11 USC § 727(a)(2)
11 USC § 727(a)(4)
Burden of Proof
Bankr. R. 4005

Stokes v. Fitzsimmons Adv. No. 89-3139
In re Fitzsimmons Case No. 388-04645

9/10/90 CEL unpublished

The debtor intentionally omitted from his Statement of Affairs certain bank accounts containing funds of the debtor. The accounts, though not in the debtor's name, were used by the debtor for deposits and withdrawals. In addition, the debtor also failed to disclose a prior chapter 13 case which was dismissed without administration. The debtor also transferred money from a joint account to one in his wife's name for the purpose of hindering creditors.

In an action to deny a discharge, Rule 4005 imposes the burden of proof of all elements upon the creditor. The court, in denying the debtor's discharge under 11 USC §727(a)(2) and 727(a)(4), found that the creditor had met that burden by a preponderance of the evidence.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

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| In Re:<br><br>JERRY C. FITZSIMMONS,<br><br>Debtor. | ) | Case No. 388-04645-P7 |
| JOSEPH R. STOKES and<br>S. PAULINE STOKES,<br><br>Plaintiffs,<br><br>v.<br><br>JERRY C. FITZSIMMONS,<br><br>Defendant. | ) | Adversary No. 89-3139<br><br>NARRATIVE MEMORANDUM OPINION |

In this proceeding the plaintiffs seek to deny the debtor's discharge under 11 U.S.C. § 727(a)(2) and § 727(a)(4).

The debtor/defendant is college educated and has demonstrated above average earning capacity. He has from time to time had his own businesses.

The debtor earned and earns his living as a salesman of chemical products

primarily used as pesticides and products related to their use in agriculture. During the period relevant to these proceedings, he also had arrangements with manufacturing and marketing companies entitling him to royalty payments based on sales of products for which he had developed formulae, and formed a corporation, Cloverleaf Products, to obtain and market a pesticide which had been banned for use by government agencies, but for which he learned there would be a limited removal of the ban on the product which he knew to be much desired for use in agriculture.

In the fall of 1984, the defendant learned that the plaintiffs, Joseph R. and S. Pauline Stokes, were selling a pizza parlor. The debtor had a son-in-law who was qualified in the restaurant and retail businesses. The defendant decided to buy the business, contemplated that he would, in turn, sell it to his son-in-law.

The defendant purchased the business in October, 1984. The contract price for the land and pizza parlor was $285,000. The realty and rest of the business were sold by separate contracts. The real property was subject to an encumbrance to First Interstate Bank, as a successor bank. The contract of sale relating to the realty provided for the $200,000 to be paid by buyer's assumption of a first mortgage balance of $97,067.24 and a second mortgage balance of $29,582.74 with a balance of $73,000 payable in installments of $704.43 per month and other payment provisions.

The sale of the pizza parlor was for $85,000, with $45,000 apportioned to the fixtures and equipment, $20,000 for goodwill and $20,000 for non-compete agreement. $30,000 was paid down, and the balance to be paid in monthly installments of $726.83 per month. The source of the down payment was an initial royalty payment of $50,000 from Wilbur Ellis

Company.

The intended sale to the son-in-law did not occur and the pizza parlor failed to generate anticipated income. In June of 1986, the plaintiffs made demand on the defendant to satisfy delinquent property taxes due the county. In October, 1986, plaintiffs advised defendant that $8,472.10 plus interest was delinquent for two tax years and gave him ten days to pay the taxes or be subject to remedies for default on the land sale contract.

The defendant made a proposal to liquidate royalty contracts to satisfy the taxes, but for reasons that are not clear, this proposal did not materialize, and the debtor chose to attempt to rescind the contract for fraud November 26, 1986. This conduct was followed by the filing of a suit for specific performance and to foreclose by the plaintiffs in the state court on December 9, 1986.

Negotiations between the parties continued over the next sixteen months, during which time the defendant was attempting to sell the property. Several proposed sales were rejected, some rejections triggered by the bank which was required to be in agreement because of the mortgage.

During the negotiations, both parties seem to have become unconscious of economic realities, perhaps caused by the plaintiffs' unjustified expectations based on a financial statement given by the defendant to a financial institution which appears to have grossly exaggerated his assets, and by the defendant's unrealistic and unsuccessful efforts to unwind or bail out the deal. The defendant's financial statement is not related to the complaint in these proceedings. It is only background for what developed into a grossly over-lawyered proceeding on both sides.

