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FOR PUBLICATION  
UNITED STATES BANKRUPTCY COURT  
NORTHERN DISTRICT OF OHIO  
EASTERN DIVISION

FILED  
99 MAR 30 PM 3:21  
NORTHERN DISTRICT OF OHIO  
CLEVELAND

In re:	)	Case No. 98-13180
	)	
RONALD J. ANNOTICO,	)	Chapter 7
	)	
Debtor.	)	Judge Pat E. Morgenstern-Clarren
	)	
<hr/>	)	
SHERWOOD FOOD DISTRIBUTORS,	)	Adversary Proceeding No. 98-1230
	)	
Plaintiff,	)	
	)	
v.	)	<b><u>MEMORANDUM OF OPINION</u></b>
	)	
	)	
RONALD J. ANNOTICO,	)	
	)	
Defendant.	)	

The Plaintiff, Sherwood Food Distributors (“Sherwood”), filed a complaint under 11 U.S.C. § 523(a)(2)(A) to determine the dischargeability of a debt allegedly owed by the Debtor-Defendant Ronald J. Annotico. The trial was held on February 26, 1999 and March 2, 1999.

**JURISDICTION**

The Court has jurisdiction to determine this matter under 28 U.S.C. § 1334 and General Order No. 84 entered in this District on July 16, 1984 by the United States District Court for the Northern District of Ohio. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I).

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**INTRODUCTION AND THE POSITION OF THE PARTIES**

Krzys Provisions, Inc. ("Krzys") was in the business of processing and selling meat products to restaurants. Mr. Annotico was the president, sole shareholder, and chief operating officer of Krzys from 1985 through 1996. During Mr. Annotico's tenure with Krzys, the company bought the majority of its goods from Sherwood. The parties agree that Krzys owes Sherwood \$67,981.31 for goods sold and delivered. (Stip. ¶ 11). (Docket 13). They disagree about whether Mr. Annotico is personally liable for the debt based on the company's loss of its corporate charter in 1987. If there is personal liability, they also disagree as to whether the debt is dischargeable.

The focal point of the dischargeability dispute is the manner in which Mr. Annotico severed his connections to Krzys in December 1996. Sherwood claims that in the weeks before Mr. Annotico left the company, he dramatically increased his purchases from Sherwood, sold his inventory to generate cash, drew the cash out of the company for his personal benefit, left insufficient assets to pay the company debts, and moved out of state, all as part of a plan to defraud Sherwood by leaving it with an unpaid bill.

Mr. Annotico denies this, alleging that all of the purchases and sales were in the ordinary course of the business, which accelerates every year in the holiday season of November and December. As part of that year-end activity, he acknowledges that the purchases from suppliers such as Sherwood increased, but argues that the sales made by Krzys also increased. Mr. Annotico blames the Sherwood loss on Joseph Sidoti, an employee and friend who purchased Krzys in December 1996 and quickly ran it into the ground. The buyer's actions, according to Mr. Annotico, caused the loss because Sherwood should have been paid from the ongoing

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business operations given the amount of inventory and the existing customer base in place in December 1996. When the business failed, no one got paid and no one was at fault.

**FACTS**<sup>1</sup>

**The status of Krzys as a legal entity**

Mr. Annotico purchased Krzys in March 1985, at which time it was an Ohio corporation. Unbeknownst to Mr. Annotico, the state cancelled Krzys' corporate charter in 1987. He continued to operate the company as if it were a corporation through 1996.

**The general operations of Krzys**

Mr. Annotico was unable to testify as to many aspects of the business. He did not, for example, know the company's average annual payroll, the monthly inventory, or cash balances by month. He does not have any business records to establish these amounts because they were lost after he left the business. He also did not know how much meat the company's meat cutters could cut in a day or any other time frame.

The Krzys tax returns provide this information about its annual purchases and year end inventories in the years leading up to this 1996 dispute:

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<sup>1</sup> Sherwood presented its case through the testimony of: (1) Ronald J. Annotico, as if on cross-examination; (2) Joanne Kato, a social friend of Mr. Annotico; and (3) Douglas Pierce, the credit manager for Sherwood, and exhibits. Mr. Annotico testified on his own behalf and called as witnesses William Lesho, a State of Ohio enforcement agent for the Department of Agriculture, and the legal processors for Huntington Bank and National City Bank. He also introduced exhibits into evidence.

