980, and had worked there through February, 1985. Prior to that he had worked with the Mississippi Bank and was in charge of their credit department and loan review department from 1976 until he joined the Great Southern National Bank. For six years prior to that he had worked as a national bank examiner.

It is a requirement of the Controller of the Currency that any loan over $5,000.00 must have a

financial statement. This requirement is checked by national bank examiners, and failures to have financial statements are listed as exceptions in their audit report. It was the policy of the bank that the credit department at the bank would automatically send a letter each year notifying the customer to submit a current financial statement. If the financial statement did not come in, exceptions were turned over to the loan officer for him to obtain the financial statement from the customer. Every borrower on commercial loans was required to maintain a current financial statement.

Pizza, Inc. began borrowing money from the bank about the same time Mr. Shoemaker came to the bank as an employee, which was November, 1980. Over a period of about three years, the bank made various loans in different amounts to open up new stores for the business. They were of relatively short repayment periods which made the monthly debt service astronomically high. The notes were getting past due and the different notes were consolidated into the note involved herein dated February 27, 1984, in the principal amount of $391,040.00. This resulted in their debt service being cut by about fifty percent. Mr. Shoemaker identified the $150,000.00 note as the one made after John Deddens was out of the business and

David Ross had taken over as the chief operating officer. Mr. Shoemaker went over the various loan applications which have been identified in detail in the earlier part of this opinion. In general terms,the bank took as collateral for the Pizza, Inc. loans a second mortgage on the personal residence of Mr. and Mrs. Ross and the personal residence of Mr. and Mrs. Deddens. They took assignments on Pizza, Inc.'s equipment and fixtures and had a life insurance policy of $300,000.00 each on Mr. Ross and Mr. Deddens. He testified there were a total of 28 separate loan applications, renewals and extensions.

Mr. Shoemaker was not aware of Mr. Ross ever giving the bank a financial statement subsequent to the December 31, 1982 statement. He said the loan applications reflected the most recent financial statements that the bank had in its possession. The last loan application was in January, 1985 for the $150,000.00 note, and it reflected that the most current financial statement the bank had on Mr. Ross was the one dated December 31, 1982.

Mr. Shoemaker also reviewed the loan applications dealing with the financing of the personal residence of Mr. and Mrs. Ross. The last application was dated October 23, 1984, and it also reflected the most current financial statement was dated December 31, 1982.

Mr. Shoemaker further testified that in the financial statements and related documents, Mr. Ross always placed a value of $1,000,000.00 on his Pizza, Inc. stock. In a similar fashion, Mr. Deddens routinely used the value of $1,000,000.00 in his financial statements for his Pizza, Inc. stock.

However, Mr. Shoemaker said that when a bank is considering a loan to a closely held corporation, the bank normally assigns a zero value to the stock of that corporation. Banks assume that if a company goes bankrupt the stock will have no value and the bank will look at the principal's financial net worth. Banks automatically netted out the value of closely held corporate stock before they did any analysis or review. He specifically testified that the Great Southern National Bank gave a zero value to the Pizza, Inc. stock shown on the financial statements of Mr. Ross and Mr. Deddens. No one connected with the bank ever felt that the stock of Pizza, Inc. was worth $2,000,000.00.

However, he testified that the financial statements of Mr. Ross and Mr. Deddens were the sole basis for the credit extended to Pizza, Inc. Mr. Shoemaker's explanation was that the financial statements for Pizza, Inc. were computer generated financial statements rather than audited statements.

The bank could not rely on Pizza, Inc.'s compiled financial statements for a large line of credit, so they had to rely upon the personal continuing guarantees of the principals.

According to Mr. Shoemaker, the net worths of Mr. Deddens and Mr. Ross were the deciding factor in the decision of the bank to extend credit to Pizza, Inc. The bank considered the financial statements of Mr. Ross to be stronger than those of Mr. Deddens. His explanation was that the net worth of John Deddens was approximately $1,300,000.00 of which $1,000,000.00 was stock of Pizza, Inc. The bank netted this out leaving Mr. Deddens wiht a net worth of $300,000.00. By the time the bank deducted his house, Mr. Deddens really did not have a whole lot of net worth. However, the bank did claim a lien on his house.

Mr. Shoemaker specifically testified that he had no recollection of ever discussing with Mr. Ross the contents of his financial statements.

