

Revocation of Discharge
11 USC § 727(d)

Fain v. Webb, Adversary No. 05-6020
Vince Webb, Case No. 603-69708-fra7

08/26/2005 FRA

Unpublished

Plaintiffs filed a complaint seeking revocation of Debtor's discharge on the grounds that he failed to report and schedule certain property of the estate which he owned at the petition date. Debtor filed a motion for summary judgment, providing evidence by document and declaration that the assets alleged to have been omitted were disclosed to the trustee and were in fact included in one or more of his bankruptcy schedules. Debtor stated that one asset, a "computer server farm," was never owned by him.

Code § 727(d)(1) requires that the party seeking revocation of discharge not know of the alleged fraud (i.e. the intentional omission of property of the estate) prior to the date that discharge is granted. The discharge objection bar date was set at 3/12/04 and the discharge was granted 1/12/05. Debtor argued that Plaintiffs became aware of facts giving rise to their complaint seeking revocation prior to 1/12/05 and the action must fail on that ground alone. Plaintiffs countered that they learned of the relevant facts after the bar date and waited until after the discharge was granted to file the action to revoke discharge, because they could not file a timely complaint objecting to discharge pursuant to Fed.R.Bankr.P. 4004.

Courts have created an exception for the situation in which the Plaintiffs allegedly found themselves, so as not to leave a party with no remedy. See Citibank v. Emery, 132 F.3d 892 (2d Cir. 1998). However, in the present case the discharge objection bar date had been extended to all parties by motion of the US Trustee to 4/26/04. Evidence was presented by Debtor that Plaintiffs became aware of facts concerning the allegations of their complaint by 3/16/04, the date of the adjourned meeting of creditors. Plaintiffs could thus have filed a timely complaint objecting to discharge or a motion to extend the time to file such a complaint. The exception provided in Citibank v. Emery thus did not apply. As Plaintiffs learned of the relevant facts prior to discharge being granted, their action under § 727(d)(1) must fail. Debtor's motion for summary judgment was granted.

CLERK, U.S. BANKRUPTCY COURT
DISTRICT OF OREGON

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF OREGON

10 IN RE)
11 VINCE LEE WEBB,) Case No.603-69708-fra7
12 _____ Debtor.)
13 CHRIS FAIN and VALERIE FAIN,)
14 Plaintiffs,) Adversary No. 05-6020-fra
15 vs.)
16 VINCE LEE WEBB,) MEMORANDUM OPINION
17 _____ Defendant.)

18 Plaintiffs filed a complaint seeking to revoke the discharge
19 entered in the Debtor/Defendant's bankruptcy case, under 11 U.S.C.
20 § 727(d). Defendant filed a motion for summary judgment and a
21 hearing was held on August 2, 2005. For the reasons that follow,
22 Defendant's motion will be granted.

23 BACKGROUND

24 Defendant filed his bankruptcy petition under chapter 7 on
25 November 24, 2003 and, after some delay, a discharge order was
26 entered on January 12, 2005. The initial deadline for filing

1 objections to discharge, or a motion for extension of time to so
2 file, was set at March 12, 2004. Fed.R.Bankr.P. 4004(a) and (b).
3 Plaintiffs filed their complaint against the Defendant/Debtor Webb
4 to revoke discharge under § 727(d)(2) on January 25, 2005. The
5 complaint alleges that the Debtor's bankruptcy schedules failed to
6 include:

7 1. A promissory note in the amount of \$300,000 from Laura
8 Traub Webb to Defendant,

9 2. Exercise equipment with a fair market value of
10 approximately \$10,000, and

11 3. A computer printer, numerous computer monitors, and a
12 computer "server farm."

13 The complaint further alleges that the Defendant acquired or
14 became entitled to acquire the omitted property that was property
15 of the estate and knowingly and fraudulently failed to report the
16 acquisition or entitlement to property, and failed to deliver the
17 property to the trustee.

18 At the hearing held on Defendant's motion for summary
19 judgment, Plaintiffs' attorney stated that the property which was
20 allegedly omitted from the Defendant's schedules was in Defendant's
21 possession and control at the bankruptcy petition date. Defendant's
22 attorney agreed that much of the property described in the
23 Complaint was owned by Defendant at the petition date.

24 Defendant's Motion for Summary Judgment

25 The Defendant submitted the following facts in his Concise
26 Statement of Material Facts:

1 1. The promissory note was disclosed in schedules and provided
2 to the trustee.

3 The divorce settlement amendment/promissory note was described
4 in Debtor's original schedules filed 2/18/04, at Sch B, line 33, as
5 "Agreement with Lora Webb (former spouse) for the sale of real
6 property on Galice Road (Unknown Value)." Schedules A and C also
7 disclosed Debtor's claim of interest in the Galice Road property
8 "subject to various post-dissolution agreements with former
9 spouse."

10 The Trustee specifically requested a copy of the Agreement
11 with Lora Webb and a copy was provided by Debtor along with other
12 requested items, along with a letter of explanation concerning the
13 items. The letter and its contents were discussed at the second
14 adjourned meeting of creditors on 3/16/04, at which Plaintiffs'
15 attorney was present.