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<u>Year</u>	<u>Amount of Prod. Purchased</u>	<u>Value of Year-End Inventory</u>
1993	\$995,206.59	\$8,500
1994	\$1,250,161.01	\$14,470
1995	\$832,396.40	\$14,470

(Def. Exhs. E, F, and G).

The returns also have this information about the company's profitability in those years:

<u>Year</u>	<u>Profit/(Loss)</u>
1993	\$18,010.02
1994	(\$6,407.53)
1995	(\$9,866.74)

(Def. Exhs. E, F, and G). Krzys has not filed a tax return for 1996. Mr. Annotico stated that he was waiting for "these matters" to be resolved before he did so, although he did not explain why this dispute would warrant delay in the filing.

**The relationship between Krzys and Sherwood**

**1. The A&W Foods incident**

Douglas Pierce was the credit manager of Sherwood in 1996. He and Mr. Annotico had known each other for a number of years, including a time span when Mr. Pierce worked at A&W Foods ("A&W") as the credit manager. These events took place between Mr. Pierce and Mr. Annotico while Mr. Pierce was at A&W:

As is common in this industry, A&W and Krzys both sold goods to each other and bought goods from each other. In 1994, A&W was in financial difficulty and owed a large amount of money to a supplier. Mr. Pierce, and others, were instructed to collect as much money

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as they could from A&W customers to try to pay the supplier. As part of that effort, Mr. Pierce asked Mr. Annotico to pay an outstanding bill to A&W. Mr. Annotico agreed to do so if A&W would pay a bill owed to Krzys, which Mr. Pierce agreed to. They exchanged checks on a Friday; on Monday, A&W stopped doing business. In the days that followed, the Krzys check cleared and the A&W check bounced. Mr. Annotico was left with an unpaid receivable from A&W of about \$40,000.

Mr. Pierce then left A&W and accepted a job with Sherwood, where he was responsible for new accounts, extensions of credit, and collection of receivables. He also continued to help collect money owed to A&W. Mr. Annotico felt that Sherwood purchased A&W in 1994, although the record did not establish that. Mr. Annotico admitted that the A&W/Pierce incident angered him and hurt his company. He felt that A&W, Sherwood, and A&W's lender conspired to defraud A&W's creditors. Despite that conviction, he continued to buy the majority of his goods from Sherwood.

**2. The purchase and payment history with Sherwood before  
November 1996**

Sherwood delivered goods to Krzys on credit and provided an invoice at the time of delivery. Krzys paid for the goods by invoice number and amount, rather than just paying an amount and having it randomly applied to outstanding balances. Krzys routinely paid the invoices by the second Friday after delivery, with some payments made the Saturday or Monday following that Friday. Payments were made on a weekly basis. Krzys usually purchased in the range of \$4-10,000 per week. Krzys always paid on time and in good funds. Sherwood extended

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this credit over the years because of the purchase and payment history between Sherwood and Mr. Annotico.

**3. The purchase and payment events with Sherwood in November and December 1996**

In 1996, Mr. Annotico, a self-described gambler, went to Las Vegas five or six times for one to two weeks. He lost approximately \$20,000 gambling and gave markers for the debt. Mr. Annotico was involved in divorce proceedings during this same year.

In November 1996, he dramatically changed the pattern of his purchases from Sherwood. On November 21, 1996, Krzys had a zero balance with Sherwood. From November 25, 1996 to December 16, 1996, Mr. Annotico purchased approximately \$67,000 in goods from Sherwood. This was about 4-1/2 times greater than the amount purchased in any other three-week period that year and also exceeded the amounts purchased in the November/December holiday season the year before. At the same time as Mr. Annotico escalated his purchases, he stopped paying on the invoices. The Sherwood business records establish that the last invoice paid was for goods purchased on November 26, 1996. Krzys did not pay any of the twenty other invoices dated on and after November 25, 1996, ultimately leaving a balance due of \$67,981.31. (Pl. Exhs.1, 3).