Mr. Shoemaker was specifically questioned regarding the December 31, 1982 financial statement. As previously noted, the W. M. Mounger Trust was shown on page two in the nonmarketable securities section to be in the name of Veronica Ross and to have a value of $1,115,000.00. It was Mr. Shoemaker's testimony that there was nothing in the statement that ever told him

the asset was not available for creditors to use to pay the debts of the Rosses. The bank considered it to be available to pay the debts of Mr. and Mrs. Ross. Mr. Shoemaker viewed it as a tangible asset, but something he would have to go to great lengths to collect. He felt it was an asset, and over a given period of time could be collected and converted to cash. It was his view that marketable securities were things like government bonds and treasury bills that can be sold and readily liquidated within a day or so.

It was Mr. Shoemaker's view that nonmarketable did not mean the trust could not be sold under any circumstances. It just meant that there was not a ready market for it, and it was not as quickly liquid as those in the marketable category.

He further testified that on Mr. Ross's financial statements the Pizza, Inc. stock should have been listed under nonmarketable securities rather than under marketable securities. Likewise, the Globescan stock, showing a value of $120,000.00, should have been listed under nonmarketable securities.

Mr. Shoemaker said the fact that the W. M. Mounger Trust was listed as a nonmarketable security in no way indicated that it was not available to pay the debts of Mr. and Mrs. Ross. He said that the only time he would consider something not to be readily available

to pay against debts, would be if it had been listed on page one, line five of the assets section labeled "Restricted or Controlled Stocks". He said that Mr. Ross could have shown the income from the trust by placing an asterick above the line for total income and explaining it.

Mr. Shoemaker further said that the fact that two of the financial statements were on forms identifying that they were for the Deposit Guaranty National Bank would have no effect because the Deposit Guaranty National Bank form provided the same type information Great Southern was interest in. Financial statements are so hard to get from companies that banks take any form that they can get. Great Southern National Bank did not care whose form the financial statement was on.

In reviewing the loan applications in regard to the home loan, Mr. Shoemaker said that the note originated on May 21, 1981; eleven advances were made against the note; and, it was fully drawn down for $160,000.00. It was renewed several times, and on October 18, 1982, the Rosses paid $60,000.00 plus interest of approximately $8,000.00. Further renewals were made on the note with some additional payments by Mr. and Mrs. Ross. On October 22, 1984, they renewed the principal amount of approximately $85,500.00, gave

them additional principal in the amount of approximately $28,500.00 for a total note of $114,000.00. Mr. Shoemaker said the net worth of the Rosses played a part in the permanent financing.

On cross-examination, Mr. Shoemaker acknowledged that the W. M. Mounger Trust had always been shown to be in the name of Mrs. Ross and that the most she had ever owed to the bank was $160,000.00 on the house loan which had been reduced to $114,000.00 for permanent financing. His explanation for the bank accepting an asset shown in the name of Mrs. Ross as justification for lending the large sums of money to Mr. Ross is that her assets could be used on their joint debts. He conceded that the home had a value of from $250,000.00 to $350,000.00, and even in bad real estate times it would have taken care of the home loan. He further conceded that the bank could have only reasonably looked to the trust to pay for the house, which really would stand for its own debt, and for the debt to Mr. Boggs of $125,000.00. Mr. Shoemaker also stated that he knew the name W. M. Mounger; that the family was an influential family in Jackson; and, that Mr. Mounger had been dead for a long time. He said that when he saw W. M. Mounger Trust on the statements and he knew that Mr. Mounger had been dead for a long time, that did not cause him to think

about a spendthrift trust. He first said that he did not know what a spendthrift trust was. Then he testified that he had heard of one and knew basically what it was, but he did not know all of the legalities of such trusts. It was his understanding that they are set up for the benefit of the family to get income from the trust, but they cannot touch the principal assets. He stated that when he saw the words W. M. Mounger; knew that he was the father of Veronica; the word "trust"; and knew that Mr. Mounger had been dead for over twenty years, he did not think about a spendthrift trust.

Mr. Shoemaker said that when he saw on the financial statements that the trust was not pledged, he did not think that the reason they might not be pledged was because they were in a spendthrift trust and could not be pledged. Although he had testified that nonmarketable securities are difficult to value and the source of the value was shown as the Deposit Guaranty National Bank, he never thought about calling the Deposit Guaranty National Bank to see why the trust, which had been in existence for twenty years, was still in existence. He never investigated why the securities were listed as nonmarketable.

