SO ORDERED.

SIGNED this 24 day of May, 2006.

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS

In Re:	
JAMES ARTHUR OTTE, **ROSANN GAY OTTE,**	**CASE NO. 03-23696-7** **CHAPTER 7**
DEBTORS.	
SUNFLOWER BANK, N.A.,	
PLAINTIFF,	
v.	**ADV. NO. 04-6007**
JAMES ARTHUR OTTE,	
DEFENDANT.	

OPINION CONCLUDING DEBTOR'S OBLIGATION TO

SUNFLOWER BANK IS DISCHARGEABLE

This proceeding is before the Court for decision following a bench trial. Plaintiff Sunflower Bank, N.A. ("Bank"), appeared by counsel Terry D. Criss. Defendant-debtor James Arthur Otte ("Debtor") appeared by counsel Carl R. Clark. The Court has heard the evidence and considered the parties' arguments, and is now ready to rule.

The Debtor was the majority shareholder and president of a company that supplied chemicals to farmers. The Bank provided the business with several types of financing that were secured by the company's assets, including its chemical inventory, and also by the Debtor's personal guaranty. The company supplied regular reports to the Bank of the amount of chemicals it had in its inventory and the debts it owed to its chemical suppliers. The Debtor signed most of the reports on the company's behalf. The business defaulted on its debt to the Bank, and the Bank obtained the appointment of a special master and then a receiver to take over the company. Eventually, the receiver decided that many of the company's chemicals were mislabeled, contaminated, diluted, or otherwise not worth their reported cost, and he was able to sell only small portions of the chemical inventory at a fraction of the prices the company paid for them.

After the Debtor filed a personal Chapter 7 bankruptcy and the normal deadline for objecting to the dischargeability of any of his debts had passed, the Bank filed a complaint seeking to have his obligation on the guaranty determined to be nondischargeable under 11 U.S.C.A. § 523(a)(2)(B) and (4).[1] The Bank contended that

[1]The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat 23, was enacted April 20, 2005, and mostly took effect on October 17, 2005. The Act did not amend § 523(a)(2)(B) or (a)(4) of the Bankruptcy Code, though, nor did it amend any other Code

the Debtor had fraudulently reported his company's inventory and that his fraud had prevented the Bank from filing its complaint timely. During the trial, the Court ruled the debt was not one for fraud or defalcation while acting in a fiduciary capacity that would be excepted from discharge by § 523(a)(4). After further considering all the evidence, the Court now concludes the Bank has not been able to establish that the debt should be excepted from discharge under § 523(a)(2)(B) as a debt for an extension of credit obtained by the use of false written statements about the financial condition of an insider of the Debtor. That means the Debtor's obligation to the Bank is not excepted from his discharge based on the merits of the Bank's claims, so the Court concludes it need not determine whether the Bank's complaint should be denied on the procedural ground that it was filed too late.

FACTS

A. Background

In about 1995, the Debtor became the majority shareholder and president of a Kansas company called Sunflower Services, Inc. ("Company"),[2] that maintained an inventory of herbicides, pesticides, and fertilizers for sale to farmers, as well as a small supply of lawn and garden chemicals. The Company also provided the service of spraying the chemicals on its customers' fields. The Company's main facility was on a

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provision involved in this case in any way that could affect the outcome.

[2]Although the word "Sunflower" appeared in both their names, the only relationship between the Bank and the Company was as creditor and debtor.

13-acre tract at Herington. It also had smaller facilities at Alta Vista and Burdick. At least as early as 1998, the Company borrowed money from the Bank. In January 2001, the Debtor signed a guaranty of the Company's debt to the Bank. The last advance the Bank made to the Company was sometime in 2002.

By September 2002, the Company was in default on some of its loans from the Bank. In June 2003, the Company owed the Bank more than $1.29 million on a revolving note that was mainly secured by the Company's inventory. All told, the Company owed the Bank about $1.89 million, secured by real estate mortgages and liens on virtually all of the Company's personal property, including the inventory.

From at least May 1998 through June 2003, the Company submitted to the Bank regular reports, known as" borrowing base certificates," concerning its inventory of chemicals and fertilizer. The Bank used these certificates to determine whether the Company had enough inventory to provide adequate security for its debts to the Bank. For each certificate, the Company was to tell the Bank how much inventory it had on hand, what the inventory had cost, what the Company owed to the distributors who had supplied the inventory, and what portion of the inventory, if any, had become unusable. The Bank wanted to limit its lending to no more than 60% of the cost of the usable inventory minus amounts owed to the suppliers of the chemicals. Before the Company defaulted on its debts to the Bank, it submitted a new certificate every month. The Debtor testified that before default, the usual arrangement was that other owners of the Company prepared the certificates and he signed them. It was not made clear, but he may have

participated to a greater extent in preparing the certificates after the Company defaulted. In any case, he continued to be the person who usually signed them for the Company.

