

11 USC 549(a)
11 USC 550(a) & (b)
727(d) (2)

Mitchell v. Deitz, Adv. No. 85-0102-S7

In re Deitz, 382-00599-S7

9/4/90 Ninth Circuit affirming BAP Published at 914 F.2d 161

The Ninth Circuit affirmed the decision of the BAP and Judge Sullivan to revoke the debtor's discharge and recover payments which the debtor made with estate assets and without the trustee's approval.

Although the discharge had not been formally entered, no objections were filed within the statutory deadline, and the court deemed the discharge entered on the 60th day after the §341a meeting. The debtor continued to operate a business that the trustee had decided to close. The debtor opened a bank account in Virginia for the business receipts. the debtor hid the account from the trustee and paid the other defendants with funds from that account.

Although he knew of the accounts' existence before the discharge, the trustee did not learn that it contained estate assets until after the discharge was deemed effective. Therefore, revocation of the discharge for fraud was appropriate.

The recovery of the estate assets from the other defendants was also affirmed. The payees were initial transferees under §550, so their attempts to establish good faith receipt of the funds were irrelevant.

914 F2d 161 (9th Cir 1990)

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IN RE DIETZ

IN RE: LELON C. DIETZ, dba
Com-Group Portland; AIRBRUSH
DIGEST PUBLISHING,
Debtors.

LELON C. DIETZ,
Appellant,

v.

JOHN MITCHELL, Trustee,
Appellee.

No. 89-35031

D.C. No.
CR 86-1873

OPINION

Appeal from the Ninth Circuit
Bankruptcy Appellate Panel
Mooreman, Ashland and Jones, Judges, Presiding

Argued and Submitted
January 8, 1990—Portland, Oregon

Filed September 4, 1990

Before: Eugene A. Wright, Thomas Tang and
William C. Canby, Jr., Circuit Judges.

Opinion by Judge Canby

SUMMARY

Bankruptcy

Affirming a judgment by the Bankruptcy Appellate Panel
revoking a debtor's discharge, the court of appeals held that
revocation was proper in the absence of a formal discharge

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and that funds received by payees in violation of the discharge order were to be returned to the estate.

Debtor Lelon C. Dietz's estate was placed by the bankruptcy court in liquidation after Dietz had defaulted on his Chapter 11 plan. Mitchell was appointed as trustee. Dietz's creditors met and the subsequent 60-day period for objecting to discharge of debts expired without any objections having been filed. The bankruptcy court never entered a formal order of discharge, even though Dietz was entitled to it on February 15, 1985. Mitchell decided to continue the operation of one of Dietz's business, but not to continue another. Despite the trustee's decision, Dietz took steps to continue the business that was discontinued by the trustee. Dietz opened a bank account in Virginia, and deposited in it proceeds from prepaid business subscriptions, accounts receivable, and a loan from his fiance. Dietz drew on the account to keep the business going and paid several individuals. Mitchell became aware of the bank account in January 1985, and obtained official records of the account on February 18, 1985. Four days later, he filed a complaint to revoke Dietz's discharge. Mitchell also filed adversary proceedings against individuals who received payments from the Virginia account. The bankruptcy court revoked Dietz's discharge. The Bankruptcy Appellate Panel affirmed.

[1] To obtain revocation of a debtor's discharge under 11 U.S.C. § 727(d)(2), a trustee had to learn of the debtor's fraud after discharge had been granted. [2] Although the bankruptcy court had not formally entered an order of discharge at the time Mitchell requested revocation, it did not err by considering the request. By deeming the discharge to have been entered on February 15, 1985, the court acted consistently with the spirit of the bankruptcy rules, contemplating that discharge was effective immediately upon expiration of the 60-day period following the creditors' meeting, so long as no objections were filed. [3] The bankruptcy court did not err by finding that Mitchell learned of the basis for revocation only

after February 15, 1985, the effective date of discharge. Although Mitchell became aware in January that the bank account existed and that Dietz had made payment from it to an employee, it was not until February 18, 1985, that he realized the account predated Dietz's involuntary bankruptcy and contained funds belonging to the estate. Sufficient evidence supported the finding that Mitchell learned of Dietz's unauthorized use of estate funds after the effective date of discharge. [4] As a trustee, Mitchell was authorized to avoid unauthorized transfers of estate property, and to recover that property from an initial transferee, or from any subsequent transferees who did not prove that they received the property in good faith, for value, and without knowledge of the voidability of the transfer. [5] The date of discharge was irrelevant to the time limit for Mitchell's recovery actions against the payees. He was entitled to sue for recovery at any time before the case was closed, or within one year after the avoidance of transfer, whichever occurred first. The record showed that he had done so within these time limits. [6] The payees were the initial transferees of the estate property in question. As initial transferees of the estate property, they were not entitled to assert good faith defenses to Mitchell's recovery actions.