Mr. Shoemaker said that, in part, the reason he did not investigate it was because Bill Hankins was

president of the bank at the time. Mr. Hankins knew David Ross; Mr. Hankins had worked at Deposit Guaranty National Bank; and, he was familiar with the trust. Mr. Hankins had told Mr. Shoemaker that he was familiar with the fact that there was a large trust over at Deposit Guaranty National Bank, and he knew the family.

Mr. Shoemaker specifically testified that Bill Hankins made the recommendation to make the loan; that he, Mr. Shoemaker, originally had no input into the matter; and he had no idea as to whether Mr. Hankins verified the assets or made any investigation as to how much they were worth.

Mr. Shoemaker stated that Great Southern never asked for an assignment of any of the marketable stocks shown on the financial statement, even in 1984 when the $150,000.00 line of credit was extended and all the problems were apparent. They still felt like they had adequate collateral to support the loan and nobody investiated the W. M. Mounger Trust.

In response to direct examination by the Court, Mr. Shoemaker stated that Mr. Hankins was the one that initiated the request for the loan, that Mr. Hankins had talked to one or both of the men, that Pizza, Inc. looked real good and it was a company that he wanted to do business with. Mr. Hankins had told them that he would set them up a line of credit of

$200,000.00 secured by a second mortgage on their residences and life insurance. Mr. Shoemaker said that Mr. Hankins told him that until title certificates could be performed and so forth, he wanted to go ahead and loan Pizza, Inc. $50,000.00 unsecured based solely on the guarantees and that it was the start of a $200,000.00 line of credit. He specifically said that Mr. Hankins was the one that would finally okay or not okay the loans, initially.

In response to questioning by the attorney for the bank, Mr. Shoemaker stated that he was the primary loan officer from the beginning. However, Mr. Hankins did the initial review and decided he wanted to do business and turned it over to him to be the servicing officer.

The testimony of Mrs. Veronica Ross in regard to the bank loan was relatively brief and may be summarized as follows:

Mrs. Ross said that all of the documents she signed in regard to the bank matters were signed at her home. Mr. Ross would bring them home, she assumed they were correct and she signed them in reliance upon her husband. She knew that everybody had to have financial statements, but she did not have any idea what they were used for.

Mr. Dennon Barron was called by the debtors as a witness and his testimony may be summarized as follows:

Mr. Barron had been engaged in the banking business for twenty-four years; he had been engaged in commercial lending for several years; and he was presently employed with the Rankin County Bank. He conceded that the brother of Mrs. Ross was a major stockholder in the bank, but asserted that that would not influence his testimony. He was permitted to testify as to the banking practices and evaluation of financial statements given to banks. He was not permitted to testify as to what type of evaluation a leasing company, such as Financial Enterprises, Inc., should put on them.

Mr. Barron testified that if he had the financial statement in front of him showing the W. M. Mounger Trust as a nonmarketable security that he would not have reasonably relied upon it to repay any debts unless he knew what kind of trust it was. On the face of the financial document, it could not be determined what type of trust it was or whether it could be relied upon to repay any debts. Mr. Barron would not assign the trust any collateral value unless he knew what it was. He stated that many trusts, by their nature, are restrictive.

On cross examination, he stated that a large part of any decision is based upon the net worth of the applicant. He said that by the debtors placing the trust on their statement they proffered it as an asset, but that did not speak to the quality of the asset.

Financial Enterprises, Inc.

As previously noted, Financial Enterprises holds five separate financial statements dated January 28, 1977, April 11, 1979, January 23, 1980, October 1, 1980, and June 30, 1982. Each of them is a preprinted form consisting of two pages. The first four financial statements all use the exact same preprinted form and it is the same preprinted form used for the financial statement dated October 1, 1980, which was held by the bank. The fifth statement dated June 30, 1982, is a different form which indicates it was preprinted for the use of Deposit Guaranty National Bank. The typed names of both David Ross and Veronica Ross are shown on the front page of each of the forms.

On the front page of the statement dated January 28, 1977, the total assets are shown to be $1,086,423.00; total liabilities are shown to be $47,554.00; and net worth is shown to be $1,038,869.00. On the second page of the statement assets in the amount of $971,036.00 are identified as follows:

No. 4. Stocks and Securities Other Than Guaranteed U. S. Government Securities and Government Agencies.

