UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of	:	
	:	
JAMES D. FOUST,	:	Case No. 88-0795-C
	:	Chapter 7
Debtor.	:	
	:	
THE UNITED STATES OF AMERICA,	:	
	:	Adv. No. 88-0193
Plaintiff,	:	
	:	
v.	:	
	:	
JAMES D. FOUST,	:	
	:	
Defendant.	:	
_____	:	
	:	
JOHN F. FOUST,	:	Case No. 88-1580-C H
	:	Chapter 7
Debtor.	:	
	:	
THE UNITED STATES OF AMERICA,	:	
	:	Adv. No. 88-0221
Plaintiff,	:	
	:	
v.	:	
	:	
John F. Foust,	:	
	:	
Defendant.	:	
	:	

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ORDER--TRIAL ON COMPLAINT TO DETERMINE DISCHARGEABILITY OF DEBT

A trial was held from July 31, 1989 through August 4, 1989, and from November 20, 1989 through November 21, 1989, on the complaints to determine dischargeability of debts. The following attorneys appeared on behalf of their respective clients: Kevin R. Query, Assistant U.S. Attorney for the United States of America on behalf of the Farmers Home

Administration (hereinafter "FmHA") and the Small Business Administration (hereinafter "SBA"); Louis M. Fusco for James D. Foust; and Clarence A. Stennes for John F. Foust. The two adversary proceedings were consolidated for trial by order filed on April 17, 1989. At the conclusion of said trial, the Court took the matters under advisement upon a briefing schedule. Briefs were timely filed and the Court considers the matters fully submitted.

These are core proceeding pursuant to 28 U.S.C. §157(b)(2)(I). The Court, upon review of the pleadings, evidence admitted, arguments of counsel, and briefs, now enters its findings of fact and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. James Foust filed a voluntary Chapter 7 petition on April 13, 1988.

2. John Foust filed a Chapter 12 petition on July 22, 1988. This case was converted to a Chapter 7 on December 29, 1988.

3. FmHA and SBA are agencies of the United States government which, in part, administer farm loan programs for eligible farm operators.

4. James and John Foust are brothers.

5. John Foust is a certified public accountant and a

farmer. At all times material herein he was also the Vice President of Financial Affairs and Chief Financial Officer for the University of Osteopathic Medicine, Des Moines, Iowa. John is also an occasional part time law student. He handled the financing of the joint operations with James.

6. James Foust lived in Warren County, maintained the farms, and handled the day-to-day operations. James was also a trucker and ran the trucking operation.

7. SBA filed a claim against James Foust and John Foust in the principal sum of $49,645.53. These claims arose from an emergency disaster loan to Foust Brothers Farms, Inc. on July 31, 1984. James and John Foust executed the promissory note evidencing the disaster loans as officers of said corporation. They also executed a personal guarantee of the corporate indebtedness on the same date.

8. FmHA filed a claim against James Foust in the sum of $48,700.00 and against John Foust in the sum of $56,505.35. These claims arose from a disaster loan of June 24, 1985, to Foust Brothers Farms, Inc., c/o John and James Foust. John and James executed the promissory note evidencing the disaster loans as officers of said corporation. They each executed a financing statement individually as debtors.

9. On September 9, 1988, a complaint, in two counts, was filed against James Foust praying that judgment be entered excepting the claims of SBA and FmHA from discharge under 11

U.S.C. §523(a)(6). At the close of trial the government was permitted to amend the complaint to add the additional claims under 11 U.S.C. §523(a)(2) for each count.

10. On October 18, 1988, a complaint, in three counts, was filed against John Foust praying that judgment be entered excepting the claims of SBA and FmHA from discharge under 11 U.S.C. §523(a)(6). At the close of trial the government was also permitted to amend this complaint to add the additional claims under 11 U.S.C. §523(a)(2) for each count.

11. Both complaints alleged James and John Foust owned and operated Foust Brothers Farms, Inc.; SBA and FmHA gave Foust Brothers Farms, Inc. emergency disaster loans; James and John Foust were the sole officers of said corporations; and James and John Foust are each personally liable for the debts of said corporation.

12. John and James Foust have conducted farming operations in Southern Iowa under a variety of business names. John Foust incorporated the following corporations by filing Articles of Incorporation with the Secretary of State on the corresponding dates:

Foust Brothers Farms, Inc.	2/6/75
Foust Brothers Leasing Co.	1977
Wind River Corporation	1/4/80
Ag-Land Investments, Limited	1/5/83
Southern Cross, Incorporated	1/5/83
Blackhorse Corporation	1/5/83
Butte Corporation	11/2/83
Bend Corporation	11/2/83
Williston Corporation	11/2/83
Ranger Corporation of U.S.	11/2/83
Savannah Corporation	11/2/83

Thunderhawk Limited	11/2/83
Teton Corporation	11/2/83
XIT, Inc.	9/18/84
Cheyenne River Corporation	2/22/85
Mesa Corporation	4/11/86
Cathedral Corporation	4/11/86
Agrivest Corporation	1/9/87
Senora Corporation	1/9/87
West Texas Corp.	1/9/87

13. As incorporated, John and James were the only officers, directors, and stockholders of the above corporations. Except for one short-term, full-time employee, and occasional part-time employees, these corporations had no other employees. These employees were paid by John and James personally.