The last certificate submitted to the Bank was dated June 13, 2003, and reported total inventory of $2.998 million and net inventory (total inventory minus amounts owed to distributors who supplied it) of $2.166 million. For the three and a half years between January 2000 and June 13, 2003, the Company's reported total inventory was usually between $2.75 and $3.75 million, while its net inventory was usually between $2 and $3 million. The loan balance shown on the June 13, 2003, certificate was just over $1.29 million.

After default, the Bank reassigned supervision of the Company's debts to a "special asset" manager named Kent Anderson, in September 2002. Anderson was the only person associated with the Bank who testified. He monitored the borrowing base certificates for compliance with the Company's inventory lending limit. Anderson went to the Company's premises three times between September 2002 and June 2003 to check on the inventory himself. He said the operation seemed to be busy when he was there, with lots of employees and customers. The Debtor testified that he helped Anderson with his inspections. Anderson found at most minor discrepancies in the amounts of chemicals the Company had reported having.

Around the start of 2003, the Company began submitting borrowing base certificates more or less every week. The Debtor testified that the Company continued to do a physical check of its inventory just once a month, and used its records of inventory

sales and purchases to calculate what to report on the intervening certificates. Near the end of March in 2003, the Bank had the Company start supplying daily reports of its inventory sales. Anderson used these reports to make sure the level of inventory the Company had on hand was not going down.

In late June or early July 2003, the Bank sued the Company to try to collect its debts. The Bank got a special master appointed who took over supervision of the Company's premises on July 16, 2003. Anderson testified that the Debtor had always been very cooperative before the Bank filed the lawsuit. The Debtor said he remained on the premises to answer questions for the special master. On August 21, 2003, the special master was replaced by a receiver, Bill Ellis ("Receiver"), who thereafter excluded the Debtor from the Company's premises. For over 25 years, the Receiver had managed cooperatives that dealt with chemicals and fertilizers. The Receiver said the Company's business essentially shut down when the special master was appointed, with very few sales of inventory occurring, if any. No retail sales occurred at all after the Receiver took over. He tried to collect the Company's accounts receivable, but indicated he was only able to collect about $15,000 from $360,000 worth of receivables. Initially, he was not authorized to sell anything, but later was given that authority and did sell some of the inventory.

The Receiver had itemized the Company's inventory for the special master a couple of weeks before being appointed as receiver. To determine the value of the products in the inventory, he relied on the most recent invoices he could find in the

Company's records and also contacted suppliers to obtain current prices from them. Once he was appointed receiver, he understood that he was to try to make sure the inventory stayed intact, and begin making efforts to liquidate the business. The Receiver indicated that some of the storage tanks at the Company's facility had their contents written on them, but also said the Company's employees had to tell him what products were contained in many others. Apparently, except for those labeled with their contents, he never saw any written records that would confirm which products were stored in which tanks.

B. The Bank's Attack on the Borrowing Base Certificates

At trial, the Bank asserted that the borrowing base certificates it relied on to determine how much to lend the Company contained false information. It presented evidence concerning five different categories of inventory for which it believed the quantities and cost values were falsely stated on the certificates. Those categories were: (1) dry lime, (2) ammonium thiosulate, (3) railroad car residue, (4) herbicides and pesticides, and (5) fertilizers. The first, second, and fifth items were included in the Company's reported fertilizer inventory; the complete fertilizer inventory included on the last certificate was reported to have cost just over $2 million. The railcar residue was reported on the last certificate as a fertilizer separate from the rest, valued at about $350,000. The herbicides and pesticides were reported as part of the chemical inventory; the complete chemical inventory was reported to have cost about $630,000.

1. Dry Lime

In the original inventory he prepared for the special master, the Receiver indicated the Company had 30,197 tons of dry lime[3]; in a report he wrote about the same time, he remarked that the quantity of lime was difficult to determine accurately because it was in piles of varying heights and shapes. Relying on price sheets he obtained from a couple of businesses, he valued the lime at $16.23 per ton, for a total of about $490,000. The Receiver emphasized he had never worked with lime before being appointed receiver for the Company and personally had no idea what it might be worth. He made efforts to sell the lime, but ultimately was unable to sell any of it and concluded it was worthless. He indicated he learned that buyers could get lime delivered to them by the business that had supplied it to the Company for the amount that it would have cost just to haul the Company's lime to them, so they were not willing to pay him anything for it.