On December 16, 1996, Mr. Pierce noticed this drastic change in payment and ordering practice. He had an "unpleasant" conversation with Mr. Annotico which ended with Mr. Pierce advising Mr. Annotico that Sherwood would no longer extend credit to Krzys. The next day, Mr. Annotico drew two checks to himself from the Krzys bank account: one for \$23,491.00 and the other for \$22,587.50, totaling \$46,078.50. The balance in the account after these withdrawals

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was \$4,804.12. Also on December 17, 1996, Mr. Annotico's divorce, in his words, "became final."

On December 20, 1996, Sherwood faxed a reclamation notice to Krzys--demanding that the company segregate the product purchased in the previous ten days and any proceeds from that product. Krzys did not respond to that notice.

Mr. Annotico ran the business through Christmas of 1996, although he was in and out after December 17<sup>th</sup>. During this time, he collected money from Krzys customers with Joseph Sidoti. Mr. Annotico moved to Las Vegas at the end of December. He testified that he completed the sale of Krzys to Mr. Sidoti before leaving town, an event which is discussed further below. He used some of the money he had withdrawn from the Krzys account to pay his gambling markers in early 1997 and the rest for living expenses.

Mr. Annotico testified that there was approximately \$100,000 in inventory when he left the business. Although he stated that the accounts receivable were "substantial," he was unable to remember the amount on that date.

Mr. Annotico did not tell Sherwood or his other customers that he intended to leave the business or move out of state. Although Krzys had a number of long-time employees, he did not tell them about his plan to sell the business and move to Las Vegas. In addition to the Sherwood purchases, Mr. Annotico also purchased products from at least three other suppliers during this period: Sysco Foods (\$38,000); Wolverine Packing Co. (\$78,400); and J.H. Routh Packing Co. (\$24,285), for a total of about \$208,666 among the four suppliers. Payment had not been made to any of these companies as of December 16, 1998.

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**The sale of the business**

Mr. Annotico testified that he entered into a verbal agreement to sell the business to Joseph Sidoti in June 1996. Mr. Annotico was prohibited by a domestic relations court order from selling his assets at that time, so they agreed that Mr. Sidoti would take over the business when the divorce was final. The purchase price was \$200,000, with \$40,000 to be paid in June and the balance to be paid at the rate of \$2,000 per month starting in February of 1997. They agreed that when Mr. Sidoti eventually took over the business, he would pay Mr. Annotico and the suppliers from his continued operation of the business. Mr. Sidoti began working at Krzys that same month.

On June 17, 1996, Mr. Sidoti paid Mr. Annotico \$26,380.03 by check and approximately \$6,000 in cash toward the down payment. Mr. Annotico used the cash for his gambling. Mr. Sidoti paid another \$7,622.98 in September of 1996, which brought the amount paid to about \$40,000. Although Sherwood questioned whether Mr. Annotico ever really entered into this transaction, the Court finds that he did have an agreement to sell Krzys to Mr. Sidoti based on the documents and testimony establishing the amounts paid and the absence of any other explanation as to why Mr. Sidoti would have paid this money.

Mr. Annotico testified that he also applied the \$46,078.50 which he withdrew from the Krzys account on December 17, 1996 toward the purchase price. He did not explain how this testimony coincided with his other testimony that those funds were part of his approximately \$63,000 salary for his services at Krzys in 1996. In that testimony, he stated that he kept his salary low before December 17, 1996 to avoid paying alimony and then decided to pay himself

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the \$46,078.50 after the divorce became final. He did not explain how he arrived at this number other than to say that it seemed appropriate to him based on his position in the business.

After Mr. Annotico left Krzys, Joseph Sidoti attempted to operate the same or a similar business under the name Ohio Provisions. He moved his business to a new location, but within a few weeks he was under investigation by the Ohio Department of Agriculture. In December 1996 or the beginning of January 1997, the Department seized some of the inventory because Mr. Sidoti was processing meat without a license. Mr. Sidoti tried to take the steps necessary to comply with the law, but did not succeed in doing so. He soon stopped doing business.