14. Foust Brothers Farms, Inc. is an Iowa corporation with John and James Foust as the sole shareholders, officers and directors. (Exh. G-1). This corporation operated land leased from other entities owned and controlled by John and James and did not own real estate.

15. Bylaws adopted by Foust Brothers Farms, Inc. stated that its goal was to increase its farming operation to at least 1,000 acres by 1985 and to at least 2000 acres by 1995. (Exh. G-2).

16. Foust Bros. Leasing Co. was a leasing company with John Foust as the sole stockholder, officer and director. Its purpose was to lease equipment to Foust Brothers Farms, Inc. (Exh. EE).

17. Southern Cross, Inc. was incorporated by John Foust.

John F. Foust was the sole stockholder, officer and director. (Exh. L). It was incorporated as a trucking company for the hauling of grain and fertilizer and owned several truck-tractors and trailers. James later acquired the majority of stock and became president of this corporation with John as vice president. Southern Cross filed a Chapter 12 bankruptcy petition on January 6, 1988. This case was filed by John and dismissed on May 3, 1988, for failure to file a plan of reorganization and appear before the court through legal counsel.

18. Ranger Corporation of U.S. was incorporated by John with "Frank Foust" (John) as the sole stockholder and director. (Exh. Q). Ranger Corporation held a bonded grain dealers license from the Iowa State Commerce Commission which was issued on 5/3/84. (Exh. LLL-2). This enabled the corporation to market the grain through major grain companies and terminals thereby avoiding marketing of grain through local elevators. John set up Ranger Corp. to market grain produced by Foust Brothers Farms, Inc. and he never intended on establishing a separate bank account for this corporation. Ranger Corporation, from the time it made reports to the Iowa State Commerce Commission from April 30, 1985 to March 2, 1986, reported that it did not purchase any grain from any source during this time period. (Exh. LLL-4). However, Ranger Corporation did receive income during this period.

Expenses incurred by Ranger Corporation were paid by Foust Brothers Farms, Inc. (Exh. LLL-3).

19. John drafted the Declaration of Trust for Franklin Trust and signed it on October 31, 1983. (Exh. Z). This agreement was between John F. Foust as Trustee, and John F. Foust as Trustor. John, as Trustor, assigned and transferred 90 shares of Teton Corporation stock to John, as Trustee. This stock was to be held in trust for Brian John Foust and Michael Franklin Foust, minor children of John and Mary Foust. The trust provided, in part, that it was irrevokable and no part of the principal or income could ever revert to or be used for the benefit of John, as Trustee, or be used to satisfy any legal obligations of John, as Trustor. This trust also contained a spendthrift provision. It authorized John, as Trustee, to continue any farming that John, as Trustor, was engaged in, but John, as Trustor, reserved the right to reside on, use, and manage any property that he transferred to the trust.

20. John, as Trustor, reserved the right to direct John, as Trustee, in connection with the retention, sale, lease, management, and control of any trust property. John, as Trustee, was also to make recommendations in writing to John, as Trustor, as to any investment action deemed advisable.

21. This declaration of trust for Franklin Trust was not filed for record until February 17, 1987.

22. Bend Corporation was incorporated by John. "Frank Foust" (John) was originally the sole stockholder, officer and director (Exh. O). Bend originally owned 160 acres of farmland in Clarke County, but this real estate ceased to be an asset later on. James became vice president of the corporation and in 1986 acquired all the stock when John and James traded stock in different corporations. Bend became James's operating company.

23. On February 1, 1984, John made an application to SBA for a disaster loan for Foust Brothers Farms, Inc. (Exh. BBB-2). John requested a loan of $337,571.00 to mature in 30 years.

24. On June 6, 1984, John and James obtained a $200,000.00 line of credit at Valley National Bank. They entered into a security agreement with Valley National on the same date. They gave Valley a security interest in their inventory, accounts, general intangibles, equipment, farm products, fixtures on real estate, and a $250,000.00 life insurance policy on the life of both debtors. The security agreement did not describe any real estate.

25. The Valley National Bank financing statement filed on June 18, 1984, did not list crops as security or provide any description of real estate.

26. On July 18, 1984, SBA approved a disaster loan to Foust Brothers Farms, Inc. in the amount of $52,300.00. (Exh.

BBB-8). The note was payable in 30 years with interest at 4 percent per annum with annual payments of $3,015.00 beginning July 1, 1985. John and James signed the note on 7/31/84 as President and Vice President, respectively, of Foust Brothers Farms, Inc. (Exh. A-2).

27. The SBA loan was collateralized by several mortgages, first, second, and third, and assignment of real estate contracts, all of which were owned by corporate entities controlled by John and James. John and James personally guaranteed the loan and executed statements of additional conditions to SBA in which they, as officers of Foust Brothers Farms, pledged to obtain and maintain crop insurance on 239 acres of corn and 40 acres of beans or substitute crop throughout the term of the disaster loan. They pledged to name SBA as loss payee for a minimum of 65% coverage on yield and Level 3 on price support.

28. John executed and signed a statement of intent to remain in his "current agricultural business through the next crop season" in consideration of the SBA approving the disaster loan on 2/1/84. (Exh. BBB-5).

29. From May until November, 1984, XIT Corporation, Teton Corporation, Bend Corporation, and Ag-Land Investments, Limited, acquired real estate contracts for the purchase of approximately 600 acres of farmland.

30. Cheyenne River Corporation was incorporated on

February 22, 1985, by John. "J. Frank Foust" was shown as the sole stockholder, officer and director. This corporation became another operating corporation for John, and did not own real estate.

