UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF FLORIDA

In re

DONALD H. ROSS, SR. and JOAN B. ROSS,

Debtors.

Case No. 91-20018-BKC-AJC
Chapter 7

LUCKY FASHIONS, S.p.A.,

Plaintiff,

vs.

DONALD H. ROSS, SR.,

Defendant.

Adv. Pro. No. 91-0416-BKC-AJC-A

MEMORANDUM OPINION AND ORDER RE PLAINTIFF'S "SECOND AMENDED COMPLAINT OBJECTING TO THE DISCHARGE OF DEBTOR OR ALTERNATIVELY TO DETERMINE DISCHARGEABILITY OF DEBT" COMBINED WITH NOTICE OF THE ENTRY THEREOF

In this adversary proceeding under Fed. R. Bankr. P. 7001(6) the plaintiff, Lucky Fashions, S.p.A. ("Lucky"), seeks a nondischargeable judgment against the defendant, Donald H. Ross, Sr., the above-named chapter 7 debtor ("Mr. Ross"), pursuant to the provisions of 11 U.S.C. §523(a)(2)(A) and (B), infra.[1]

The ultimate questions for judicial determination here are whether or not Lucky's asserted claims against Mr. Ross should be excepted from his general discharge and whether or not fees and costs should be imposed against Lucky in favor of Mr. Ross for commencing the instant adversary proceeding.

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[1]Shortly prior to the trial of this adversary proceeding, Lucky withdrew its asserted claims pursuant to 11 U.S.C. §727(a) objecting to Mr. Ross' general discharge.

By virtue of 28 U.S.C. §157(b)(2)(I), these are core proceedings.

Based on the testimony, the exhibits thereto, statements of counsel, and the entire case record as a whole, the court[2] makes the following findings of fact and conclusions of law in accordance with Fed. R. Bankr. P. 7052 and hereby denies Lucky's section 523(a)(2)(A) and (B) complaint against Mr. Ross and also denies Mr. Ross' request to impose fees and costs against Lucky.

The relevant background facts may be briefly summarized as follows: Lucky, an Italian company located in Milan, Italy, is engaged in the fabric converting business. It buys white fabric and then prepares the printing on the fabric and sells the fabric as finished print piece goods. Lucky's fabric is generally sold to swimwear manufacturers internationally. Mr. Luciano Putignano ("Mr. Putignano") is one of the two principals of Lucky.

Mr. Ross is the former principal of Ste. Jan-Marie ("Ste. Jan"), an American corporation that designed, manufactured and marketed high-fashion swimwear. Lucky was a trade creditor of Ste. Jan, being at some times relevant here the latter's major supplier of printed fabric used in the manufacturing process.

Messrs. Putignano and Ross originally met at an industry fair in Monte Carlo where they were introduced by a mutual friend. This industry fair meeting resulted in Ste. Jan's initial placing of a relatively small credit order with Lucky, which admittedly did not request a credit report or otherwise search the credit worthiness of Ste. Jan. Lucky received payment from Ste. Jan for the first order in due course. It is noted that Lucky, Ste. Jan, and Messrs. Putignano and Ross are experienced business persons. Subsequently, the business relationship between Lucky and Ste. Jan financially ripened for both entities and steadily increased as evidenced by approximately $150,000.00 in gross sales in 1985 between them and by approximately $1,000,000.00 in gross sales in both 1987 and 1988.

[2]Chief Bankruptcy Judge David S. Kennedy for the Western District of Tennessee, sitting by assignment.

Lucky granted Ste. Jan credit terms from the inception of their business relationship. The original credit terms between Lucky and Ste. Jan required that full payment be made with 60 days of the date of the invoice. Notwithstanding late payments from time to time by Ste. Jan, Lucky nonetheless continued to extend exceptionally generous payment terms to Ste. Jan. Credit terms were later extended by Lucky to 90 days and eventually were extended to <u>180</u> days!