Face Value (Bonds) No. of Shares (Stocks)	Description of Security	Registered in Name of	Cost	Present Market Value	Income Received Last Year	To Whom Pledged
	Delta Insustries	V.M.Ross		170,350		
	DGB Corp.	V.M.Ross		36,156		
	Rep. of Texas Corp.	V.M.Ross		3,000		
	Common Income Trust	V.M.Ross		7,530		
	V.M.R. Trust	V.M.Ross		616,000		
	Globescan Travel	D.L.Ross		120,000		
	Globescan Travel Vicksburg	D.L.Ross		18,000		

No. 5. Real Estate. The legal and equitable titles to all the real estate listed in this statement is solely in the name of the undersigned.

On the front page of the same financial statement total income is shown as $46,503.00 and the sources are identified as salary $20,000.00; dividends $4,365.00; and other income - trust $22,138.00.

On the front page of the statement dated April 11, 1979, total assets are shown to be $2,286,724.00; total liabilities are shown to be $146,195.00; and net worth is shown to be $2,140,529.00. On the second page of the statement assets in the amount of $1,934,178.00 are identified as follows:

No. 4. Stocks and Securities Other Than Guaranteed U. S. Government Securities and Government Agencies.

Face Value (Bonds) No. of Shares (Stocks)	Description of Security	Registered in Name of	Cost	Present Market Value	Income Received Last Year	To Whom Pledged
	Werehauiser	V. Ross		189,360		
	DGB Corp.	V. Ross		23,586		
	V.M.R. Trust			839,702		
	Pizza, Inc.			750,000		
	Globescan Travel			120,000		
	Rep. of Texas Corp.	V. Ross		4,000		
	Common Income Trust	V. Ross		7,530		

On the front page of the same financial statement total income is shown as $66,000.00 and the sources are identified as salary $35,000.00; dividends $6,000.00; and other income $25,000.00.

On the front page of the statement dated January 23, 1980, total assets are shown to be $2,536,724.00; total liabilities are shown to be $150,695.00; and net worth is shown to be $2,386,029.00. On the second page of the statement assets in the amount of $2,184,178.00 are identified as follows:

No. 4. Stocks and Securities Other Than Guaranteed U. S. Government Securities and Government Agencies.

Face Value (Bonds) No. of Shares (Stocks)	Description of Security	Registered in Name of	Cost	Present Market Value	Income Received Last Year	To Whom Pledged
	Werehauiser	V. Ross		189,360		
	DGB Corp.	V. Ross		23,586		
	VMR Trust	V. Ross		839,702		
	Pizza, Inc.	D. Ross		1,000,000		
	Globescan Travel	D. Ross		120,000		
	Rep. of Texas Corp.	V. Ross		4,000		
	Common Income Trust	V. Ross		7,530		

On the front page of the same financial statement total income is shown as $66,000.00 and the sources are identified as salary $35,000.00; dividends $6,000.00; and other income $25,000.00.

On the front page of the statement dated October 1, 1980, total assets are shown to be $2,728,364.00; total liabilities are shown to be $150,695.00; and net worth is shown to be $2,577,669.00. On the second page of the statement assets in the amount of $2,375,818.00 are identified as

follows:

No. 4. Stocks and Securities Other Than Guaranteed U. S. Government Securities and Government Agencies.

Face Value (Bonds) No. of Shares (Stocks)	Description of Security	Registered in Name of	Cost	Present Market Value	Income Received Last Year	To Whom Pledged
	Werehauiser	V. Ross		381,000		
	VMR Trust	V. Ross		839,702		
	Pizza Inc.	D. Ross		1,000,000		
	Globescan Trvl	D. Ross		120,000		
	Other Stocks	V. Ross		35,116		

On the front page of the same financial statement total income is again shown as $66,000.00 and the sources are identified as salary $35,000.00; dividends $6,000.00; and other income $25,000.00.