COUNSEL

Jonathan Yost, Huntington Beach, California, for the appellants.

Steve Rissberger, Ranson, Blackman & Simson, Portland, Oregon, for the appellees.

OPINION

CANBY, Circuit Judge:

John Mitchell, the trustee in bankruptcy, requested that the bankruptcy court deny or, in the alternative, revoke Lelon

Dietz's chapter 7 discharge; and that it order certain individuals to return various sums of money that Dietz, without Mitchell's authority, had paid them from estate assets. The bankruptcy court granted Mitchell's requests, and the Bankruptcy Appellate Panel affirmed in all respects. Dietz and the payees appeal. We affirm.

FACTS

In the fall of 1984, after Dietz had filed a voluntary petition for relief and had subsequently defaulted on his chapter 11 plan, the bankruptcy court placed Dietz's estate into liquidation under chapter 7 of the bankruptcy code, 11 U.S.C. §§ 701 - 766, and appointed Mitchell as trustee. Dietz's creditors met in December 1984, and the subsequent 60-day period for objecting to discharge of debts expired without any objections having been filed. Although Dietz thereby became entitled to discharge on February 15, 1985, the court never entered a formal order to that effect.¹

Pursuant to his authority, Mitchell had decided to operate one of Dietz's two sole proprietorships ("Com-Group", a custom printing operation) and *not* to operate the other ("Airbrush", a magazine publishing and distribution operation). Despite the trustee's decision, Dietz took steps to continue Airbrush. Without informing Mitchell or the creditors, Dietz opened a bank account in Virginia, and deposited in it proceeds from prepaid subscriptions, accounts receivable and a loan from his fiance. Dietz also drew on the account in order to keep the business going.

Mitchell first became aware of the Virginia account sometime in January 1985; he obtained official records of the

¹The bankruptcy rules provide that interested parties may object to discharge within 60 days after the meeting of creditors, and that, if there is no objection within that period, the court "shall forthwith grant the discharge." Bankr. Rule 4004.

account on February 18, 1985. Four days later, on February 22, 1985, he filed a complaint in which he asked that the court either deny or revoke Dietz's discharge.² Subsequently, Mitchell filed several adversary proceedings against individuals who had received payments from the Virginia account.

The bankruptcy court ruled that, because no objection had been filed within 60 days after the meeting of Dietz's creditors, Dietz's discharge was "deemed to have been entered" on the 60th day, i.e., February 15, 1985. The court also found, among other things, that the Virginia account was property of the chapter 7 estate, that Dietz knowingly and intentionally failed to disclose the account's existence in order to misappropriate assets of the estate, and that Dietz acted to hinder and defraud the trustee and creditors of the estate. Consequently, the court revoked the discharge.³ It also determined that nine of the eleven individuals who received funds from the Virginia account must repay the estate.

DISCUSSION

Dietz and the Virginia account payees claim that the bankruptcy court's resolution of Mitchell's actions suffered from procedural and substantive defects. Having reviewed the court's findings of fact for clear error and its conclusions of law *de novo*, see *Daniel v. Security Pac. Nat. Bank (In re Daniel)*, 771 F.2d 1352, 1353 (9th Cir.), *cert. denied*, 475 U.S. 1016 (1986), we reject these challenges. We affirm the judgment both as to the revocation of Dietz's discharge and as to the liability of the nine payees to make repayments to the estate.

²Mitchell phrased his request in the alternative because, although Dietz had become entitled to discharge, the court had not yet entered a formal order.

³As an alternative ruling, the court determined that the discharge had not yet occurred when Mitchell filed his complaint, and then *denied* the discharge. Because we uphold the court's decision on revocation, we do not reach this ruling.

A. *Revocation of Discharge*

[1] The bankruptcy code provision under which Mitchell brought this action states that on request of a trustee the court shall revoke a discharge if

the debtor acquired property that is property of the estate . . . and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee

11 U.S.C. § 727(d)(2). Courts have interpreted this section to require that the trustee must have learned of the debtor's fraud *after* discharge had been granted. *See, e.g., Werner v. Puente (In re Puente)*, 49 Bankr. 966, 969 (Bankr. W.D.N.Y. 1985); *In re Lyons*, 23 Bankr. 123, 125-26 (Bankr. E.D. Va. 1982).⁴ Dietz claims that Mitchell's request for revocation was insufficient for two independent reasons: first, there was nothing to revoke since the court had never entered an order of discharge; second, Mitchell knew before the date of discharge the facts on which he based his request for revocation. Neither of these contentions has merit.