16 [Concise Statement of Material Facts: Webb Affidavit ¶¶ 8 -
17 13, Exh. 2-5, 12-14, 16].

18 2. Exercise and Computer Equipment.

19 Debtor informed the trustee before the 3/16/04 adjourned
20 meeting of creditors that Debtor had purchased fitness equipment,
21 computers, monitors, and trade show related equipment from CD
22 Micro, (a corporation of which Defendant was formerly chief
23 operating officer and which also was in bankruptcy) in August 2003,
24 and was keeping some of the items at his home and some of the items
25 were still at the offices of CD Micro. The items were detailed on
26 an invoice dated 8/11/03, in the amount of \$39,618. Debtor

1 informed the trustee's attorney that all the items listed on the
2 invoice belonged to the Debtor's bankruptcy estate.

3 [Concise Statement of Facts: Webb Affidavit, ¶¶ 17 and 17;
4 Exh. 5].

5 At the 3/16/04 adjourned meeting of creditors, the trustee's
6 attorney examined Debtor relating to the exercise equipment and
7 computer equipment in which Debtor claimed an interest. Plaintiff
8 Chris Fain and his attorney were present at this meeting.

9 [Concise Statement of Facts: Webb Affidavit, ¶ 18 and page 6,
10 line 16 through page 7, line 18].

11 Debtor repurchased the plasma screen, trade show equipment,
12 and other non-exempt assets from the bankruptcy estate of CD Micro,
13 in a private sale conducted by agents of the trustee.

14 Debtor's original and amended Sch B, line 4 listed "household
15 goods and furnishings," including audio, video, and computer
16 equipment of \$10,000 value. Sch B, line 27 also listed "trade show
17 and office equipment (in possession of CD Micro, Inc.)" of \$20,000
18 value. Debtor claimed an exemption as to the trade show and office
19 equipment on his initial and amended Sch C. Debtor's Statement of
20 Financial Affairs filed 2/18/04 at Item 14 "Property Held for
21 Another Person," disclosed that debtor was holding miscellaneous
22 equipment belonging to CD Micro.

23 3. Computer "Server Farm."

24 The only server farm of which the Debtor is aware is that
25 which was previously owned by CD Micro, and at one time was under
26 the control of the trustee, and is the property of a private

1 investor. The server farm was the subject of court action in both
2 Defendant's bankruptcy case and in the CD Micro bankruptcy,
3 including a proceeding before Judge Alley in the summer of 2004, at
4 which both Plaintiff and his attorney were present. Debtor has not
5 acquired any server farm that is property of Debtor's bankruptcy
6 estate or knowingly and fraudulently failed to report, deliver, or
7 surrender any property of the estate to the trustee.

8 [Concise Statement of Facts: Webb Affidavit, ¶¶ 20, 21].

9 Debtor made a proposal to Plaintiff Chris Fain for the
10 development of an "irewards" website. Debtor was to provide
11 consulting services and to set up the equipment necessary for the
12 web site. If the proposal had been accepted, Debtor would have
13 purchased the necessary equipment. Debtor did not own the
14 equipment, nor was any of the equipment listed in the proposal
15 property of the bankruptcy estate.

16 [Supplemental Affidavit of Webb provided with Defendant's
17 Reply in Support of MSJ, responding to a document provided by
18 Plaintiffs in their Response].

19 Plaintiffs' Concise Statement of Material Facts

20 1. Fain is a creditor of the Debtor. [Fain Affidavit ¶ 1].

21 2. In June 2004, Defendant's attorney had a telephone
22 conversation with Chris Fain and indicated that he was speaking on
23 behalf of Defendant and said that Defendant would sell to Chris
24 Fain a "server farm" for \$100,000 to \$150,000. The offer was later
25 reduced to writing.

26 [Fain Affidavit, ¶ 2, Exh. 1].

1 fact from which a fact-finder might return a verdict in its favor.
2 Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 257 (1986).
3 Fed.R.Bankr.P. 7056, which incorporates Fed.R.Civ.P. 56(e),
4 provides that the nonmoving party may not rest upon mere
5 allegations or denials in the pleadings, but must respond with
6 specific facts showing there is a genuine issue of material fact
7 for trial. Absent such response, summary judgment shall be granted
8 if appropriate. See Celotex Corp. v. Catrett, 477 U.S. 317, 326-27
9 (1986).

10 DISCUSSION

11 Code § 727(d)

12 (d) On request of the trustee, a creditor, or the United
13 States trustee, and after notice and a hearing, the court shall
revoke a discharge granted under subsection (a) of this section if-

14 (1) such discharge was obtained through the fraud of the
15 debtor, and the requesting party did not know of such fraud
until after the granting of such discharge;

16 (2) the debtor acquired property that is property of the
17 estate, or became entitled to acquire property that would be
18 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; or

19 (3) the debtor committed an act specified in subsection
20 (a)(6) of this section.