The Court notes that from the end of 2000 until April 30, 2003, according to the information on the certificates, neither the quantity nor the cost of the Company's stock of dry lime ever fluctuated; the Company continually reported that its fertilizer inventory included 40,000 tons[4] of lime, valued at $20 per ton, for a total value of $800,000. In May 2003, the lime inventory was reduced by 500 tons and had a reported value of $790,000. The last certificate introduced into evidence, dated June 13, 2003, still listed

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[3]In one of his reports to the state court, the Receiver said 7,430 tons of lime were at Herington, and 22,767 tons were located at Junction City, a place where the Company had no facility. Of the Company's three facilities, the one at Alta Vista would appear to have been the closest to Junction City, so the Receiver may have meant the bulk of the lime was located there.

[4]Though the certificates did not specify the size of the units, comparing the Company's figures with the Receiver's makes clear the Company was reporting the number of tons it had.

$790,000 worth of lime. There was no indication that this product was not what the Company had reported it to be, and the Receiver's lament that the quantity was hard to determine accurately undoubtedly explains much of the 9,300 ton difference between his report of the amount of lime the Company had and the last quantity the Company reported. The difference between the $20 per ton value the Company reported and the $16.23 per ton value the Receiver initially used for the lime (a decline of about 18%) suggests the market price dropped substantially sometime after the Company bought its lime inventory. The Receiver's testimony also suggested that the Company's supplier started to sell lime directly to farmers after the Company was closed down. The combination of these events appears to be what caused the Company's lime to become essentially worthless for the Receiver's purposes. In any event, the Court was not convinced that the Company's reports of the quantity and cost of its dry lime were false.

The Court notes the Bank never suggested at trial that the lime should have been reported on the certificates as "out-of-date and otherwise unusable inventory." The Bank never suggested that the quantity of the lime was misrepresented or that its cost was misstated on the certificates. The trial testimony focused only on the fact the Receiver could not find a market for it. Anderson said the Company was supposed to report on the certificates what the various products in its inventory had cost, not their current market values, and that he was supplied materials to help him ensure the Company met that obligation. No evidence suggested the lime had not cost the Company the $790,000 reported on the certificates. In the end, it appears most of the value of the lime was lost

because the Receiver could not find a market for it, not because the product was not really in the Company's inventory or the product the Company had was actually something other than dry lime.

2. Ammonium Thiosulfate Contamination

Sometime around March 2003, the Debtor told Anderson that a product stored in a million-gallon tank had become contaminated because a valve separating it from an adjoining tank had been improperly installed. The Debtor also told Anderson that he planned to mix another product with the contaminated one in an effort to salvage as much of it as he could. This contamination was the only thing that caused Anderson any concern about the Company's inventory before the spring of 2003. He testified his memory was that the contamination had affected several hundreds of thousands of dollars worth of inventory.

The Receiver testified that a valve between two storage tanks was installed incorrectly by a third party so that it was closed when the lever handle was in line with the pipes between the tanks and open when the handle was perpendicular to them; this is the opposite of the standard operation of such a valve. Because the valve was open instead of closed, two products — ammonium thiosulfate solution[5] and ammonium sulfide solution — got mixed together in the million-gallon tank. The resulting mixture had little or no commercial value, and also contained dangerous levels of hydrogen

[5]In testimony, the Receiver called the product "thiosul," and in written reports he and others prepared, it was variously referred to as "thiosul," "12-0-0-26," and "ammonium thiosulfate." The Company's certificates appear to have reported the product as "12-0-0-26."

sulfide. The Receiver's original inventory had reported the Company had 1,330 tons of ammonium thiosulfate, but he later revised that to 1,103 tons because he learned the formula he had first used to calculate how much was in the million-gallon tank based on the measured height of the level of the liquid in it was wrong. He originally listed the value of the ammonium thiosulfate as $100 per ton, but later concluded it was worthless as a result of the contamination. The Receiver also said he was told that the Company's employees had spent time moving some of the contaminated product from the million-gallon tank to another location, although he did not say when it was moved, how much was moved, where it was moved, or what became of it.

The Company's last borrowing base certificate, dated June 13, 2003, reported that it had 2,990 tons of a fertilizer product identified by one of the names the Receiver used for ammonium thiosulfate. The certificate reported the value to be $100 per ton, or $299,000 total. It appears that most, if not all, of the Company's inventory of this product was stored in the tank that became contaminated. The Court concludes that once the Debtor reported the contamination of the million-gallon tank to Anderson, who understood the problem to involve hundreds of thousands of dollars worth of the Company's inventory, the Bank knew (or should have known) that it could no longer rely on this product as protecting its position on its loans to the Company. At most, the Bank could hope the Debtor's plan to salvage some of the product might succeed. None of the evidence presented suggested that the plan recovered any of the product's value.