**ISSUES**

1. Is Mr. Annotico personally liable for the money owed to Sherwood?
2. If Mr. Annotico is personally liable, is the debt non-dischargeable under 11

U.S.C. § 523(a)(2)(A)?

**DISCUSSION**

**I.**

**Is Mr. Annotico personally liable for this debt?**

The evidence establishes that Krzys ceased to be a corporation after its corporate charter was cancelled in 1987. Mr. Annotico continued to operate the business for many years, during which time he purchased the products which are the basis of this dispute. Mr. Annotico contends that Sherwood is a corporate creditor and he is not personally liable to it. Essentially, he argues that because he was doing business as Krzys Provisions, Inc. and believed that the corporation existed, he has no personal liability for the debt. Ohio law is to the contrary.

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Ohio Revised Code § 1701.88(A) provides:

[w]hen the articles of a corporation have been canceled . . . the corporation shall cease to carry on business and shall do only such acts as are required to wind up its affairs, or to obtain reinstatement of the articles . . . and for such purposes it shall continue as a corporation.

Therefore, "when the articles of a corporation are canceled, whether by the Secretary of State or otherwise, the authority of the corporation to do business ceases and after such termination officers who carry on new business do so as individuals, lose the protection of the Corporation Act, and are personally responsible for such obligations as they incur." *Chatman v. Day*, 7 Ohio App. 3d 281, 282 , 455 N.E.2d 672, 674 (1982). See also *Nabakowski v. 5400 Corp.*, 29 Ohio App.3d 82, 503 N.E.2d 218 (1986). Mr. Annotico made the purchases from Sherwood at a point in time when the Krzys corporate charter had been canceled for nine years. The purchases were not acts required to wind up the corporate affairs and were instead new business conducted by an officer of the former corporation. As a result, Mr. Annotico is personally liable for this debt.

II.

Is the debt non-dischargeable under 11 U.S.C. § 523(a)(2)(A)?

A.

Given that Mr. Annotico is personally liable for the Sherwood debt, the next question is whether the debt is dischargeable. A discharge under 11 U.S.C. § 727(b) does not discharge an individual from a debt:

- (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--

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- (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's . . . financial condition; . . . .

11 U. S.C. § 523(a)(2)(A). Exceptions to discharge are to be narrowly construed against the creditor and in favor of the debtor based on the Bankruptcy Code's policy to give honest debtors a fresh start. *Mfrs. Hanover Trust Co. v. Ward (In re Ward)*, 857 F.2d 1082 (6th Cir. 1988).

Sherwood argues that Mr. Annotico obtained its property through false pretenses or false representations within the meaning of § 523(a)(2)(A) when he obtained goods without intending to pay for them. As noted above, Sherwood claims that Mr. Annotico schemed to obtain a large amount of goods, sell them quickly to generate cash, take the cash out of the company, and leave the company unable to pay its debts. Sherwood claims further that Mr. Annotico was inspired to do this based on what he saw A& W do to him and that he was motivated to do so because of his anger over what Mr. Pierce and/or Sherwood had done in connection with the 1994 A&W check swap. Mr. Annotico denies that he was angry personally with Mr. Pierce or Sherwood and claims that he was entitled to take the cash either as salary or as part of the purchase price. He blames the non-payment on Mr. Sidoti's inept handling of the business and takes the position that Sherwood did not meet its burden of proof.

B.

A false pretense is "an implied misrepresentation or conduct intended to create or foster a false impression." *Blascak v. Sprague (In re Sprague)*, 205 B.R. 851, 859 (Bankr. N.D. Ohio 1997). A false representation under this section involves an express misrepresentation by a debtor. *Id.* A debtor's intentional failure to disclose material facts can constitute a misrepresentation under § 523(a)(2)(A). *Semaan v. Allied Supermarkets, Inc. (In re Allied*

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*Supermarkets, Inc.*), 951 F.2d 718 (6<sup>th</sup> Cir. 1991). Purchasing on credit involves an actual or implied representation of intent to repay. *AT & T Universal Card Services v. Rembert (In re Rembert)*, 141 F.3d 277 (6<sup>th</sup> Cir. 1998), *cert. denied*, 119 S.Ct. 438 (1998). In order to have a debt declared non-dischargeable under this section, a creditor must prove that the debtor obtained property through a material misrepresentation known to the debtor to be false when made or made with gross recklessness as to its truth; the debtor intended to deceive the creditor; the creditor justifiably relied on the misrepresentation; and the reliance was the proximate cause of the loss. *In re Rembert*, 141 F.3d 277 (6<sup>th</sup> Cir. 1998). The debtor's intent is measured by a subjective standard. *Id.* The question is whether it is more probable than not that the debtor had a fraudulent intent, taking into account all of the circumstances. *Id.* The creditor has the burden of proving each element under § 523 by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279 (1991).