In the litigation, the bank's counterclaim for foreclosure against Stokes was granted. The Stokes prevailed on their claim against Fitzsimmons for specific performance and a deficiency judgment of $48,614.72 plus interest and attorney fees in excess of $32,000.

Execution by the bank was stayed for a brief period, and Fitzsimmons was given that same time to specifically perform, during which time he continued his unsuccessful attempts to sell the business. Fitzsimmons then surrendered the keys to the business to Stokes' attorney.

When scheduled for a creditors' debtor examination, the defendant filed a Chapter 13 skeletal petition (filed through a different attorney than the one handling his negotiations, whose firm did no bankruptcy work). The attorney surprisingly admitted that he knew the debtor was not eligible for Chapter 13, but filed it as a negotiating tool. The Chapter 13 filing was converted after a few days to Chapter 7, and a short time later the challenged schedules and statement of affairs were filed. In fairness to the attorney representing the debtor in these discharge proceedings, he was not involved in the bankruptcy filings.

The plaintiffs countered with their complaint, amended complaint and second amended complaint objecting to the debtor's discharge.

The defendant's initial responses have been motions for dismissal, for partial summary judgment, assertions of plaintiffs' litigative harassment, and an amended answer, affirmative defenses and counterclaim. The counterclaim seeks judgment for harassment and increasing cost of litigation for which he requests reasonable attorney fees. The parties proposed to pursue this aspect of the litigation separately from the discharge trial.

Discovery was aggressive and extensive by both sides. Prior to trial, the parties, remarkably, submitted a joint pretrial order. In that document the defendant represented that

after the trial on the discharge issue he will move to amend his answer "to include counterclaims for avoidance of transfer under 11 U.S.C. § 544 and violation of the automatic stay under 11 U.S.C. § 362 . . ."

The plaintiffs "reserve any objections and defenses to the additional counterclaims asserted by defendant."

The pretrial order proposed that the plaintiffs amend their second amended complaint by deleting reference to royalty contracts or royalty payments referred to in the second sentence of paragraph 4, and by deleting paragraphs 5, 8, and 9 of the second amended complaint. Thus, there remain for disposition the plaintiffs' allegations seeking denial of the defendant's discharge for the alleged transfer of assets with intent to hinder, delay or defraud creditors proscribed by 11 U.S.C.
§ 727(a)(2) and for allegedly knowingly and fraudulently making "false oath and accounts in the bankruptcy proceedings by failing to disclose all of his assets, by failing to disclose all of the bank accounts for which he was an authorized signer during the two years preceding the bankruptcy, by misrepresenting income which he received from royalties, and by failing to disclose a prior Chapter 13 bankruptcy proceeding" in violation of 11 U.S.C. § 727(A)(4).

Plaintiffs have the burden of proof of all elements of the basis of the objections. Bankruptcy Rule 4005; see In re McNamara, 89 B.R. 648 (Bankr. N.D. Ohio 1988). After this burden has been met by proof of facts supporting a prima facie case, the burden may shift to the defendant to go forward with the evidence to support his defense.

Herein the court finds that in paragraph 4 of the debtor's statement of affairs submitted with his Chapter 7 petition, he listed only two bank accounts. In fact, within two years

preceding his bankruptcy petition, he had been an authorized signer by himself or with others on at least five other bank accounts. He failed to list those other accounts on his Statement of Affairs for a Debtor Engaged in Business. In paragraph 10 of the Statement of Affairs, the defendant also failed to disclose a prior Chapter 13 filing in 1980.

The defendant claims that he gave bank account information to his attorney, which the evidence did not support. The defendant also states that he made disclosure at the creditor's meeting, and that the balances in the accounts were minimal or the accounts closed. It is true that for the most part that at the time of filing he was correct. The disclosure came, however, only when a representative of Key Bank confronted him with evidence of the omitted accounts. One of the accounts, in the name of Cloverleaf Products, he used for substantial deposits of personal funds and disbursements for personal purposes of himself and his spouse. Cloverleaf Products, Inc. was a corporation formed for a legitimate purpose. Failure to list the Cloverleaf Products bank account was, however, an important omission because of the deposits to the account and disbursements from it.

To be a basis for denial of discharge, the false oaths must be to a material fact. But omissions may constitute a false oath. In re Bastrom, 106 B.R. 223 (Bankr. Mont. 1989); In re Shebel, 54 B.R. 196 (Bankr. Vt. 1985).