31. Foust Brothers Farms obtained a disaster loan from FmHA on June 24, 1985. (Exh. B-2). John and James signed the promissory note for said corporation. The note was for $48,700.00 with interest at 5 percent, to be repaid on January 1, 1986.

32. On June 18, 1985, FmHA perfected a security interest in the 1985 growing crops of debtor corporation. (Exh. B-2). In addition, John and James committed themselves to obtain federal crop insurance on the crops to protect FmHA's interests.

33. On August 28, 1985, Valley Bank filed a financing statement in which Foust Brothers Farms, Inc., over the signature of John Foust, President, granted said bank a security interest in growing crops on approximately 630 acres in Warren County for the 1985 crop year. (Exh. 54).

34. On September 11, 1985, Valley Bank filed a financing statement in which John and James Foust granted said bank a security interest in growing crops on farm ground located in Lucas, Clarke, Polk, and Warren Counties. This security interest included crops on real estate conveyed in and assigned to XIT, Inc., Teton Corporation, Bend Corporation,

Ag-Land Investments, Blackhorse, Thunderhawk, Savannah, and Ag-Land I, a Partnership, and real estate titled in Lena Foust, mother of John and James Foust. (Exh. 55).

35. Cheyenne River Corporation was utilized by John and James as the operating company to farm approximately 804 acres of leased farm ground in Warren County commencing in 1985. This tract is located in sections 27, 33, and 34, White Oak Township, Warren County, and will be described herein as the "Veasman Farm." This farm is located in the same general area of the county as was the Foust Brothers Farms' farming operation.

36. Foust Brothers Farms planted approximately 440 acres of corn in 1985 on real estate held by Savannah Corporation, Blackhorse Corporation, Ag-Land Corporation, Thunderhawk, and John and James Foust. This was the land contained within the 630 acres of farmland located in Warren County in which FmHA held a security interest in the crops.

37. Cheyenne River Corporation planted approximately 555 acres of corn on the Veasman/Farm tract in 1985. This farm produced an average yield of 116 bu. per acre in 1985. (Exh. AAAA-3).

38. John and James contend that the yield of corn from those tracts operated by Foust Brothers Farms, approximately 400 acres, was 7,182 bu., or approximately 18 bu. per acre. John and James attributed this poor result to the use of

defective herbicide.

39. James hired several truckers to assist in the hauling of grain from the fields during the harvest of the 1985 corn crop. One driver, Richard Stewart, hauled over 6,800 bu. of corn from farms operated by Foust Brothers Farms in 1985. Two other people, including James, also hauled grain from the Foust Brothers Farms fields prior to the arrival of Mr. Stewart on the scene and also as Mr. Stewart was hauling the grain from the field.

40. Average corn production in Warren County for 1985 was 130.1 bushels per acre. (Exh. HHH-2).

41. Corn was hauled from the fields to drying bins located on James's home place and to the drying facility located on the Veasman Farm. John and James contend that all of the Foust Brothers Farm's grain for 1985 was stored in the blue silo on the Veasman Farm.

42. At the time of the closing of the FmHA loan, John and James represented that the grain was to be sealed. However, Foust Brothers Farms was not eligible to seal grain because of converted and co-mingled grain.

43. On December 17, 1985, John wrote a letter to FmHA. (Exh. CCC-2). John acknowledged that the loan was due January 1, 1986, and wanted to change the terms of the note so that it could be amortized over a 5-year period. John stated that due to wet weather and early snow that they were still trying to

harvest the crops and that no grain had been sold. John stated that they had contacted Federal Crop Insurance on the late harvest and those fields hit by hail early in the growing season. Nothing was stated about losses due to defective herbicide.

44. This request was rejected by FmHA by letter dated December 26, 1986, on the basis that there was no security for re-amortization for a 5-year period and FmHA's security was the 1985 crop.

45. John and James failed to pay FmHA on 1/1/86, and FmHA attempted to schedule office visits to discuss the problem (Exh. CCC-2). John and James delayed the meeting until 4/4/86.

46. After the grain was harvested, dried and stored, James's trucks were observed hauling grain from the storage facility on the Veasman Farm during late 1985 and early 1986. During this period of time, John and James sold grain to elevators located from Warren County, Iowa, to elevators located on the Mississippi River. These grain sales, plus sales to area farmers, netted more than $44,000.00.

47. On March 2, 1986, Ranger Corporation sent in its final report as a grain dealer to the Iowa State Commerce Commission. This report was over the signature of John Foust, President.

48. On March 6, 1986, John purchased a 160-acre farm in

Lucas County. (Exh. GG). On the same date, John, with his wife, Mary, conveyed this farm to the Teton Corporation for $1.00 and other valuable consideration. (Exh. GG).

49. On March 29, 1986, James reported the theft of from 3,000 to 5,000 bu. of corn from the blue silo located on the Veasman Farm. (Exh. KKK). Approximately one week later John reported that the loss was 10,000 to 12,000 bu. of corn. The Warren County Sheriff investigated but was unable to establish theft of grain.

