

**IN THE UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF ARKANSAS
BATESVILLE DIVISION**

IN RE: DOROTHY EILENE HERRIN

**1:01-bk-10180 E
CHAPTER 7**

GREGORY COMPANY, INC.

PLAINTIFF

VS.

AP NO.: 1:01-ap-1009

DOROTHY EILENE HERRIN

DEFENDANT

ORDER DENYING COMPLAINT

On November 13, 2002, the Court heard Creditor Gregory Company, Inc.'s ("**Gregory**") Complaint Objecting to Discharge. Debtor, who was also present, appeared through her attorneys, Larry Dean Kissee and Jerrie Grady. Plaintiff appeared through its attorney, Tim Weaver. Following oral argument and testimony by the Debtor, Dorothy Herrin, and Jess Wilson on behalf of the Plaintiff, the parties rested, and the Court denied Gregory's complaint. This Order serves to clarify the Court's oral ruling.

This is a core proceeding under 28 U.S.C. § 157(b)(2)(I). This Order shall constitute findings of fact and conclusions of law pursuant to Bankruptcy Rule of Procedure 7052.

FACTS

Debtor filed a petition for bankruptcy under Chapter 7 of the United States Bankruptcy Code on April 1, 2001. Plaintiff's Complaint asks the Court to find that a debt of Debtor's unincorporated business is nondischargeable pursuant to 11 U.S.C. § 523 due to fraud committed by the Debtors' late husband, Don Herrin, on behalf of his sole proprietorship called "Don Herrin Company."

Debtor counterclaimed for conversion of certain personal property belonging to Don Herrin Company following the death of Mr. Herrin, and requested punitive damages in the amount of \$100,000.00.

Don Herrin Company (the “**Company**”) was a subcontractor providing both goods and services to building projects. The Plaintiff, a general contractor, contracted with the Company for the purchase of certain materials and labor on a project called Good Samaritan Village in Mountain Home, Arkansas pursuant to a written contract dated December 20, 1999. The Company submitted invoices to Plaintiff for materials which had supposedly been paid for by the Company and were to be delivered to the project site. The evidence produced at trial established that with respect to certain materials, the Company did not pay for the materials but billed the Plaintiff for the materials and received payment for those materials from the Plaintiff. It was also established that these materials were not delivered to the project site, and the Plaintiff was forced to purchase the same materials a second time. Don Herrin died prior to resolution of these problems. The Company ceased to exist after Don Herrin’s death, and to the extent his wife co-signed documents, she remained liable for these debts. In April 2001, Dorothy Herrin, wife of Don Herrin (the “**Debtor**”), filed this Chapter 7 seeking to discharge the debt to plaintiff, along with other debts.

Plaintiff alleges that Debtor conducted the business with her husband and is an owner and principal of the Company. It was established at trial that Debtor was a homemaker, spending her time doing laundry, cooking, and taking care of Mr. Herrin’s children from his first marriage. Debtor was not a licensed contractor, and had no actual involvement in the business, other than to write an occasional check when directed to do so by her husband; the family and the business functioned out of the same bank account. Debtor did not sign any of the documents between the Company and the Plaintiff which created the obligation from the Company to the Plaintiff. Debtor had no

communication with the Plaintiff until after her husband's death, when the problems which are the subject of this litigation were brought to her attention. The Company was listed in Debtor's name for tax purposes, and she co-signed certain notes. However, as Debtor's husband was completely in charge of the business and ran the home with "an iron fist," Debtor had little choice concerning whether to sign papers, and it was very clear that she had no understanding of the implications of the company being in her name for tax purposes. After the death of Debtor's husband, Debtor took a job outside the home waiting on tables, earning \$3.10 an hour, plus tips.

DISCUSSION

Based on the evidence produced at trial, the Court found that the Debtor's late husband, Don Herrin, had defrauded Plaintiff for materials he received payment for but did not deliver. The Court made this finding based on an Application for Payment introduced in evidence which showed that a representation was made about the materials supplied by Comfort Company, and based on that representation, the Plaintiff paid Mr. Herrin, and the materials were never delivered to Plaintiff according to the testimony of Mr. Wilson.

For the reasons explained herein, the Court found that Mr. Herrin's fraud could not be imputed to Debtor, and accordingly, the debt owed Plaintiff is dischargeable in Debtor's bankruptcy case.

A principal may be held liable for his agent's fraudulent acts such that he is denied a discharge in bankruptcy if the fraud is proven, and it is accompanied by proof that the debtor knew or should have known of the fraud. *See Walker v. Citizen's Bank of Maryville (In re Walker)*, 726 F.2d 452, 454 (8th Cir. 1984) (*citing In re Lovich*, 117 F.2d 612, 614-615 (2nd Cir. 1941)). In *Walker*, the Eighth Circuit explained:

[M]ore than the mere existence of an agent-principal relationship is required to charge the agent's fraud to the principal. However, as indicated, actual participation in the fraud by the principal is not always required. If the principal either knew or should have known of the agent's fraud, the agent's fraud will be imputed to the debtor-principal. When the principal is recklessly indifferent to his agent's acts, it can be inferred that the principal should have known of the fraud.

Id. In this case, Mr. Herrin's fraud cannot be imputed to Debtor for two reasons: (1) it was not proven that she is a principal of the Company; and (2) she did not act with reckless indifference with respect to her husband's actions where he gave her no choice to participate in the operation of the business.

The Court finds that the Debtor is not a principal even though she signed her income tax returns which stated she owned the Company. The Court found the other evidence indicated that she had no involvement with the relationship that created the debt owed Plaintiff. The December 20, 1999 contract between Mr. Herrin and the Plaintiff as well as the Application for Payment from the Comfort Company clearly prove that the relationship that gave rise to the fraudulent acts existed between the Company and the Plaintiff, and that the Plaintiff was looking to Mr. Herrin as the principal of his company. The evidence at trial also illustrated that the Debtor had little or no involvement in the Company, and it was held in her name for tax purposes only. Surely, if the Debtor had participated in the business, then after her husband's death, she would be qualified for a job outside the home other than being a waitress. For these reasons, the Court finds that no principal-agent relationship existed between the Debtor and her late husband, such that his fraudulent actions could be imputed to her.

The Court also finds that even if a principal-agent relationship were established between the Debtor and her late husband, the Debtor was not recklessly indifferent to her late husband's fraudulent acts. The evidence was very clear that the Debtor was not given the option of being

involved with the company; her involvement was not allowed and as a consequence, she could not have learned of her husband's actions. Accordingly, she was not recklessly indifferent to his actions, and his actions cannot be imputed to her.

The Debtor was not allowed to put on evidence to prove the allegations stated in the counterclaim because she did not respond to discovery as specifically ordered. Because the trial was held on both the complaint and counterclaim, the counterclaim is dismissed with prejudice for failure of proof.

CONCLUSION

For the reasons stated herein, the Court finds that Plaintiff's Complaint is **DENIED**, the debt owed to Plaintiff is dischargeable, and the counterclaim is **DISMISSED WITH PREJUDICE**.

IT IS SO ORDERED.

HONORABLE AUDREY R. EVANS
UNITED STATES BANKRUPTCY JUDGE

DATE: _____

cc: Mr. Tim Weaver, attorney for plaintiff
Jerrie Grady, attorney for plaintiff
Mr. Larry Dean Kisse, attorney for defendant/debtor
Mr. Richard Cox, Chapter 7 Trustee
U.S. Trustee