21 Code § 727(d)(2), the grounds asserted for revocation by
22 Plaintiffs, applies to property of the estate acquired by a debtor
23 during a bankruptcy case rather than to property held by Debtor at
24 the petition date. See 7 Collier on Bankruptcy ¶ 727.15[4] (15th
25 ed. revised 2005). An action for revocation of discharge for the
26 intentional omission of assets from the debtor's schedules would be

1 brought under Code § 727(d)(1), which requires a showing of fraud
2 in fact. Collier, supra at ¶ 727.15[3]. As Plaintiffs assert that
3 the omitted assets were held by Defendant at the petition date, the
4 requirements of § 727(d)(1) are applicable.

5 Plaintiffs' Knowledge Prior to Discharge

6 § 727(d)(1) requires that the party requesting revocation of
7 discharge not know of the alleged fraud prior to the date that
8 discharge was granted.¹ Defendant argues that all of the
9 information concerning the alleged omissions was brought to
10 Plaintiffs' attention prior to January 12, 2005 (the date of
11 discharge). Plaintiffs counter that they were unaware of the
12 information giving rise to their allegations until after the
13 March 24, 2004 discharge objection bar date, and were therefore
14 unable to file either a timely motion for extension of time to
15 object to discharge or a timely complaint objecting to discharge.
16 They therefore waited until the discharge was granted and filed the
17 complaint to revoke discharge.

18 Under a strict interpretation of § 727(d)(1), the situation
19 Plaintiffs allegedly found themselves in would make no difference.
20 However, courts have created an exception for situations such as
21 the one described so that a party is left with no remedy. See
22 Citibank, N.A. v. Emery (In re Emery), 132 F.3d 892 (2d Cir. 1998).

23 Defendant's bankruptcy case was filed on November 24, 2003 and
24 the bar date for objecting to discharge was initially set at

25 ¹ While Code § 727(d)(2) does not specifically contain a prohibition
26 regarding the requesting party's pre-discharge knowledge, as does §
727(d)(1), courts have interpreted § 727(d)(2) to require that the party
seeking to revoke discharge of a debtor under that subsection not learn of
the debtor's fraud until after discharge has been granted. In re Dietz,
914 F.2d 161, 163 (9th Cir. 1990).

1 March 12, 2004. On the motion of the United States Trustee,
2 however, an order was entered extending the bar date for "any
3 interested party" to object to discharge to April 26, 2004 [doc.
4 #44, case 03-69708]. That order was served on interested parties,
5 including the attorney for the Plaintiffs. The discharge order was
6 ultimately not entered until January 12, 2005.

7 Defendant's attorney filed an affidavit [Exh. 7] with a
8 partial transcript of the adjourned meeting of creditors held on
9 March 16, 2004, showing that attorney Michael Bird appeared at the
10 meeting representing Chris Fain. In that meeting, Defendant's
11 attorney discussed with the Trustee the promissory note for
12 \$300,000 and his explanation of it [Exh. 7, p. 3]. Office
13 equipment and fitness equipment were also discussed [Exh. 7, p. 7],
14 as was the transfer of assets from CD Micro to the Defendant made
15 in August 2003.

16 Defendants were on notice, either actual or constructive, by
17 the date of the March 16, 2004 adjourned meeting of creditors of
18 most, if not all, of the basis of their allegations. A creditor
19 must exercise diligence in investigating the facts during the case,
20 especially after having been put on notice of possible fraud. Mid-
21 Tech Consulting, Inc. v. Swendra, 938 F.2d 885 (8th Cir. 1991).
22 The party requesting revocation of discharge bears the burden of
23 proving its lack of knowledge of the fraud before discharge;
24 failure to so prove will be fatal to the party's cause of action.
25 Werner v. Puente (In re Puente), 49 B.R. 966 (Bankr. W.D.N.Y.
26 1985).

1 More than five weeks passed from the date of the adjourned
2 meeting of creditors to the extended date by which interested
3 parties were required to file either a complaint objecting to
4 discharge or a motion for extension of time to file such a
5 complaint. Being on notice of the facts of the asserted fraud, or
6 at least of possible fraud, Plaintiffs could have filed either a
7 complaint objecting to discharge or a motion for extension to so
8 file by the April 26, 2004 deadline. That timely knowledge of
9 possible fraud prevents Plaintiffs from pursuing their action to
10 revoke the discharge granted to Defendant.

11 Server Farm

12 Even if one could successfully argue that the Plaintiffs did
13 not have sufficient knowledge of possible fraud to file a complaint
14 or motion for extension by the deadline until they learned of the
15 "server farm" in June 2004, the evidence presented does not meet
16 the evidentiary burden placed on Plaintiffs. The only evidence
17 that Plaintiffs present that the Debtor had a "server farm" which
18 was property of the estate and failed to report it, is a
19 conversation in June 2004 (at least six months after the petition
20 date) between Plaintiff Chris Fain and Debtor's attorney concerning
21 an offer to sell and a written proposal dated August 16, 2004.
22 There is no evidence that the Debtor actually possessed or had an
23 interest in a server farm at that date, or that the server farm was
24 property of the bankruptcy estate. By supplemental affidavit,
25 Debtor said he intended to obtain a server farm if the proposal was
26 accepted.