50. Foust Brothers Farms was declared ineligible for the feed grain program by ASCS for the 1986 crop year. Therefore, Foust Brothers Farms no longer had a guaranteed payment of $3.03 a bushel for corn grown in its operation. John and James determined that their corporate landowners, landlords, could not rent to the Foust Brothers Farms since they would not receive the government guaranty. John and James were eligible to participate in government programs if their operation was transferred to another entity. On 4/25/86, John went to the Warren County ASCS office and executed a farm reconstitution whereby all but 80 acres of land, 58.9 tillable acres, previously farmed by Foust Brothers Farms, was transferred to Cheyenne River as operator. John and James were listed as personal owners of both Foust Brothers Farms and Cheyenne River Corporation. John kept 80 acres, leased from Thunderhawk, Ltd., in the name of Foust Brothers Farms on

the basis that he had made a commitment to SBA that Foust Brothers Farms would remain in business for two years following the disaster loan. (Exhs. SS-1, VV-7, and VV-8). However, Foust Brothers Farms' 80 acre tract was not included in federal farm programs because John and James determined that that ground would not be planted in corn that year because of crop rotation.

51. On August 20, 1986, Cedar Falls Trust and Savings Bank conveyed, by Quit Claim Deed, the Veasman Farm to Mesa Corporation. (Exh. AAAA-6 and AAAA-7). John Foust personally guaranteed the loan. (Exh. AAAA-1). The sale was for $150,000.00 plus assumption of a contract and mortgage for a total sale price of $501,442.69. The first interest payment was due October 1, 1986.

52. In 1986, Cheyenne River planted 212 acres of corn on farmland previously operated by Foust Brothers Farms; Foust Brothers Farms planted 74 acres of corn, none of which was in the federal program; and Cheyenne River planted 482 acres of corn on the Veasman tract. Cheyenne River harvested and retained the crop from the Veasman Farm from the 1986 crop year. All of the Foust operating corporations farmed real estate owned or controlled by John and James Foust or entities owned by John or James Foust.

53. FmHA discovered the 1986 farm reconstitution and on December 30, 1986, requested that the Warren County ASCS

office show FmHA as joint payee on future payments processed on land formerly farmed by Foust Brothers Farms. On March 10, 1987, FmHA filed a non-standard UCC-1 notice with the Iowa Secretary of State asserting an interest in personal property John and James owned under the name of Cheyenne River. ASCS thereafter issued two 1986 deficiency payments in the sum of $2,201.46 and $201.03. Cheyenne River and FmHA were made joint payees. John crossed out FmHA's name on the deficiency checks and endorsed the checks without contact with FmHA.

54. The payments to SBA on a disaster loan were made as follows:

Due Date	Date Paid	Amount
7/31/85	7/1/85	$3,015.00
7/31/86	11/25/86	$3,015.00

Neither Foust Brothers Farms nor John or James made any further payments on this loan. SBA received $14,851.92 in 1988 as offsets from ASCS payments due to entities controlled by James and John.

55. FmHA has not received a payment on its loan.

56. John Foust established a personal bank account at West Des Moines State Bank, West Des Moines, Iowa, on June 8, 1983, and paid personal and corporate debt from this account. (Exhs. XXX-1 through 5). John and James operated their companies without separate and distinct financial records and accounts. Checks made payable to the different corporations were endorsed by John and James and regularly deposited into

their personal accounts.

57. On October 6, 1986, John changed the account name at West Des Moines State Bank to the Franklin Trust Account and the authorized signature was John F. Foust, Trustee. (Exh. XXX-1). John continued to pay personal and corporate debt and expenses from this account. John also deposited his earnings from the University of Osteopathic Medicine and Health Sciences into this account. (Exh. XXX-3).

58. John also had an account at Valley Bank. Monies from the operating loan at Valley Bank were deposited into this account and from there monies were transferred into the West Des Moines State Bank account where John dispensed funds for personal and corporate expenses and debt. (Exhs. XXX 1 through 5).

59. Farm supplies were purchased in bulk and applied as John and James directed without regard to the financial investments of each corporate entity. Machinery was transferred and used without regard to the distinct operations of the various corporate entities.

60. The various corporations were thinly capitalized, at best, and required continual infusion of capital by John and James to keep them operational.

61. The separate corporate entities did not have separate financial statements. John Foust prepared consolidated financial statements under his personal name.

62. Foust Brothers Farms received $33,204.00 on April 10, 1986, for crop losses sustained during the 1985 crop year. (Exh. DDD-1). Foust Brothers Farms received $16,949.00 on March 25, 1987, for crop losses sustained during the 1986 crop year. (Exh. EEE-1). Entities controlled by John and James received crop insurance payments from 1986 through 1988. At no time did John and James Foust obtain crop insurance to protect the interests of SBA and FmHA.

63. John and James reconstituted their farming operation again in 1987, moving farmland formerly farmed by Foust Brothers Farms from Cheyenne River to Bend Corporation.

64. On December 31, 1987, John filed a voluntary Chapter 12 petition on behalf of Foust Brothers Farms. This case was dismissed on May 3, 1988, for failure to file a plan and for failure to have counsel appear for the debtor. FmHA and SBA, as well as other creditors, were scheduled as creditors having unsecured claims without priority. (Exh. C).

65. On January 6, 1988, John filed a voluntary Chapter 12 petition on behalf of Southern Cross, Inc. This case was dismissed on May 3, 1988, for failure to file a plan and for failure to properly administer the proceedings. (Exh. D-1).

66. On July 22, 1988, a voluntary Chapter 12 bankruptcy petition was filed by John F. Foust, personally. This case was converted to a proceeding under Chapter 7 on December 29, 1988, and Trustee appointed.