The Court believes the information reported on the Company's borrowing base

certificates about the ammonium thiosulfate has been shown more likely than not to have been false, once the contamination occurred. Even after the product was contaminated, the Company continued to include it on the certificates in the "total inventory of fertilizer & chemicals" category, but failed to report it in the "out-of-date and otherwise unusable inventory" category, and failed to deduct its cost from the "net eligible inventory" category. However, Anderson testified that the Debtor informed him of the contamination and that he knew hundreds of thousands of dollars worth of inventory was involved, so in March 2003, the Bank was made aware that part of the inventory could not be counted on to provide much or any value to protect its position. There was no evidence showing when the valve was incorrectly installed, or suggesting the Debtor failed to report the contamination to Anderson as soon as he became aware of it. Likewise, nothing presented indicated the Debtor knew before the Receiver did that the contaminated product would turn out to be worthless. Both the Receiver and Anderson indicated the loss was caused by another company's improper installation of a valve between two of the Company's storage tanks, and the worthlessness of the resulting solution. The contamination of the ammonium thiosulfate caused a loss of inventory value that had nothing to do with any false reporting on the certificates. Because nothing indicated the contamination occurred any time before the Bank learned of the situation, the Bank could not have relied to its detriment on the representations that the ammonium thiosulfate continued to be viable inventory after it was contaminated.

3. Railcar Residue

In April 2003, the Company took on a job cleaning out railcars that contained a residue of molasses or some other substance. The Company planned to sell as fertilizer the mixture of water and the substance that the cleaning would produce, and it included a value for this material on its borrowing base certificates. Anderson disagreed, however, with the value the Company was reporting. He understood the Debtor was using a retail sales value, and thought some sort of cost value should be used instead. Anderson wrote adjustments on some of the certificates and then directed the Company to report the railcar inventory separately after that. It is clear the Bank did not rely to its detriment on any inaccurate statements in the certificates about the railcar residue.

4. Herbicides and Pesticides

Early on, the Receiver believed that he had to get the Company's herbicide and pesticide chemicals analyzed in order to be able to sell them. At the end of September 2003, with help from a company called United Suppliers that dealt with agricultural chemicals on a regular basis, he took samples of a variety of the herbicides and pesticides in the Company's inventory and sent them to Continental Analytical Services, Inc., asking for an analysis to determine whether each sample contained the brand-name product he thought it did. There was no testimony explaining how the samples were collected. Most of the sampled chemicals were liquid solutions, and the Receiver did not indicate whether they agitated the products in the containers to mix them up or did anything else to make sure the samples taken were representative of the solutions' contents. The Receiver got a report from Continental the next month, on October 21, but

did not understand it, so he sent it on to United Suppliers and asked it to interpret the report for him, which the company did. He ultimately came to understand that the tests indicated the samples he had submitted generally contained little or none of the active ingredients they should have if they were the products he thought they were.

An employee of Continental, Gregory Groene, testified about his company's analysis of the chemical samples the Receiver sent to it. He explained that his company tested only for the active ingredients that should have been in the samples if they were the brand-name products the Receiver understood them to be. The Receiver took eight samples to Continental, seven liquids and one solid, all identified by a brand name. The solid sample and one of the liquid samples were identified by the same brand name, so they were apparently the same product in different forms. One of the samples contained a significant percentage of one of the two active ingredients tested for, but otherwise, the samples all contained much smaller percentages of the active ingredients than they should have if they were the products the Receiver told Continental he thought they were. Continental could have run tests looking for other active ingredients if the Receiver had asked it to, but testing for unknown ingredients would have involved a costly process of elimination. Continental sent its report to the Receiver, but so far as Groene knew, no one with the company ever told the Receiver in laymen's terms that the products he brought in were not what he thought they were. Groene conceded that the active ingredients in the liquid products might separate from the solution they were in if they sat in storage for a time, and that a well-mixed sample would probably be more

representative of the overall contents of the solution.

The Court's evaluation of the Bank's exhibits indicates that the cost reported on the Company's last certificate of the inventory represented by the seven different products the Receiver asked Continental to test was about $418,000, two-thirds of the cost of all the chemicals reported. The Court gleaned from the testimony that the volume of these products was not very large, so a thief might have made off with significant portions of them in a relatively short time in fairly small tanks.