In May, 1989, Mr. Ross on behalf of Ste. Jan traveled to Milan, Italy to meet with the two principals of Lucky. The purpose of this meeting was to discuss a repayment plan for the past due debt owed by Ste. Jan to Lucky and to further discuss anticipated future shipments of new merchandise to Ste. Jan by Lucky. As a result of the meeting, an informal document setting forth a proposed repayment schedule was prepared by Lucky and initialed by Mr. Ross on behalf of Ste. Jan. In accordance with the proposed repayment plan, Ste. Jan would pay Lucky the sum of $500,000.00 during the months of September through December, 1989, an additional $100,000.00 would be paid in January, February, and March, 1990, and the balance of $160,000.00 would be paid in May, June, and July, 1990. The proposed repayment schedule coincided with Ste. Jan's seasonal nature of its business. Ste. Jan believed June, July, and August to be slow months for sales. Ste. Jan felt that sales usually began to pick up in September with October and November being good months. Traditionally, January, February, March, and April were the best months for Ste. Jan.

In accordance with the proposed repayment schedule, Ste. Jan sent post-dated checks to Lucky for payment on various delinquent invoices. Post-dated checks totalling the sum of $750,000.00 were sent by Ste. Jan to Lucky. Two of the checks aggregating approximately $36,000.00 cleared the bank. Additionally, two other checks aggregating approximately $90,000.00 cleared the bank - these were not checks included in the post-dated checks, but were for payments for the months of May and June, 1990. The July, 1990 post-dated check did not clear the bank and Lucky did not submit any further checks for payments.

On September 1, 1989, Mr. Ross on behalf of Ste. Jan wrote to Lucky advising it of, inter alia, Ste. Jan's financial difficulties and providing assurances that future payment would be made on post-dated checks, whereupon Lucky shipped, for example, another $140,000.00 in merchandise in the months of October and November, 1990. It is observed that Lucky continued to fail to investigate Ste. Jan's creditworthiness or to ferret out ordinary credit information.

Due to unabated financial difficulties, on September 10, 1990, Ste. Jan filed a voluntary petition under chapter 7 of the Bankruptcy Code ("Code"). Lucky asserts a claim of approximately $1,200,000.00 against Ste. Jan. On January 3, 1991, Mr. Ross filed a voluntary petition under chapter 7 of the Code. Lucky seeks in the instant adversary proceeding to have its particular trade debt against Ste. Jan judicially determined to be a nondischargeable judgment against Mr. Ross in his <u>individual</u> capacity.

Pursuant to 11 U.S.C. §523(a), a general discharge under section 727 of the Code 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 -
>
> "(A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> "(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...."

Initially, it should be noted that the general philosophy of the laws of Congress relating to bankruptcy is to give the debtor a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of pre-existing debt. Local Loan Co. v. Hunt, 292 U.S. 23, 244 (1934); Lines v. Frederick 400 U.S. 18, 19 (1978). Applying this clearly stated fresh-start policy, the exceptions to discharge delineated in section 523(a) of the Code are construed narrowly against a creditor and liberally in favor of the debtor. Gleason v. Thaw, 236 U.S. 558 (1915); In re Hunter, 780 F.2d 1577 (11th Cir. 1986). Thus, a creditor filing a complaint under section 523(a) bears the burden of proving that its particular claim falls within one of the exceptions enumerated in that section. Under the Supreme Court case of Grogan v. Garner 498 U.S. _____, 111 S.Ct. 654, 112 L. Ed. 2d 755 (1991), this burden is met by a preponderance of the evidence.

Lucky asserts that the aforesaid proposed repayment schedule coupled with the subsequent post-dated checks, and the September 1, 1989 letter constitute violations of 11 U.S.C. §523(a)(2)(A) and because these representations were contained in "writings" that these documents also constitute violations of 11 U.S.C. §523(a)(2)(B) as well.

It is expressly noted that a false representation or false pretense under section 523(a)(2)(A) must be of a kind involving moral turpitude or intentional wrong. Fraud implied in law which may exist without imputation of bad faith or immorality is insufficient. See, e.g., Neal v. Clark, 95 U.S. 704 (1887); 3 Collier On Bankruptcy, ¶523.08[4], p. 523-39 (15th ed).