67. John filed a voluntary Chapter 12 bankruptcy petition for Cheyenne River on February 28, 1989. This case will be referred to as Cheyenne River No. 1. Cheyenne River No. 1 was dismissed on May 15, 1989, as John's stock was an asset of his Chapter 7 estate subject to the control of the Chapter 7 Trustee; Cheyenne River failed to file complete and adequate schedules; said corporation failed to fulfill its duties as debtor-in-possession; and said corporation failed to cooperate and provide financial information as required by the U.S. Trustee and Chapter 12 Trustee.

68. On June 20, 1989, John filed a second voluntary Chapter 12 petition for Cheyenne River. This case will be referred to as Cheyenne River No. 2. This petition was filed without schedules or statements and two days before the U.S. Marshal was to execute a writ of replevin issued on June 15, 1989, by the United States District Court, Southern District of Iowa, Central Division, in the case of United States of America, Plaintiff, v. Cheyenne River Corporation, Defendant, Civil No. 89-363-A.

69. Cheyenne River No. 2 was dismissed on July 18, 1989.

DISCUSSION

I. Corporate Veil

Initially, the Court must determine whether it should disregard the corporate entities, "pierce the corporate veil"

and conclude that Defendants are personally liable to FmHA and SBA.

Defendants assert that FmHA and SBA did not plead an action to pierce the corporate veil and the debts to SBA and FmHA remain corporate obligations. Pleadings under the Federal Rules of Civil Procedure are designed to give the opposing party fair notice of the claim asserted. Shelter Mutual Insurance Company v. Public Water Supply, 747 F.2d 1195, 1197 (8th Cir. 1984); see Oglala Sioux Tribe of Indians v. Andrus, 603 F.2d 707, 714 (8th Cir. 1979); Fed.R.Civ.P. 8(a). The FmHA and SBA complaints alleged that James and John Foust owned and operated Foust Brothers Farms, Inc.; SBA and FmHA gave Foust Brothers Farms, Inc. emergency disaster loans; James and John Foust were the sole officers of said corporation; and James and John Foust are each personally liable for the debts of said corporation. Defendants therefore had fair notice of the FmHA and SBA claims against James and John Foust personally, and that the corporate entities should be disregarded.

Bankruptcy courts in other jurisdictions have previously considered the issue of piercing the corporate veil in the context of a dischargeability proceeding. See e.g., In re Tesmetges, 87 B.R. 263, 271 (Bankr. E.D.N.Y. 1988); In re Botten, 54 B.R. 707 (Bankr. W.D. Wisc. 707, 709). In Botten, the court concluded that in the context of 11 U.S.C.

§523(a)(2)(A), the veil of the corporate debtor would be pierced to hold the individual debtor liable where the individual debtor (who was president, director, and stockholder of the corporate debtor) intermingled corporate accounts and kept insufficient business records. Botten, 54 B.R. at 709.

The Court looks to Iowa law in determining whether to pierce the corporate veil. See Botten, 54 B.R. at 708. The U.S. Bankruptcy Court, Northern District of Iowa outlined Iowa law on piercing the corporate veil in In re Manchester Hides, Inc., 45 B.R. 794, 799 (Bankr. N.D. Iowa 1985):

> In Northwestern National Bank v. Metro Center, Inc., 303 N.W.2d 395, 398 (Iowa 1981), the Iowa Supreme Court observed that "central to corporate law is the concept that a corporation is an entity separate and distinct from its shareholders." This concept is, however, subject to the rule that "the corporate device cannot in all cases insulate the owners from personal liability." Briggs Transportation Co., Inc. v. Starr Sales Co., Inc., 262 N.W.2d 805, 809-10 (Iowa 1979). Interpreting this "pierce the corporate veil" doctrine in Iowa, the Eighth Circuit found the following determinative factors: [A] corporation's existence is presumed to be separate, but can be disregarded if (1) the corporation is undercapitalized, (2) without separate books, (3) its finances are not kept separate from individual finances, individual obligations are paid by the corporation, (4) the corporation is used to promote fraud or illegality, (5) corporate formalities are not followed or (6) the corporation is merely a sham.
>
> Lakota Girl Scout Council, Inc. v. Harvey

> Fund Raising Management, Inc., 519 F.2d 634, 638 (8th Cir. 1978); accord, e.g., Darling Stores Corp. v. Young Realty, Co., 121 F.2d 112, 116 (8th Cir. 1941) (applying Iowa law); Northwestern National Bank, 303 N.W.2d at 398-99; Team Central, Inc. v. Teamco, Inc., 271 N.W.2d 914, 923 (Iowa 1978); Briggs Transportation Co., 262 N.W.2d at 810.

The Iowa Court of Appeals held that a court may disregard the corporate entity and impose personal liability on stockholders where limiting liability would be inequitable. Boyd v. Boyd and Boyd, Inc., 386 N.W.2d 540, 545 (Iowa App. 1986).