**Material Misrepresentation**

When Mr. Annotico purchased products on credit from Sherwood from November 26, 1996 to December 16, 1996, he impliedly represented that he intended for Sherwood to be paid for the products purchased. Moreover, based on Krzys' long history of paying its invoices weekly and according to terms, Mr. Annotico impliedly represented that Sherwood would be paid for its products as it had in the past. These representations were, however, materially false. They were materially false because the evidence establishes that Mr. Annotico did not intend that Sherwood would be paid.

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**Intention to Deceive**

The totality of the evidence establishes that Mr. Annotico purchased the products on credit without ultimately intending that Sherwood would be paid for them. The purchases from Sherwood increased during the period of November 26, 1996 to December 16, 1996 while the payments to it totally stopped. This was the first time in the parties' relationship that Sherwood was not paid according to terms and Mr. Annotico has not provided any explanation for the total cessation of payments during this period. Then, on December 17, 1996, the day after Sherwood indicated it would no longer extend credit, Mr. Annotico withdrew \$46,078.50 from the Krzys account. Mr. Annotico gave conflicting versions of what this money represented, saying at one point that it was for salary and a bonus, and at another point that it was applied as a payment toward the purchase price for the business. The Court finds that this money was not salary or a bonus based on the absence of any supporting documents or any history as to salary and bonus paid before 1996. The Court also finds that this money was not part of the purchase price for the business because even Mr. Annotico's own testimony on this point did not support it. He did not testify that this was part of the original agreement reached in June 1996 or that the agreement was in any way modified. The Court rejects, therefore, Mr. Annotico's explanations that he withdrew the funds either as salary/bonus or as an agreed-upon payment for the business.

The absence of any legitimate reason for the cash withdrawal and the timing of that action establish that Mr. Annotico used the increased purchases of Sherwood products to generate increased receivables; he then used those receivables to pay himself when it became clear that Sherwood, his main supplier, would no longer extend credit. Mr. Annotico seemed to feel that the timing of the cash withdrawal was explained and justified by his testimony that his

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divorce became final that same date. He did not, however, introduce any documentation to support this fact nor did he explain what he meant by "final" or why that would give him the right to withdraw this money from the company. Based on the sequence of events, it is clear that Mr. Annotico made the disputed purchases from Sherwood with the intention of deceiving it and without intending that it would be paid.

In reaching this conclusion, the Court also believes it is significant that Mr. Annotico left the business without telling his suppliers. Mr. Annotico testified that he successfully competed against others with lower prices because he offered fast, personal service. Under those circumstances, a person selling a business and intending for it to succeed would normally be expected to introduce the new owner to existing customers and suppliers to smooth the transition and create confidence that the new owner would provide the same good service. Mr. Annotico did not do this. He also did not inform the Krzys long-time employees about the move. If he intended for the business to continue, then surely part of its success would come from retaining workers who had a good history with the company. Mr. Annotico's actions are not consistent with someone who intended the business to continue, to generate funds, and to honor its obligations. They are instead consistent with the act of someone who took what he could get and ran.

In support of the opposite conclusion, Mr. Annotico asserts that he intended that Sherwood would be paid by Mr. Sidoti from the ongoing business. This assertion is unsubstantiated by the evidence which is entirely inconsistent with an intent to repay. When Mr. Annotico left the business, it owed in excess of \$200,000 to four of its suppliers. Mr. Annotico's December 17, 1996 payments to himself left only \$4,804.12 in the Krzys account.