The Bank is asking the Court to believe that on September 29, 2003, when the samples were taken, the materials on the Company's premises contained practically none of the chemicals reported on the borrowing base certificates. The Bank further suggests this was true not only on August 21, 2003, when the Receiver took over and barred the Debtor from the premises, and on July 16th when the special master was appointed, but also on June 13th when the Company's last certificate was submitted. Two facts cause the Court to find it probable that at least some of the reported inventory was on the premises until the Company's business was shut down. First, Anderson testified that when he was on the premises doing inspections, there were lots of customers and employees present and the place was busy. Second, in response to the Court's question, the Receiver said that while he heard some unsubstantiated rumors about problems with the quality of the products the Company had sold, no one ever actually complained directly to him about the quality of anything they bought from the Company. The fact he did not get such complaints from the Company's customers when he tried to collect its

accounts receivable from them suggests that while the Company remained in business, the products it sold were effective. If there had been general customer dissatisfaction with the Company's products or services, the Bank could have presented testimony to demonstrate this. Likewise, if the inventory on hand, as suggested by the test results, truly contained no sellable products, the Bank would have been able to develop more convincing evidence to establish this fact.

5. Fertilizers

The Receiver said that in early December of 2003, he was talking to some of the Company's former owners and employees, and they suggested that the products in the fertilizer inventory might not be what he thought they were. That was the first time the Receiver thought there might be a problem with the fertilizer. A few days later, the Receiver and one of the former owners of the Company took samples of agricultural fertilizer products, and another former owner delivered the samples to Kansas State University's soil testing laboratory. The Receiver did not indicate how the samples were taken, or whether any effort was made to agitate the products before taking them. He did not describe what steps, if any, he took to prevent tampering with the samples before they arrived at KSU, or explain why these former co-owners of the Company should be considered more trustworthy than the Debtor.

An employee of the KSU lab, Gary Griffith, testified about the lab's tests on the fertilizer samples that the Receiver sent. The first group delivered consisted of thirteen samples of farm fertilizers that were received at the lab on December 11, 2003. They

were tested for nitrogen, phosphorus, and potassium.

Griffith thought all the samples the KSU lab tested were liquids. He was asked some questions about whether the substances his lab tested for could settle out to different levels in solutions if they sat for extended periods of time, and he said they would not normally do so in a fertilizer if the period of time was a few weeks or even two months. Then he was asked, "Will hot temperature increase potential separation or slow it down?" and he answered, "Normally lower temperature is a problem with fertilizer so the high temperature can either cause a reaction or if in some way it promoted rapid evaporation."[6] Since the Receiver testified that the Company's inventory sat unused from mid-July until he took the first fertilizer samples almost five months later, and he took the samples in December, a time by which Kansas has nearly always had some freezing temperatures, Griffith's testimony suggests the fertilizer solutions might have suffered some separating before the Receiver took the samples.

Unlike Groene's testimony about Continental's testing of herbicides and pesticides, Griffith did not indicate the KSU lab tried to determine whether the samples contained the ingredients a particular brand-name product should have in it. He did not try to determine what any product was to be used for. Instead, he testified the lab analyzed the first thirteen samples only to determine how much of three specific nutrients, nitrogen, phosphorus, and potassium, each of them contained. He did not indicate

[6]Transcript of trial held August 17, 2005, Dkt. # 52, at 153.

whether the results of the KSU testing were consistent with any specific products. Rather, it was the Receiver who tried to explain what the test results meant in relation to the borrowing base certificates.

The Receiver testified that only two of the thirteen samples of farm fertilizers had any value. However, a review of his testimony reveals that he was unsure what the test results meant with regard to five of the thirteen products tested. He said he thought another four of the products and probably a fifth were not useful as fertilizer. Of the remaining three products, he was able to sell two and the third, according to the testing, was what he believed it to be.

The Debtor objected to the Receiver’s interpretation of the KSU report, and the Court sustained the objection because (1) the Receiver did not conduct the tests, (2) his testimony was vague at best, and (3) in many instances, he said he did not know what something meant, or he was otherwise not able to interpret the report. Since Griffith did not attempt to interpret the report beyond what the test results showed, there is no evidence in the record to support the Bank’s contention that the borrowing base certificates contained false information about the agricultural fertilizers. Further, even if the Receiver’s testimony were considered, his uncertainty, coupled with the lack of testimony about how the samples were taken, rendered the evidence insufficient to convince the Court the Bank had met its burden to prove the certificates falsely reported the Company’s inventory of agricultural fertilizers.