Applying the Lakota factors to Foust Brothers Farms, Inc., the other corporate entities, and John and James Foust, this Court disregards the corporate entities and holds John and James Foust personally liable for the Foust Brothers Farms, Inc. indebtedness to SBA and FmHA. John and James Foust, individually or together, are the sole shareholders, officers and directors of all the corporate entities, including Foust Brothers Farms, Inc. John and James Foust conducted their farming operations through Foust Brothers Farms, Inc. and the other corporations. In conducting the farming operations, John and James Foust intermingled the funds and assets of Foust Brothers Farms, Inc. with the other corporations, and failed to keep separate books and records. Further, John and James Foust comingled corporate funds with their personal funds. John and James Foust treated the separate entities as one joint farming enterprise with

substantial and total control over the enterprise exercised by John Foust. John and James Foust treated the corporate entities as single entities depending upon the existing circumstances. They entered into contracts for the benefit of one corporation on behalf of another corporation and received, advanced and allocated funds, assets and liabilities without regard to the actual benefit or burden to the individual corporations. The sole criteria in making these decisions was whether the act benefited James and John personally.

John and James over-extended their use of the various corporate entities to perpetrate fraud and evade contractual liabilities. They so dominated the corporate entities that they primarily transacted their own business rather than the business of the respective corporate entities. The financial, policy, and business practices were so dominated by John and James that the various corporations had no essential existence of their own.

Therefore, it would be inequitable to allow John and James Foust to shield themselves from liability based on the corporate fiction of Foust Brothers Farms, Inc. and the other corporate entities.

II. 11 U.S.C. §523(a)(2)(A)

11 U.S.C. §523 lists ten exceptions to discharge and provides in relevant part:

> (a) A discharge under section 727. . . does not discharge an individual debtor from any debt--
>
> . . .
>
> (2) for money, property, services, or an extension, renewal, or re-financing 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. . .

To prevent discharge because of fraud under 11 U.S.C. §523(a)(2)(A), a plaintiff must prove actual fraud, not fraud implied in fact. In re Simpson, 29 B.R. 202, 209 (Bankr.N.D.Iowa 1983). The elements of actual fraud include: (1) the debtor made false representations; (2) at the time the representations were made the debtor knew they were false; (3) the debtor made the representations with the intent to deceive the creditor; (4) the creditor relied upon such representations; and (5) the creditor sustained the alleged loss and damages as a proximate result of the false representation. Matter of van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987); Simpson, 29 B.R. at 209.

The plaintiff has the burden of proving each of the elements of actual fraud by clear and convincing evidence. Id. Regarding the evidence presented, the Eighth Circuit has stated that it:

> must be viewed consistent with the congressional intent that exceptions to discharge be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the Code. These considerations, however, "are applicable only to honest debtors."

Van Horne, 823 F.2d at 1287 (citations omitted).

The first two elements of actual fraud are self-explanatory. Concerning the third element, intent to deceive the creditor, the Eighth Circuit recently stated:

> Because direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred. When the creditor introduces circumstantial evidence proving he debtor's intent to deceive, the debtor "cannot overcome [that] inference with an unsupported assertion of honest intent." The focus is, then, on whether the debtor's actions "appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor."

Id. at 1287-88 (citations omitted).

Although intent to deceive may be inferred from the circumstances of the case, such a finding of intent generally requires a showing that the defendant knew or should have known of the falsity of his statement. In re Valley, 21 B.R. 674, 679-80 (Bankr. D. Mass. 1982). In assessing the defendant's knowledge and liability for fraud, the court will scrutinize the acumen and experience of the defendant. Matter

of Newark, 20 B.R. 842, 857 (Bankr. E.D.N.Y. 1982).

The fourth element of actual fraud is the creditor's reliance on a false representation. The Eighth Circuit does not require that the creditor's reliance be shown to be reasonable. In re Ophaug, 827 F.2d 340 (8th Cir. 1987). In Ophaug the Court stated that the statute was clear on its face and that 11 U.S.C. §523(a)(2)(A) does not require a creditor to prove that his reliance on the debtor's fraudulent misrepresentations was reasonable. The creditor need only prove that he relied on the debtor's fraudulent misrepresentations in extending credit to the debtor.

The fifth and final element, proximate cause, requires that the debtor's action was the act, without which the plaintiff would not have suffered the alleged loss and damages. Van Horne, 823 F.2d at 1288-89.

In the instant case, Plaintiff has proven by clear and convincing evidence the necessary elements under 11 U.S.C. §523(a)(2)(A). At the time FmHA and SBA made their respective loans to Foust Brothers Farms, Inc., John and James Foust led SBA and FmHA to believe that the loans were to a separate corporate entity, independently operated and maintained. However, John and James Foust knew that Foust Brothers Farms, Inc. was part of one joint farming enterprise with mixed records and funds. John and James Foust never intended to operate Foust Brothers Farms, Inc. as a separate corporate

entity, and intended to deceive SBA and FmHA. This intent may be inferred by John and James Foust's consistent and extensive disregard of any separate corporate identity of their companies. SBA and FmHA relied on the representation of a separately operated Foust Brothers Farms, Inc. corporate entity to their detriment, and made the respective loans to Foust Brothers Farms, Inc. SBA and FmHA were denied the opportunity to fully assess the liability of the joint farming operation they were funding, and their damages are the proximate result of John and James Foust's misrepresentation. See Botten, 54 B.R. at 709. Plaintiff has proven by clear and convincing evidence Counts I and III of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(2)(A), and Counts I and II of Plaintiff's complaint against James Foust pursuant to 11 U.S.C. §523(a)(2)(A). Plaintiff has not proven by clear and convincing evidence Count II of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(2)(A).

Plaintiff has not proven by clear and convincing evidence that John and James Foust made a false representation to SBA when they pledged to name SBA as loss payee for a minimum of 65 percent coverage on yield and level 3 on price support in connection with SBA's disaster loan to Foust Bros. Farm, Inc.