On the front page of the final statement dated June 30, 1982, total assets are shown to be $3,154,987.00; total liabilities are shown to be $143,944.00; and net worth is shown to be $3,011,043.00. On the second page of the statements assets in the amount of $2,495,910.00 are identified as follows:

SCHEDULE A - U.S GOVERNMENTS & MARKETABLE SECURITIES

Number of Shares or Face Value (Bonds)	Description	In Name Of	Are These Pledged?	Market Value
	V. M. Ross Trust	V. Ross	NO	129,503
	Globescan, Inc.	D. Ross	NO	120,000
	Pizza, Inc. Mr. Gattis	D. Ross	NO	1,000,000
878 shrs	Weyerhaeuser Co.	V. Ross	NO	32,376
	Other Stocks	D. & V. Ross	NO	20,000

SCHEDULE B - NON-MARKETABLE SECURITIES

Number of Shares	Description	In Name Of	Are These Pledged?	Source of Value	Value
	W. M. Mounger Trust	V. Ross	NO	DGNB	1,194,031

On the front page of the same financial statement dated June 30, 1982, total income for the year ending December 30, 1980, is shown as $76,468.00 and the sources are identified as salary $39,600.00 and dividends $36,868.00.

Although the names of both the debtors were typed on the first page of all five financial statements, only Mr. Ross signed the first four statements. They were not signed by Mrs. Ross. The last statement dated June 30, 1982, was signed by both of the debtors.

In regard to the indebtedness to Financial Enterprises, Inc., during the course of the trial, Mr. and Mrs. Ross were called as adverse witnesses, and they also testified on direct examination. The sole witness for Financial Enterprises, Inc. was the previously identified Kenneth E. Boggs.

The testimony of David L. Ross may be summarized as follows:

Mr. Ross confirmed that Mr. Boggs had known the family of Mrs. Ross, the Moungers, from earlier days. Mr. Ross testified that in 1977 he met with Mr. Boggs on several occasions at the offices of Financial Enterprises to establish their business relationship. Mrs. Ross was probably available at one or two of the meetings. During those meetings Mr. Boggs talked about

the possibility of having to go against the personal assets of Mr. and Mrs. Ross. Mr. Ross stated that he never disclosed to Mr. Boggs or anyone at Financial Enterprises that the trust was a spendthrift trust and could not be pledged. However, Mr. Ross stated that Mr. Boggs never asked him any questions about the trust. He reiterated that the reason the trust was shown on the financial sttements was to explain the sources of income, other than salary listed on the front page of the statements.

Mr. Ross's explanation as to why the trust assets were listed under the stocks and securities section of the first four financial statements and under nonmarketable securities in the last financial statements was that the forms were printed differently. The form used for the first four statements did not have a nonmarketable securities section. The trust was not life insurance and it was not real estate, so Mr. Ross put the trust under the stocks and securities section. The printed form used for the last financial statement contained a nonmarketable securities section so he placed it under that section.

Mr. Ross said that John Deddens went on the first line of credit. Mr. Deddens had gone to Mr. Boggs, made a deal and then told Mr. Ross. It was at that time Mr. Ross gave Mr. Boggs the first financial statement.

After that Pizza, Inc. routinely leased equipment for the stores through Financial Enterprises.

Mr. Ross stated that Mr. Boggs was the main person who brought the whole problem with the business to his attention. This was because of late payments on the equipment to Financial Enterprises.

Mr. Ross acknowledged that the meetings he and his wife attended with Mr. Boggs were for the purpose of determining whether money would be loaned to Pizza, Inc. to buy equipment for the pizza business. He and his wife, Mr. and Mrs. Deddens and Pizza, Inc. all guaranteed the loans, and it was his intention to pay back the loans.

During the meetings no questions were asked pertinent to his wife's trust fund. Mr. Ross did not make any statements or volunteer any information during the meetings pertinent to the trust fund.

Mr. Ross said that the trust shown as the VMR Trust on the first four financial statements was actually the same asset as the W. M. Mounger Trust shown on the last financial statement.

As previously noted, Mr. Ross and Mr. Shoemaker had testified that Mr. and Mrs. Ross obtained financing from the bank to construct and then permanently finance their home. This home loan was not shown on the financial statement dated June 30, 1982

and held by Financial Enterprises, Inc. Mr. Shoemaker had also testified that there was a SBA loan of $18,000.00 which was not reflected on the June 30, 1982 statement. Mr. Ross's explanation in response to questions by his attorney was as follows:

> A. The only thing I can say is that at that time--I know they were talking about some of the assets going up and down. We had sold some of the assets off of that. For instance, you had Delta Industries in there. Delta Industries sold out to Weyerhauser. Weyerhauser all of a sudden appears in the financial statement. Ready Mix also appears in there, and it was just a real good type tax thing, I should say stock swap. We sold a lot of Weyerhauser stock. We traded options on Weyerhauser stock. And as far as the omission of liabilities like that, it may have been an honest mistake, you know, I don't know. But I think if I had left off a liability, I probably somewhere in my little brain, I left off an asset so that one could offset the other. We had a lot--I was building a house and I would really have to sit down and get my dates worked out to find out whether or not I really did leave anything off there. I am not convinced I did.
>
> Q. Some of the other questions that Mr. Latham elicited from Mr. Shoemaker in cross-examination concering the SBA loan and assets fluctuating up and down, were those ordinary transactions that were occurring on a more or less day-to-day basis, you would sell asset A and acquire asset B, or sell asset A and use the money to live on?