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Mr. Annotico did testify that there were substantial receivables and \$100,000 in inventory remaining in the business when he left. His selective memory regarding these matters was not credible, however, in light of his inability to recall any other detailed information regarding the business. Additionally, his testimony that \$100,000 in inventory remained also lacked credibility because it is totally inconsistent with the amount of inventory which the business had at year's end in the preceding three years. The highest amount of inventory in those years was approximately \$14,000.

Mr. Annotico also argues that his intention that the business continue and pay its debts is shown by the fact that he was also owed money by Mr. Sidoti and the only way for him to be paid was through the ongoing business operations. Again, the circumstances do not support this argument. The agreement with Mr. Sidoti was that Mr. Annotico would receive a \$40,000 down payment (which he did) and then \$2,000 a month starting in February 1997 for the \$160,000 balance. Instead of waiting for those monthly payments, Mr. Annotico took \$46,000 from the till before he left. Had he not done so, it would have taken until about February of 1999—two years—for him to be paid the same \$46,000. By his actions, Mr. Annotico obviously reduced his own risk and had very little at stake in the ongoing success of Krzys. This undercuts his argument that he intended for the business to continue and pay the bills.

Mr. Annotico further supports his position by denying that he had any animus toward Mr. Pierce or Sherwood based on the A&W incident. Sherwood did not, however, have to prove that Mr. Annotico's actions were based on such a dislike. What Sherwood did prove through the testimony about A&W is that Mr. Annotico was familiar with the concept of pulling in receivables to generate cash at the expense of one's creditors based on his unpleasant experience

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with A & W Foods. Sherwood also proved that Mr. Annotico needed a large amount of money to pay his gambling markers and to support himself after he moved to Las Vegas. He accomplished this by depleting the cash, leaving the company with substantial debt and little in the way of liquid assets.

In sum, after considering the totality of the circumstances, the Court finds that it is more probable than not that Mr. Annotico subjectively did not intend for Sherwood to be paid for the goods.

**Justifiable Reliance and Proximate Cause**

Sherwood relied on Krzys' past payment history as it continued to extend credit on the purchases made between November 25, 1996 and December 16, 1996. This reliance was justifiable given the long-standing relationship between the parties. That reliance was also the proximate cause of Sherwood's \$67,981.13 loss in this matter. Mr. Annotico did not argue to the contrary.

**CONCLUSION**

For the reasons stated, judgment will be entered in favor of Plaintiff Sherwood Food Distributors. A separate judgment will be entered in accordance with this Memorandum of Opinion.

Date: 30 March 1999

Pat E. Morgenstern-Clarren  
Pat E. Morgenstern-Clarren  
United States Bankruptcy Judge

Served by mail on: Marvin Sicherman, Esq.  
Susan Gray, Esq.  
Waldemar Wojcik, Trustee

By: Joyce L. Gordon, Secretary  
Date: 3/30/99

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UNITED STATES BANKRUPTCY COURT  
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In re: )  
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RONALD J. ANNOTICO, )  
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Debtor. )  
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SHERWOOD FOOD DISTRIBUTORS, )  
)  
Plaintiff, )  
)  
v. )  
)  
RONALD J. ANNOTICO, )  
)  
Defendant. )

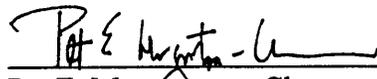
Case No. 98-13180  
Chapter 7  
Judge Pat E. Morgenstern-Clarren  
Adversary Proceeding No. 98-1230

**JUDGMENT**

For the reasons stated in the Memorandum of Opinion filed this same date,

IT IS, THEREFORE, ORDERED that Judgment on the Complaint is entered in favor of the Plaintiff, Sherwood Food Distributors. The Defendant-Debtor is personally liable to the Plaintiff in the amount of \$67,981.13 and this debt is determined to be non-dischargeable under 11 U.S.C. § 523(a)(2)(A).

Date: 30 Mar 1999

  
\_\_\_\_\_  
Pat E. Morgenstern-Clarren  
United States Bankruptcy Judge

Served by mail on: Marvin Sicherman, Esq.  
Susan Gray, Esq.  
Waldemar Wojcik, Trustee

By: Joyce L. Gordon, Secretary  
Date: 3/30/99