A bare promise to be filled in the future does not render

a debt nondischargeable for fraud or misrepresentation, since fraud cannot be based on statements or promises to perform in the future absent proof of scienter. However, where promises are made with the positive intent not to perform, or the promissor knew or should have known of his prospective inability to perform, the misrepresentation consisting of the promise of future performance may be found to be fraudulent so as to render the resulting debt nondischargeable under 11 U.S.C. §523(a)(2)(A). In re Gans, 75 B.R. 474, 486 (Bankr. S.D.N.Y. 1987).

Plaintiff has not proven by clear and convincing evidence that John and James Foust had the positive intent not to name SBA as loss payee, or the prospective inability to name SBA as loss payee. John and James Foust gave Valley National Bank a security interest in their farm products prior to making the pledge to name SBA as loss payee on crop insurance. However, the Valley National Bank financing statement filed on June 18, 1984 did not list crops as security or provide any description of real estate, and therefore, Valley National Bank did not have a security interest in crops of John and James Foust. See First National Bank in Creston v. Francis, 342 N.W.2d 468 (Iowa 1984). Thus, John and James Foust could have named SBA as loss payee, and Plaintiff has not proven by clear and convincing evidence that John and James Foust had the positive intent not to name SBA as loss payee.

III. 11 U.S.C. §523(a)(6)

11 U.S.C. §523(a) provides in pertinent part:

> A discharge under §727...does not discharge an individual debtor from any debt--
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity.

It is well-settled that 11 U.S.C. §523(a)(6) includes debts for willful and malicious conversion. In re Jacobs, 47 B.R. 526, 527 (Bankr. S.D. Fla. 1985). Plaintiff must prove by clear and convincing evidence the elements of a willful and malicious conversion under 11 U.S.C. §523(a)(6). See America Honda Finance Corp. v. Loder, 77 B.R. 213, 214 (N.D. Iowa 1987).

Conversion is generally defined as a wrongfully assumed "dominion over personal property by one person to the exclusion of possession by the owner and in repudiation of the owner's rights." In re Hicks, 100 B.R. 576, 577 (Bankr. M.D. Fla. 1989); In re Pommerer, 10 B.R. 935 (Bankr. D. Minn. 1981).

In ruling on a transfer and breach of a security agreement, the Eighth Circuit Court established the definition of willful and malicious. In re Long, 774 F.2d 875, 881 (8th Cir. 1985). According to the Eighth Circuit Court, willful means headstrong and knowing (intentional). Malicious means

targeted at the creditor, at least in the sense that the conduct is certain or almost certain to cause financial harm. In re Long, 774 F.2d at 881.

In the instant case, Foust Brothers Farms, Inc. obtained a disaster loan from FmHA on June 24, 1985. As security for the disaster loan, Foust Brothers Farms, Inc. gave FmHA a security interest in the 1985 growing crops of Foust Brothers Farms, Inc., and FmHA perfected its security interest in the 1985 growing crops on June 18, 1985.

Foust Brothers Farms, Inc.'s failure to remit the $33,204.00 received on April 10, 1986 for crop losses sustained during the 1985 crop year to FmHA constitutes conversion of the insurance proceeds due to FmHA, the security interest holder on 1985 crops. John and James Foust also converted the interest given to FmHA in 1985 crops by selling 1985 crops in late 1985 and early 1986 without remitting the proceeds to FmHA. The reported theft of grain was a subterfuge to cover the missing grain. In addition, John and James Foust have attempted to conceal the conversion by stating that the yield of corn from those tracts operated by Foust Brothers Farms was 18 bu. per acre, and attributing this poor result to use of defective herbicide. Because the average corn production in Warren County for 1985 was 130.1 bu per acre, and because John and James Foust failed to discuss losses due to defective herbicide in the December 17, 1985

letter to FmHA, the Court rejects this assertion.

Defendants assert that Valley Bank had a security interest in the 1985 crops prior to FmHA and therefore Defendants did not convert FmHA's interest in the 1985 crops. However, FmHA perfected it security interest in the 1985 growing crops on June 18, 1985. Valley Bank filed a financing statement in which John and James Foust granted said bank a security interest in growing crops on approximately 630 acres in Warren County for the 1985 crop year on August 28, 1985. Further, on September 11, 1985, Valley Bank filed a financing statement in which John and James Foust granted said bank a security interest in growing crops on farm ground located in Lucas, Clarke, Polk, and Warren counties. The Valley financial statement filed June 18, 1984, did not list crops or describe any real estate. Therefore, the FmHA security interest was perfected prior to the Valley Bank security interest in the 1985 growing crops.

John and James Foust also assert that the Foust entity landlords had a security interest in the 1985 crops prior to FmHA, and therefore Defendants did not convert FmHA's interest in the 1985 crops. However, as described supra, the Court disregards the Foust Brothers corporate entities. Therefore, FmHA has a security interest in the 1985 crops prior to any interest of the Foust Brothers corporate landlords.