A. No, I--to go through--we had--when I first started Mr. Gatti's, we had--just before we started it, we had a baby--Veronica had a baby, I should say. She had severe heart problems. So, she stayed in the hospital approximately two months, I would say. And I was going back and forth and the travel business just hit all of a sudden when I was in a real peak, peak season. When I purchased this property I was going to develop, that I was developing to put my own house on, I put a cul de sac in and I sold off a couple of lots off of it. Then--I am just going to go through this real quick--then our child at 18 months died in surgery. Nine months later we adopted a child. A few months later we get flooded on Riverwood Drive, the '79 flood. And after that it was just, you know, trying to get back in the house and everything. There was a lot of things going on in my life that I could easily have made a mistake, you know, or just didn't put it in the right place.

The testimony of Mrs. Veronica Ross in regard to the Financial Services, Inc. indebtednesss was again relatively brief and may be summarized as follows:

Mrs. Ross said that she was childhood friends with the daughter of Mr. Boggs. Again, she basically testified that she would sign various forms when requested by Mr. Ross. She remembered going to the office of Mr. Boggs. She did not remember discussing her trust with Mr. Boggs or anyone else since the business was started and she believed that she would have remembered it. Mrs. Ross said the only money that she knew she owed to the bank was the house loan; that

she did not intend to deceive anyone; and that she had never told the Bank, Financial Enterprises or any other creditor that the big trust was available to satisfy creditors. She had always known since her father died that the big trust was not available for such purposes.

She said that all she had ever gotten out of the W. M. Mounger Trust was income because her father had deliberately set it up that way for his three daughters.

The testimony of Kenneth E. Boggs may be summarized as follows:

Mr. Boggs was the sole stockholder and executive officer of Financial Enterprises, Inc. Ninety-eight percent of his business was in the area of equipment leasing, which was a method of financing equipment. His business relationship with Mr. and Mrs. Ross, Mr. and Mrs. Deddens and Pizza, Inc. was initiated in 1977. He did not remember exactly how the relationship was initiated, but he had an idea that Mr. Deddens and Mr. Ross came to his office to tell him they were building a restaurant. Mr. Boggs' normal procedure was to tell people what documents would be needed and that he would have to look to some outside source of income in case the venture was a total failure. For this reason he would ask for personal financial statements.

Mr. Boggs financed all of Pizza, Inc.'s equipment needs. The leases were extended on the credit of the personal financial statements of the principals, John Deddens and David Ross. Personal guarantees were secured from Mr. and Mrs. Deddens and Mr. and Mrs. Ross.

Mr. Boggs could not say how many times Mrs. Ross came in with Mr. Ross. However, he did get reacquainted with Mrs. Ross. He had known her father very well and they had fished together on occasions. He knew that Mr. Mounger had left a considerable estate to Veronica Ross and the other children. The initial financial statement showing stocks with considerable value and a trust fund were in keeping with what he knew about the Mounger family.

Mr. Boggs was asked by his attorney: "In 1977 when you received the financial statement from David and Veronica Ross, it was shown thereon a description of a security, a VMR Trust. Did you take any action to inquire as to what kind of security that was? Did you take any action; did you talk to anybody?" He answered: "Oh, I talked to them about these stocks and assets on this financial statement." He then went on to explain that he probably only made one out of every fifty applications for loans on new businesses and only one out of two hundred applications

in regard to restaurants because used restaurant equipment is of so little value. Mr. Boggs then explained more about the equipment leasing business. He said that during the time he got reacquainted with Mrs. Ross and the various documents were being signed, he asked her about the various stocks on the financial statement. He testified that "I looked right straight at Veronica and said, 'Veronica, you know that if this thing never makes a pizza, you will be paying this out of your trust.' And she said, 'I understand.'".