To except a debt from discharge under section 523(a)(2)(A), a creditor must prove the following essential elements: that the debtor obtained property through a material misrepresentation that at the time the debtor knew was false or that such misrepresentation was made with gross recklessness as to its truth; that the debtor intended to deceive the creditors;[3] that the creditor reasonably relied on the false representation; and that its reliance was the proximate

[3] A debtor's "intent to deceive" need not be implicit and may be inferred in appropriate cases from the circumstances as a debtor's unsupported assertions of an honest intent will not overcome the natural inferences from the facts.

cause of loss. See, e.g., In re Kimzey, 761 F.2d 421, 423 (7th Cir. 1985); 3 Collier On Bankruptcy, ¶523.08[4] (15th ed.). Each of these elements must be proved.

To except a debt from discharge under section 523(a)(2)(B), a creditor must prove the following essential elements: that the debtor used a statement in writing; that is materially false; that represents the debtor's or a insider's financial condition; that the creditor reasonably relied upon; and that the debtor caused to be made or published with intent to deceive. Each of the elements of section 523(a)(2)(B) must be proved. More specifically, to come within the exception of section 523(a)(2)(B), the statement in writing must either have been written by the debtor, signed by the debtor, or the particular writing must have been adopted and used by the debtor. See, e.g., Engler v. Van Steinburg, 744 F.2d 1060 (4th Cir. 1984). It is not sufficient to show that the statement is incorrect in fact. It must be materially false. "False" means more than erroneous or untrue and imports an intention to deceive, and a materially false statement in writing must have been knowingly and intentionally untrue to bar a discharge. See, e.g, In re Coughlin, 27 B.R. 632 (1st Cir. B.A.P. 1983). Intent to deceive is explicitly made an element of the false financial statement exception which makes the section 523(a)(2)(B)(iv) exception operative only if the statement in writing is "made or published with the intent to deceive". Ordinarily, if the debtor has no knowledge of the alleged false statement or if the debtor honestly thought the facts stated therein were true, it would not constitute a bar to a discharge. See, e.g., Doyle v. First Nat'l Bank of Baltimore, 231 F. 649 (4th Cir. 1916); Becker v. Shields, 237 F.2d 622 (8th Cir. 1956). Section 523(a)(2)(B) does not cover every material statement of fact made in writing to the creditor to induce the credit. It is confined in its application to statements respecting the financial condition of the debtor or of an insider. E.g., section 523(a)(2)(B) does not apply to a deed. In re Phillips, 804 F.2d 930 (6th Cir. 1986). The creditor's reliance on the statement must have been "reasonable". In re Kreps, 700 F.2d 372 (7th Cir. 1983). The final element required to bring a debt within the false financial statement exception is set forth in section 523(a)(2)(B)(iv) as follows:

> "That the debtor caused [the statement] to be made or published with the intent to deceive."

Under the circumstances existing here the proposed repayment schedule between Lucky and Ste. Jan constitutes a mere promise of future performance which was subsequently breached by Ste. Jan. 3 Collier On Bankruptcy, ¶523.08, p. 523-54 (15th ed.), provides as follows:

> "A mere promise to be executed in the future is not sufficient to make a debt nondischargeable, even though there is not excuse for the subsequent breach." (case citations omitted.)

There is insufficient evidence to find and conclude that the purchase of merchandise on credit from Lucky by Ste. Jan, or an extension, renewal, or refinancing of credit, was done by Mr. Ross with the required and requisite intent not to pay therefor or comply therewith. Failure of a commitment made in good faith to make payments does not constitute an impermissible violation under 11 U.S.C. §523(a)(2)(A). See, e.g., In re Carpenter, 13 C.B.C. 2d 1158 (Bankr. N.D. Ga. 1985). Although Ste. Jan, Mr. Ross, and others including perhaps Lucky may have been overly optimistic in their beliefs and hopes regarding Ste. Jan's repayments, such mistaken beliefs, however, do not constitute false pretenses, false representations or actual fraud within the meaning of 11 U.S.C. §523(a)(2)(A) and the proposed repayment schedule under the circumstances does not constitute a "statement in writing" as contemplated in 11 U.S.C. §523(a)(2)(B) so as to impose a nondischargeable judgment against Mr. Ross. It is also observed that after the May, 1989 meeting Ste. Jan was unable to obtain immediate rollover of its bank's line of credit which was due to circumstances substantially beyond its control. It is further observed that troubled market conditions within the industry itself were also beyond Ste. Jan's control.