The circumstances surrounding the harvesting, storing and

sale of the grain show that John and James Foust knew that they were not legally able to sell the crops or keep the 1985 crop insurance proceeds and thus they willfully converted the crops and insurance proceeds. In addition, failure to remit the grain proceeds and crop insurance proceeds was certain to cause financial harm to FmHA and was thus malicious. John and James Foust abandoned use of the Foust Brothers Farms, Inc. corporate entity obligated to Plaintiff at the time of the conversion. Therefore, the circumstances in the instant case are apposite to those in Long, 774 F.2d 875, 882 (8th Cir. 1985), where the Eighth Circuit allowed discharge of the creditor's claim because the corporate president and guarantor failed to pay over to the creditor collateral proceeds, but utilized the funds in keeping the corporation functioning in an active business. Plaintiff has proven by clear and convincing evidence Count I of Plaintiff's complaint against John Foust pursuant 11 U.S.C. §523(a)(6), and Count I of Plaintiff's complaint against James Foust pursuant 11 U.S.C. §523(a)(6).

Concerning Count II of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(6), Foust Brothers Farms was declared ineligible for the feed grain program by ASCS for the 1986 crop year. Therefore, Foust Brothers Farms no longer had a guaranteed payment of $3.03 a bushel for corn grown in its operation. John and James determined that their corporate

landowners, landlords, could not rent to Foust Brothers Farms since they would not receive the government guarantee. John and James were eligible to participate in government programs if their operation was transferred to another entity. On April 25, 1986, John went to the Warren County ASCS offices and executed a Farm Reconstitution whereby all but 80 acres of land, 58.9 tillable acres, previously farmed by Foust Brothers Farms, was transferred to Cheyenne River as operator. John and James were listed as personal owners of both Foust Brothers Farms and Cheyenne River Corporation.

FmHA discovered the 1986 farm reconstitution and advised the Warren County ASCS office on December 30, 1986, requesting future payments processed on land formerly farmed by Foust Brothers Farms bear the joint name of FmHA. On March 10, 1987, FmHA filed a non-standard UCC-1 notice with the Iowa Secretary of State asserting an interest in personal proprty John and James owned under the name of Cheyenne River. ASCS thereafter issued two 1986 deficiency payments in the sum of $2,201.46 and $201.03. Cheyenne River and FmHA were made joint payees. John crossed out FmHA's name on the deficiency checks and endorsed the checks without contact with FmHA.

The circumstances surrounding John's crossing out FmHA's name on the joint payee deficiency checks, and endorsing the checks without contact with FmHA show that John willfully converted the ASCS 1986 deficiency payments. In addition,

failure to remit the ASCS deficiency payments was certain to cause financial harm to the joint payee FmHA. John Foust crossing out the FmHA name on the deficiency checks and endorsing the checks without contact with FmHA constitutes willful and malicious conversion under 11 U.S.C. §523(a)(6), and Plaintiff has proven by clear and convincing evidence Count II of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(6). Further, crossing out the FmHA name on the deficiency checks and endorsing the checks without contact with FmHA is further evidence of John Foust's willful and malicious intent in converting the FmHA crop and insurance proceeds, and supports Count I of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(6).

Concerning John and James Foust's willful and malicious conversion of an SBA interest in 1985 crop insurance proceeds, John and James Foust pledged to obtain and maintain crop insurance and name SBA as loss payee for a minimum of 65% coverage on yield on level 3 on price support. However, John and James Foust did not obtain said crop insurance and SBA did not have a security interest in Foust Brothers Farms in crops or crop insurance. Therefore, SBA did not have an interest in the 1985 crop insurance proceeds, and John and James Foust could not have willfully and maliciously converted said crop insurance proceeds. Further, the evidence presented does not show that John and James Foust willfully and maliciously

disposed of rentals and other real estate income subject to the guarantees and mortgage interest of SBA. Plaintiff has not proven by clear and convincing evidence Count III of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(6) and Count II of Plaintiff's complaint against James Foust pursuant to 11 U.S.C. §523(a)(6).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes:

1) John and James Foust are individually liable for the Foust Brothers Farms, Inc. debt to SBA and FmHA;

2) Plaintiff has proven Counts I and III of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(2)(A);

3) Plaintiff has not proven by clear and convincing evidence Count II of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(2)(A);

4) Plaintiff has proven by clear and convincing evidence Counts I and II of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(6);

5) Plaintiff has not proven by clear and convincing evidence Counts III of Plaintiff's complaint against John Foust pursuant to 11 U.S.C. §523(a)(6);

6) Plaintiff has proven by clear and convincing

evidence Counts I and II of Plaintiff's complaint against James Foust pursuant to 11 U.S.C. §523(a)(2)(A);

7) Plaintiff has proven by clear and convincing evidence Count I of Plaintiff's complaint against James Foust pursuant to 11 U.S.C. §523(a)(6);

8) Plaintiff has not proven by clear and convincing evidence Count II of Plaintiff's complaint against James Foust pursuant to 11 U.S.C. §523(a)(6);

9) The debt of John and James Foust due to FmHA is non-dischargeable under 11 U.S.C. §523(a)(2)(A) and 11 U.S.C. §523(a)(6); and

10) The debt of John and James Foust due to SBA is non-dischargeable under 11 U.S.C. §523(a)(2)(A).

IT IS ACCORDINGLY ORDERED that judgment shall be entered for FmHA in the amount of $48,700.00 against James Foust and $56,505.35 against John Foust.

IT IS FURTHER ORDERED that judgment shall be entered for SBA in the amount of $49,645.53 against James Foust and $49,645.53 against John Foust.

Dated this ___1st_____ day of October, 1990.

_____
Russell J. Hill
U.S. Bankruptcy Judge