1. *Revocation in the absence of formal discharge*

[2] Although the bankruptcy court had not formally entered an order of discharge at the time Mitchell requested revoca-

⁴In adopting a rule that the trustee may only secure revocation of the discharge for fraud that he or she discovers *after* the discharge, neither *Puente* nor *Lyons* was faced with a situation where a trustee learns of the debtor's fraud such a short time before the granting of the discharge that there is no effective opportunity to enter a timely objection to the discharge. *Cf. In re Meo*, 84 Bankr. 24, 28 (Bankr. M.D. Pa. 1988) ("when the misconduct is discoverable in time to allow a creditor or the trustee to object to discharge or request an extension of time to do so within the 60 days of the date first set for a meeting of creditors, the bar date of Rule 4004(a) governs"). We, too, are not presented with that question, and we express no opinion on it.

tion, it did not err by considering the request. *See In re Meo*, 84 Bankr. 24, 28 (Bankr. M.D. Pa. 1988) (explicitly permitting creditor to seek revocation after 60-day period had closed without objection, and no formal discharge had occurred). By “deem[ing the discharge] to have been entered” on February 15, 1985, the court acted consistently with the spirit of the bankruptcy rules, which contemplate that discharge is effective immediately upon expiration of the 60-day period following the creditors’ meeting, so long as no objections are filed. *See Bankr. Rule 4004(c)*; B. Weintraub and A. Resnick, *Bankruptcy Law Manual*, ¶ 3.04[1] at 3-19 (rev. ed. 1986) (noting that in the absence of timely objections discharge is “automatic” and “a matter of course”).

2. *Date on which Mitchell acquired relevant information*

[3] Nor did the bankruptcy court clearly err by finding that Mitchell learned of the basis for revocation only after February 15, 1985, the effective date of discharge. Although Mitchell became aware in January⁵ that the Virginia account existed and that Dietz had written a check on that account to an Airbrush employee, Mitchell did not know that the funds in the account were estate assets. Indeed, Dietz had informed Mitchell that the funds in the account were the proceeds of a loan. According to Mitchell’s testimony, it was not until February 18, 1985, when he received official records from the Virginia bank, that he realized the account predated Dietz’s involuntary bankruptcy and contained money belonging to the estate. Thus, sufficient evidence supported the finding that Mitchell learned of the critical fact — Dietz’s unauthorized use of estate funds — after the effective date of discharge.

⁵The only evidence that Mitchell learned of the Virginia account earlier than January came in the testimony of Larry Wrenn, which Mitchell disputed. The court expressly found Mitchell more credible than Wrenn on this subject. Like the Bankruptcy Appellate Panel, we shall not disturb the trial court’s assessment of relative credibility.

B. *Liability of Virginia Account Payees*

[4] The bankruptcy code provisions under which Mitchell proceeded against the Virginia account payees allowed him, as trustee, to "avoid" unauthorized transfers of estate property, and to recover that property from the initial transferee, or from any subsequent transferees who did not prove that they received the property in good faith, for value, and without knowledge of the voidability of the transfer. *See* 11 U.S.C. §§ 549(a), 550(a) and (b). The Virginia account payees claim that Mitchell's attempted recovery must fail, first, because he filed the actions after Dietz's discharge became effective; and, second, because the payees were initial transferees and received the property in good faith. Both of these arguments are incorrect.

1. *Timeliness of Mitchell's recovery actions*

[5] Contrary to the payees' argument, the date of discharge was irrelevant to the time limit for Mitchell's recovery actions. The code entitled him to sue for recovery at any time before the case was closed, or before one year after the avoidance of transfer, whichever occurred sooner. *See* 11 U.S.C. § 550(e). The record shows that the case was still open when Mitchell brought his actions on April 16, 1985. Further, since Mitchell sought both avoidance and recovery in the same complaints, his recovery actions were, of course, within a year of transfer avoidance.⁶

2. *Payees' status and good faith defenses*

[6] In the face of the bankruptcy court's finding that Dietz himself was the initial transferee and the payees subsequent transferees, both Mitchell and the payees argue on appeal that

⁶Mitchell's complaints were also timely as petitions for avoidance. He filed them before the case was closed and before two years after the date of the transfers. *See* 11 U.S.C. § 549(d).

the payees were initial transferees. In light of the parties' agreement, we have assumed, without deciding, that the payees were indeed the initial transferees of the estate property in question. From this premise, it follows that the payees' attempts to establish good faith defenses are irrelevant. As initial transferees, they were not entitled to assert good faith defenses to Mitchell's recovery actions. *Compare* 11 U.S.C. § 550(a) *with id.* at § 550(b). Thus, to dispose of the payees' appeal on this point, we need not consider whether the bankruptcy court erred in finding their good faith defenses inadequate.⁷

AFFIRMED.

⁷In any case, review of the bankruptcy court's decision on these defenses would be impossible, since, as the Bankruptcy Appellate Panel noted, the payees did not include in the record on appeal a transcript of the relevant proceedings. Moreover, in their brief to this Court, the payees have not cited a single piece of evidence to support a finding of good faith receipt.