However, in response to the question by his attorney Mr. Boggs never gave any testimony showing that he made any further inquiry or investigation of the trust assets. He did testify that he did not learn about the nature of the trust assets until the business got in trouble and he was talking to Mr. Ross about the problems. Mr. Boggs stated that if he had known the trust was a spendthrift trust he would not have gotten into the business relationship with Mr. and Mrs. Ross.

Mr. Boggs also testified that in June of 1982 he did not know that the home loan on the residence of Mr. and Mrs. Ross had been omitted from their financial statement.

On cross examination, Mr. Boggs said that he had been in the lending business for eighteen years and that he had paid close attention to the financial

statements. In regard to the 1982 statement that showed the trust to be nonmarketable, he did not overlook it. It was a question of how he chose to interpret "marketable". Mr. Boggs was asked if it raised a red flag in his mind when it suddenly shifted from marketable to nonmarketable. His explanation was that the only reason it shifted is that the form was different from the other forms, which did not have "nonmarketable" on them. When the financial statement came to him in 1982, he did not make any investigation or inquiries as to why there had been a change from marketable to nonmarketable.

In regard to the first financial statement in 1977, Mr. Boggs testified that he did not look primarily at any particular asset but he looked at the overall picture. In his opinion, in addition to the trust, the various other stocks had good value and that Mr. Ross's travel business had been operating. He thought he could reasonably assume that the financial statement was correct having known Veronica for most of her life and knowing that her father had left a sizable sum of money to her. He said that he normally did not look to homesteads because they are so well shielded.

In regard to the $160,000.00 home loan that was omitted from the June 30, 1982, statement the Court is not confident that it correctly interpreted the

substance of Mr. Boggs' testimony. The Court believes that Mr. Boggs meant that the fact that the $160,000.00 loan was omitted on a home having a value of approximately $300,000.00 would adversely affect the net worth shown on the statement, but that a home with that much equity would influence a positive credit decision because it would show stability of the borrower.

The equipment leases were not introduced into evidence. Mr. Boggs testified that the last lease was on December 21, 1982, for the store in Picayune, Mississippi. The lease prior to that was approximately eight months to a year.

CONCLUSION

Having fully considered the evidence, both oral and documentary, and viewing the record as a whole, the Court finds that Great Southern National Bank and Financial Enterprises, Inc. have not met their burden of proof by clear and convincing evidence.

Preliminarily, the Court finds that Veronica M. Ross is not liable to Great Southern National Bank for any amounts owing on the promissory notes dated February 24, 1984, and January 31, 1985, from Pizza, Inc. to the bank. They are corporate notes; she never guaranteed the notes; and, she simply has no personal

liability on the notes. Therefore, no finding has to be made as to Veronica M. Ross in regard to any exception to discharge on these loans.

The Court now turns to the remaining indebtednesses.

It will first consider the indebtednesses to the Great Southern National Bank.

In particular, the Court is not persuaded by what it considers to be clear and convincing evidence that the bank relied on the financial statements. Nor is the Court persuaded that any reliance that the bank might have had was reasonable. Further, the Court is not convinced that the financial statements were materially false.

Despite the testimony of Mr. Shoemaker that the financial statements of Mr. Ross and Mr. Deddens were the sole basis for the credit extended to Pizza, Inc., this Court views the matter in a different perspective. Pizza, Inc. had been organized in 1977 and had been successful. In 1980 it appeared to be a customer that any bank would have desired. The president of Great Southern National Bank, Mr. Hankins, was an experienced banker, was familiar with Mr. Deddens, with Mr. and Mrs. Ross and with the Mounger family. He actively sought their business and offered to loan them money.

Additional loans were made to Pizza, Inc., business was good and it continued to expand and meet its financial obligations. It was during this time frame that practically all of the indebtedness in the large note was accumulated. The Court is not convinced that the financial statements paid any part in the decision of Mr. Hankins and the bank to seek what, at the time, was a desirable customer. These same comments also apply to the home loan which actually originated in May of 1981. At that time the corporate business was good and the home loan was well secured. To this date, the home loan still appears to be well secured.

The Court's view of the line of credit which was extended in May, 1984, is that it was a conscious decision by the bank to risk "putting good money after bad" in an effort to at least partially rescue the existing large loan. Apparently, this was a reasonable risk because all but $150,000.00 was paid back on the original principal amount of $5,000.00,disregarding interest. The Court is of the opinion that this was a business decision which Great Southern National Bank made, and it was not based on information contained in financial statements obtained almost two years before.