Generally, payment by check is a representation to the seller that the buyer has sufficient funds in the account to cover the purchase and intends to pay for the purchase; however, an insufficient funds check is not conclusive evidence of an intent to defraud, but must be considered in light of all the facts and circumstances. See, e.g., In re Wise, 6 B.R. 867 (Bankr.

M.D. Fla. 1980). Checks not honored by a bank because of insufficient funds do not ipso facto constitute a false financial statement. See, e.g., Obrist v. Christensen, 337 F.2d 220 (9th Cir. 1964). Here, Lucky requested the post-dated checks. Mr. Putignano felt that the post-dated checks would give Lucky strong and forceful leverage for subsequent collection purposes. The court cannot find and conclude under a totality of the circumstances that Mr. Ross had actual knowledge at the time of the issuance of the post-dated checks that Ste. Jan had no future ability to ultimately fund the checks. Further, the court finds that the issuance of the post-dated checks did not constitute false pretenses, false representations or actual fraud to bar Mr. Ross' individual discharge under 11 U.S.C. §523(a)(2)(A) and that these checks are not "statements in writing" within the meaning and contemplation of 11 U.S.C. §523(a)(2)(B). Lucky has also failed to convince the court that the September 1, 1989 letter constitutes, under these circumstances, a violation of the provisions of 11 U.S.C. §523(a)(2)(A) and (B). Mr. Ross sufficiently explained the basis for the statements set forth in this letter. It is undisputed that Ste. Jan eventually became unable to meet its financial obligations. For purposes of this adversary proceeding the financial difficulties of Ste. Jan have been sufficiently explained to the court. At times relevant here Ste. Jan also began to experience problems collecting its accounts receivable, which further contributed to its financial difficulties. In the latter part of September, 1989, Ste. Jan's experienced a significant decrease in the draws from its factor, which dropped from 78% to approximately 40% to 50%. The market continued to change in late September, 1989 and thereafter. There is insufficient proof for the court to find under the circumstances that the September 1, 1989 letter was published with the intent to deceive or defraud Lucky or that it was made with gross recklessness to warrant an exception to Mr. Ross' discharge under the laws of Congress relating to bankruptcy.

The court is not unmindful of the concerns of Lucky. The court is also not unmindful of the plight of Mr. Ross, who encumbered virtually all of his personal assets (e.g., his homestead residence, his mother's condominium, various certificates of deposits, etc.) attempting to resuscitate

Ste. Jan. Obviously, Mr. Ross felt a reasonable expectation that the debt obligations of Ste. Jan could eventually be met. Lucky cannot now close its eyes to the business realities of the past. Lucky knew at times relevant here that Ste. Jan was experiencing financial difficulties. There is an inherent risk that any credit transition may go bad. Lucky and Ste. Jan both made a tremendous amount of money during better financial times and climates. It is unfortunate that Ste. Jan did not fully repay Lucky the debt it is contractually owed; however, such failure under these circumstances, should not result in Mr. Ross being saddled with a staggering individual nondischargeable judgment in favor of Lucky and against him arising out of the corporate debt owed by Ste. Jan to Lucky.