On January 20, 2004, about a month after the Receiver sent the first fertilizer

samples, he sent samples of twenty-one lawn-and-garden fertilizer products to KSU for analysis. The Company had bought these products from third-party suppliers in small packages suitable for retail sale. The KSU lab tested them for the same three nutrients as the first group and also for eight micro-nutrients The Receiver said the lawn chemicals tested to be what he expected them to be, but that he had no luck selling them anyway. No testimony was offered to show that statements on the borrowing base certificates about the quantity or the cost of these chemicals were false.

C. Alternative Explanations for the Inventory Problems that Do Not Involve Fraud by the Debtor

The evidence included specific facts and additional suggestions besides the Debtor's alleged fraud that could explain the apparent conflicts between the information reported on the borrowing base certificates and the Receiver's experiences with substantial portions of the Company's inventory. The Company's last certificate reported it had just under $3 million in inventory (before deducting amounts owed to suppliers), so the ammonium thiosulfate ($299,000) and dry lime ($790,000) problems discussed above explained the loss of over one-third of the value the Company reported in June 2003. Those problems did not involve any fraud by the Debtor. Beyond that, the Debtor suggested a variety of possible explanations for the other problems the Receiver experienced with the Company's inventory, including: (1) disgruntled former employees, former owners, or others with access to the facility might have made off with products and, to hide the theft, diluted what remained in the affected tanks with water; (2) the rinse

water or rainwater run off stored at the facility might not have been tracked accurately; (3) the Receiver might have been misinformed, either inadvertently or deliberately, by Company owners or employees other than the Debtor about what products were contained in many of the unlabeled tanks; and (4) the product samples submitted for testing might have been unrepresentative, either because the solutions were not well-mixed, or because some of the samples were mishandled or tampered with, either negligently or deliberately, by one of the Company's co-owners who helped the Receiver with them.

1. Access to the Storage Facilities for Former Employees, Former Owners, and Others

When he was appointed, the Receiver changed all the locks on the five buildings and two gates at the Company's Herington facility. The fact he did this then indicates the special master did not take similar precautions when he was appointed five weeks earlier. In fact, no evidence was presented to show that the special master took any steps to prevent anyone from stealing or tampering with the inventory.

The Receiver also made other efforts to protect the inventory. He would stay at the facility from 8:00 a.m. to 5:00 p.m, Monday through Friday. He watched for signs of tampering with the inventory, including, several times a week, checking the levels of liquids in tanks and going into the buildings to look at the inventory stored there. He did admit, though, that just looking at the level of the liquid in a tank would not tell him whether the tank contained a chemical product or just water. An ungated dirt path provided vehicle access to the premises, but he watched it for tire tracks and assumed a neighboring farmer would have alerted him if someone went in that way. He sometimes

left the facility in the evening and drove several miles away before returning again to make sure no one was sneaking onto the premises to steal or tamper with anything. A few times, he returned to the facility at 8:00 or 9:00 at night to check on it. He said that he felt these activities were just part his job as receiver, and that he did not do them because he was suspicious that anything improper was happening. The Receiver testified he never saw signs or received any reports indicating that anyone ever stole or tampered with any of the Company's inventory after he took over the premises.

On the other hand, the Receiver gave a number of people keys so they could have access to the facility. He rented a one-million-gallon storage tank[7] to a company that used it for ammonium chloride, and gave that company's employees keys to one gate, one building, and the storage tank. He also gave keys to (1) an adjacent business owner who had no other way to access his own property, (2) the local fire department in case of emergency, and (3) a former employee of the Company whom he hired to haul away rain water that had to be contained on the premises because of the chemicals stored there. Clearly, a number of people had access to the facility and could have taken some of the liquid inventory from any of the storage tanks without alerting the Receiver to their actions so long as they added water to restore the level of liquid in the tank. This would probably have been even easier to do during the five weeks when the special master was in charge of the Company's premises.

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[7]This was a different tank than the one that suffered the contamination problem.

The Debtor testified that on three occasions during the year before the Bank sued the Company, the Bank set off all the money in the Company's account, bouncing its payroll checks and, not surprisingly, upsetting its employees. He did not give more specific dates when the setoffs occurred, or indicate whether the employees ultimately received all the pay they had coming to them. In any event, receiving payroll checks that bounced might have been enough to motivate employees to make off with inventory after the Company was shut down, even if they had finally received all their wages. The Receiver testified that when he was appointed, one of the Company's former employees had a couple of pieces of its equipment, and refused for a time to return them, although he eventually did return at least one of the pieces. No evidence was presented to show that former employees or even former owners did not similarly take some of the Company's inventory.

The Court simply cannot rule out the possibility that substantial portions of the Company's inventory were stolen sometime after the special master was appointed on July 16, 2003, but before the Receiver had the samples taken more than two months later, on September 29. There were a number of people who would have been familiar with the property, and a variety of ways for any of them to access the storage facilities before the Receiver was appointed. Even after the Receiver took over, there was no on-site security other than his intermittent presence, and locked doors and gates to which a number of people had keys.