Mr. Shoemaker testified eloquently as to how he relied on the financial statements to make his

decisions. However, the controlling hand of Mr. Hankins pervaded these loans from the beginning in November, 1980, when Mr. Shoemaker was newly arrived at the bank, until the last loan application dated January 31, 1985 (Exhibit 32). In the section of the last loan application labeled "Officer's Recommendation" is the notation initialed by Mr. Shoemaker which states: "This loan (formally overdraft) was prior approved by Bill Hankins before he left the bank."

Assuming for purposes of argument that the bank did rely on the financial statements, the Court is of the opinion that this reliance was not reasonable. The Great Southern National Bank is a sophisticated lender. It is difficult for this Court to conceive of any sophisticated lender that was seriously relying upon a financial statement for repayment not to make at least some minimal inquiry or investigation when it saw the major assets consisted of a "trust" and stock in a corporation showing a value of $1,000,000.00 which the bank chose to disregard from the beginning. Either one of these two factors would have been a "red flag" to any prudent lender that was relying upon the financial statements to at least make some minimum investigation. A simple telephone call to the Deposit Guaranty National Bank as trustee or a request for a copy of the trust would have sufficed. Any sophisticated lender,

and indeed any person with ordinary business sense, would know that by their nature trusts are restrictive.

In regard to the value of $1,000,000.00 which Mr. Ross and Mr. Deddens each placed on their Pizza, Inc. stock, Mr. Shoemaker readily admitted that the bank never believed that the company had a total value of $2,000,000.00, The bank summarily disregarded this value placed on the financial statements. In effect, the bank knew that the financial statements were defective on their face.

In considering the meaning of "nonmarketable", Mr. Shoemaker interpreted it to mean that an asset was simply not "liquid" but that it could be collected. Mr. Ross's interpretation was that "nonmarketable" meant that it could not be sold. There certainly seems to be as much logic in the interpretation of Mr. Ross as there is in the interpretation of Mr. Shoemaker.

The Court will now consider the indebtednesses to Financial Enterprises, Inc.

Although Financial Enterprises, Inc. presented better support for its complaint, again the Court is not persuaded by what it considers to be clear and convincing evidence.

Obviously, Mr. Boggs and his company, Financial Enterprises, Inc., were sophisticated

lenders. He had been engaged in the lending business for eighteen years and reviewed and accepted or rejected large numbers of loan applications. He personally interviewed Mr. and Mrs. Ross and emphasized their personal responsibilities for the corporate debt.

However, the previous comments of the Court involving the significance of a large portion of the assets shown on the financial statements consisting of "trusts" apply with equal weight in regard to Financial Enterprises, Inc. Mr. Boggs did not make even a minimal investigation as to the trusts. Again, a simple telephone call to Deposit Guaranty National Bank or a request for the trust instruments would have sufficed.

Mr. Boggs's interpretation of "nonmarketable" was similar to that of Mr. Shoemaker, and the previous comments of the Court again apply.

In the case of Financial Enterprises, Inc., except for the first lease in 1977, the remaining leases were made at a time when Pizza, Inc. was experiencing success and growth, and its record of performance with Financial Enterprises, Inc. was good enough to justify further leases.

In regard to the dischargeability of Mrs. Ross's debts in particular, the only financial statement she signed was one dated June 30, 1982, and there was only one lease entered into after that date.

In regard to both creditors, the Court is also of the opinion that the proof and any inferences from it did not establish that Mr. or Mrs. Ross caused the financial statements to be made with an intent to deceive or that they acted with gross recklessness. Except for the initial equipment lease when the business was just beginning and the final line of credit from the bank after the financial problems were known, the other debts were incurred at times when Pizza, Inc. was experiencing success and repayment by it appeared to be very likely. Although the largest trust was restricted, three trusts were in existence which contained large assets; the trusts were providing income in the amounts shown on the statements; and, the publicly traded stocks and real estate were owned as shown on the statements. Granted, the statements were factually inconsitent in some respects, but not to the point of being materially false and indicating an intent to deceive.

Therefore, the Court is of the opinion that the complaints of the Great Southern National Bank and Financial Enterprises, Inc. should be dismissed. Separate orders of dismissal will be entered by this Court.

THIS the 26th day of October, 1989.

U. S. BANKRUPTCY JUDGE