Based on the foregoing the court concludes, after considering a totality of the particular facts and circumstances and applicable law, and after construing strictly Lucky's asserted exception to Mr. Ross' discharge, that Lucky failed to prove at trial by a preponderance of the evidence that Mr. Ross violated, inter alia, the intent provisions of either 11 U.S.C. §523(a)(2)(A) or (B) and that the court should not infer intent or find gross recklessness as to the truth. Accordingly, Lucky's complaint against Mr. Ross should be denied. Because each element under 11 U.S.C. §523(a)(2)(A) and (B) is an essential one, it shall be unnecessary for the court to address the other statutory elements including the reasonable reliance issue notwithstanding Lucky's failure to use normal and ordinary precautionary measures prior to making such large credit shipments of merchandise.

Simply stated, this court does not believe the particular facts and circumstances surrounding this corporate debt owed by Ste. Jan to Lucky are sufficient to generate individual liability and damages to Mr. Ross for Ste. Jan's breach of corporate contract or for a perceived or possible tort of Ste. Jan or Mr. Ross. Like Lucky, Mr. Ross has also encountered substantial loss and damages as a result of Ste. Jan's financial problems. Lucky also failed to prove by a preponderance of the evidence that Mr. Ross was guilty of positive fraud or fraud in fact, involving moral turpitude or intentional wrong, or fraud in law. Further, the court finds and concludes that Mr. Ross did not act in bad faith in these transactions or that perceived acts of immorality should not be imputed, in spite of Lucky's assertions to the contrary.

Mr. Ross now seeks to impose attorney's fees and costs as well as sanctions against Lucky for his defense of this lawsuit which he asserts was commenced against him by Lucky in bad faith seeking to except a corporate debt from his individual discharge and to, inter alia, otherwise harass him thereby increasing the litigation costs.

Generally, one who contracts with a corporation must look to it alone for performance of contracts and, absent certain limited exceptions, shareholders and officers are not liable for any of the obligations of the corporation. The corporation is an entity distinct from its shareholders, officers and directors, and its debts are not debts of the shareholders, officers, or directors. In re Bailey, 112 B.R. 449, 450-451, (Bankr. M.D. Fla. 1990). It is well-settled in this Judicial District, however, that an officer, director, or shareholder of a corporation will not be shielded by the corporate form from liability for a tort, including fraud, in which he himself is involved. In re Seaborne, 106 B.R. 711 (Bankr. M.D. Fla. 1989), In re Gitelman, 74 B.R. 492 (Bankr. S.D. Fla. 1987), McMillan v. Firestone, (In re Firestone), 26 B.R. 706 (Bankr. S.D. Fla. 1982). Nevertheless, merely being an officer or agent of a corporation does not render one personally liable for a tortious act of a corporation. Specific direction or sanctions of, or participation or cooperation in, a possibly wrongful act of commission or omission, which operates to the injury or prejudice of the complaining party, is necessary to generate individual liability and damages of an officer or agent of a corporation for the tort of the corporation. See Seaborne, supra at 715, citing Lobato v. Pay Less Drug Stores, Inc., 261 F.2d 406, 408 (10th Cir. 1958) and Firestone, supra., at 714.

Although the court has expressly found that Mr. Ross has not committed acts or otherwise engaged in conduct which would trigger a nondischargeable judgment against him under 11 U.S.C. §523(a)(2)(A) and (B), the court nevertheless finds and concludes, considering a totality of the particular facts and circumstances and applicable law, that the position of Lucky was sufficiently justified in filing this adversary proceeding, notwithstanding the subsequent denial of the complaint. Such an award against Lucky under the particular circumstances would be unjust.

ORDER AND NOTICE

Based on the foregoing,

IT IS ORDERED AND NOTICE IS HEREBY GIVEN THAT:

1. The above-referenced second amended complaint filed by the plaintiff, Lucky Fashions, S.p.A., against the defendant, Donald H. Ross, Jr., is hereby denied.

2. The request made by the defendant, Donald H. Ross, Jr., seeking to assess attorney's fees and costs against the plaintiff, Lucky Fashions, S.p.A., is hereby denied.

BY THE COURT

____

DAVID S. KENNEDY
CHIEF UNITED STATES BANKRUPTCY JUDGE

DATE: July 13, 1992

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