2. Rain and Rinse Water

The Debtor explained that due to EPA regulations, the Company had to be very careful to contain rainwater that fell on its property and to segregate in separate containers all the water used to rinse out the containers and tanks it used in selling and spraying chemicals on farmers' fields. Chemicals that were good to use on one crop might be deadly to another, so when the next job involved a switch to an incompatible crop, the rinse-water had to be retained until the Company got another job to spray a field of a crop that was compatible with that chemical. In addition, many chemicals came in two-and-a-half gallon jugs that had to be triple-rinsed before being discarded, and the rinse-water had to be retained. The chemical residues in all this water had to be tracked, and be sprayed later on a field that was compatible with that residue. To dispose of the rainwater, the Company would mix it with a product that was being sprayed on a field, using enough rainwater to dilute any residual chemicals the rainwater might have in it.

Groene testified that he did not know what concentrations of the herbicides and pesticides would be used when applying them to crops. Since the Company commonly sprayed the products it sold on its customers' fields, rather than supplying the products without applying them, the tested samples might have been ones the Company stored in its tanks already diluted to levels that could be applied directly to farmers' fields. With respect to the fertilizer tests, the Receiver conceded that some of the results were possibly consistent with rainwater from the Company's containment facility.

3. Misinformation about Contents of Storage Tanks

As indicated earlier, the Receiver testified that many of the Company's storage

tanks did not have labels to tell him what they contained, nor did he find any records that supplied that information. Instead, he could only rely on what former owners and former employees told him was in the unlabeled tanks. This makes mistaken identification of the contents a significant possibility, whether intentional or not. The further possibility exists that the samples which were tested came from containers that held rinse-water residue or rainwater runoff, rather than the chemicals the Receiver was told they contained.

4. Sample-gathering Deficiencies

As indicated in the discussion of the evidence about the herbicides, pesticides, and fertilizers, the Receiver did not explain how he went about taking the samples he sent off to be analyzed. The experts who testified about the test results both indicated settling and separation of the chemicals in liquid solutions could have occurred and could have skewed the results by making the samples unrepresentative of the solutions they were taken from. This raises the possibility the tests might have been misleading because of sample-gathering deficiencies.

D. Lack of Evidence of the Debtor's Participation in Any Fraudulent Activity

The Debtor testified that the information in all the borrowing base certificates was true to the best of his knowledge. He indicated that although he signed the certificates, most of them were actually prepared by other owners of the business, whom he trusted and believed could count the inventory as well as anyone. No one testified that the Debtor personally participated in diluting any of the products in the Company's inventory, or that he knew anyone else was diluting them. None of the evidence

suggested that the Debtor knew anything in any of the borrowing base certificates was false (except perhaps the failure to report the ammonium thiosulfate inventory in the unusable category after it became contaminated). Of course, such evidence is usually difficult to obtain, but if the Debtor participated in deliberately handling the inventory in ways that reduced $2 million of value (not counting the dry lime and ammonium thiosulfate inventory) to nearly nothing, it is likely some sort of proof of such activity could have been uncovered. In fact, even the Debtor's testimony that other owners of the Company were mainly in charge of handling and tracking the Company's inventory was not contradicted. This suggests the other owners were at least as likely as the Debtor to have created any false information that was reported to the Bank about the inventory.

E. The Bank's Delay in Filing Its Complaint

The Debtor and his wife filed their Chapter 7 petition on September 2, 2003, and the meeting of creditors required by § 341(a) of the Bankruptcy Code was first set for September 25. The Clerk's Office sent creditors a notice that told them when the meeting of creditors would be held, and advised them they had until November 24 to file a complaint objecting to the Debtor's discharge or to the dischargeability of any of his debts. The Bank did not ask for an extension of that deadline, but did not file its complaint objecting to the dischargeability of the Debtor's obligation to it until January 15, 2004. The Debtor contends the Bank's complaint should be denied because it was filed too late. The Bank responds that the Debtor's fraud remained hidden until after the deadline had passed, preventing it from discovering the grounds for its complaint in time

to meet the deadline. As indicated earlier, the Court concludes it need not resolve this procedural dispute since it is finding in favor of the Debtor on the merits of the Bank's complaint.

DISCUSSION

The Bank seeks to have the Debtor's obligation on his guaranty of the Company's debts to the Bank excepted from discharge under 11 U.S.C.A. § 523(a)(2)(B). As relevant here, that provision excepts from discharge a 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 . . . 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.

Exceptions to discharge are to be narrowly construed, and doubts are to be resolved in the debtor's favor because of bankruptcy's fresh start objective.[8] To succeed on its claim here, the Bank must prove each element under § 523(a)(2)(B) by a preponderance of the evidence.[9] This means the Bank had to convince the Court that it was more likely than not that: (1) the Company was an insider of the Debtor; (2) the borrowing base certificates were written statements about the Company's financial condition; (3) the

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[8] *Bellco First Fed. Credit Union v. Kaspar (In re Kaspar)*, 125 F.3d 1358, 1361 (10th Cir. 1997).

[9] *See Grogan v. Garner*, 498 U.S. 279, 286-87 (1991); *see also* 4 *Collier on Bankruptcy* ¶523.04 at 523-23 to -24 (Resnick & Sommer, eds.-in-chief, 15th ed. rev. 2005) .

certificates contained materially false information about the Company's inventory; (4) the debtor is liable to the Bank for credit extended, renewed, or refinanced in reliance on the certificates; (5) the Bank reasonably relied on the false information; and (6) the Debtor supplied the false information with the intent to deceive the Bank.

The Company certainly constituted an "insider" of the Debtor under the Bankruptcy Code's definition of that term.[10] The borrowing base certificates appear to qualify under § 523(a)(2)(B) as written statements concerning the Company's financial condition, and the Debtor has not argued otherwise. The first and second elements of the Bank's claim, then, were established. There is similarly no question that the Debtor is liable to the Bank on his personal guaranty of the Company's debts. Some facts lead the Court to question the extent to which the Bank relied on the certificates in extending credit to the Company, even though the Debtor did not seriously challenge the reliance element. These facts include the reports of exactly the same quantity and cost of the lime for over two years, the failure to indicate any inventory had ever gone out of date or become unusable, and Anderson's doubts about the value of the railcar residue inventory. Since the conclusions reached below are sufficient to defeat the Bank's claim, however, the Court will assume, without deciding, that the Bank actually relied on the certificates in extending credit.

The Court is convinced that the Bank has failed to prove the other elements of its

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[10]*See* 11 U.S.C.A. § 101(31)(A)(iv) (for individuals, "insider" includes "corporation of which the debtor is a director, officer, or person in control.")

claim. The only facet of the certificates that has been shown more likely than not to be false is the failure to indicate on them that the ammonium thiosulfate had become unusable as a result of the contamination. Even on this point, though, the Court is not convinced the Debtor knew before the Company was shut down that the contamination would turn out to be an unsolvable problem. The Receiver had to have the contaminated solution tested and communicate with one of the Company's suppliers in order to reach the conclusion it was worthless. In addition, the Debtor told Anderson about the problem and Anderson understood it affected several hundreds of thousands of dollars worth of the inventory, so it is unlikely that Anderson and the Bank continued to rely on the ammonium thiosulfate inventory as protection for its loans to the Company. In any event, continued reliance on the Company's supply of this product after Anderson was told of the contamination would not have been reasonable.

Certainly the Bank has established a possibility that some of the information reported on the certificates was false. The Debtor has established, however, that third parties had plenty of opportunities to dilute or steal the Company's inventory, and otherwise falsify the information. It is possible the information was true when the Debtor signed the certificates, and any dilution or misidentification of the inventory occurred after the special master and then the Receiver took control of the Company's assets. Even if much of the information was false when the Debtor signed the certificates, the Bank was not able to convince the Court that the Debtor was aware the information was false when he signed the certificates, or that he intended to deceive the Bank by supplying any

false information. Indeed, assuming the certificates were accurate at one time, the Bank failed to establish when it believes the certificates became sufficiently incorrect to be considered false.

It is even possible that the inventory testing the Receiver had done suggested problems with the inventory that did not exist. Perhaps the Receiver was misinformed about what products unlabeled tanks contained, so many of the tests were looking for the wrong active ingredients. Perhaps due to settling or separation, the chemical samples were not representative of the solutions from which they were taken.

CONCLUSION

For these reasons, the Court concludes that the Bank has failed to meet its burden of proving by a preponderance of the evidence that (1) the Debtor supplied false information on the borrowing base certificates, (2) the Bank reasonably relied on false information that the Debtor supplied, and (3) the Debtor supplied the false information with the intent to deceive the Bank about the Company's financial condition. The Debtor's obligation on his guaranty of the Company's debts to the Bank is therefore dischargeable. This conclusion moots the Debtor's argument that the Bank's complaint should be denied because it was filed too late.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based on this ruling will be entered on a separate

document as required by FRBP 9021 and FRCP 58.

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