The value of the accounts may not be significant. Nevertheless, they need be disclosed to enable the trustee and creditors to analyze past transactions relevant to administration of the estate. If relevant to discovery of past transactions, materiality may be present. See In re Kessler, 51 B.R. 895 (Bankr. Kan. 1985); In re Butler, 38 B.R. 884 (Bankr. Kan. 1984).

Omission of assets may constitute both a concealment to hinder or delay creditors and a false oath. Detriment to creditors need not be shown. See Farmers Co-operative Ass'n. v. Strunk, 671 F.2d 391 (10th Cir. 1982).

In addition, the defendant failed to disclose the filing of a prior Chapter 13 case in 1980. He seeks to excuse his omission of filing of a Chapter 13 in 1980 as not a knowing and fraudulent omission because the earlier case was dismissed without administration. Considered alone, this omission might not justify denial of discharge; however, the cumulative omissions may be considered in determining the factual question of the debtor's fraudulent intent or reckless indifference in response to the petition questions tantamount thereto.

After the entry of the plaintiff's judgment, the defendant replaced a joint account held by himself and his wife with a new account in her name only. He admittedly made deposits of his earnings and withdrawals from that account after it was placed in his wife's name.

The transfer of property by the debtor to his spouse while insolvent, while retaining the use and enjoyment of the property is a classic badge of fraud. See In re McNamara, supra; In re Kaiser, 722 F.2d 1574 (2nd Cir. 1980).

Evidence was also introduced relating to transfer of property in Oregon City. It was alluded to in the pretrial order at page 20 thereof. Plaintiffs have made a post-trial motion to amend the pleadings to conform to evidence presented surrounding the transfer. The defendant has resisted the motion. The schedules inexpertly allude to the transaction and the court finds that the evidence surrounding the ultimately aborted transaction was not so concealed as to support the objection on the ground that the transfer was made to hinder or delay creditors. Because there was no surprise to the defendant, the court will consider the amendment to

conform with the evidence allowed, although properly it should have been made before considering the filing of two amended complaints. The court, however, finds that the plaintiffs failed on this ground to establish a knowing and fraudulent concealment in making the transfer, and that the reference to it in the schedules negatives intent to conceal. The transaction has no bearing on the court's decision in the proceeding.

Finally, the plaintiffs urge that they are entitled to prevail on a preponderance of the evidence standard, and the defendant urges a clear and convincing proof standard.

It is difficult to reconcile the hornbook law that the right to discharge is to be liberally construed with the lesser standard, and there is a split of authority on the question. See In re Bone, 7 B.R. 549 (Bankr. M.D. Ga. 1980). The issue does not appear to have been ruled on under the Bankruptcy Code by the Ninth Circuit Court of Appeals. See In re Ayala, 107 B.R. 271 (Bankr. E.D. Ca. 1989). However, the reasoning appears to be that the ordinary standard in civil cases, the preponderance of the evidence, should be applied and the court believes that to be the trend in this circuit and applicable to these proceedings. This court finds, however, that applying either standard the evidence supports the conclusion that the defendant in signing his schedules and statements of affairs did so clearly knowing of the omissions with the intent to provide only minimal basis for creditor scrutiny of his past transactions. His answers in testimony were vague and slippery, as they were at the § 341(a) creditors' meeting and in depositions.

There was in his wife's bank account, on which he admitted he signed checks and made deposits, in excess of $700 at the time of his filing. This is not a significant amount, but the evidence surrounding its use was to have it as a vehicle to hinder or delay creditors. While

he was not a nominal signatory to the account, his accessible use of it should have been disclosed in the statements of affairs and schedules.

It has been said that the discharge is reserved for the honest debtor who is entitled to a fresh start after laying his non-exempt assets at the feet of his creditors.

As the court in In re Ayala, supra, opined, "Unfortunately, the Bankruptcy Code does not provide for a petty denial of discharge. It simply provides for denial of discharge. Logically, the amount of money is immaterial except for the single purpose of tending to negate fraudulent intent." See also, In re Chalik, 748 F.2d 616 (11th Cir. 1984); In re Tully, 818 F.2d 106 (1st Cir. 1987); In re Mascola, 505 F.2d 274 (1st Cir. 1974); In re Diodati, 9 B.R. 808 (Bankr. Mass. 1981).

The defendant's discharge will be ordered denied pursuant to 11 U.S.C. § 727(a)(2) and 11 U.S.C. § 727(a)(4).

This narrative Memorandum Opinion contains the court's Findings of Fact and Conclusions of Law and pursuant to Bankruptcy Rule 7052 they will not be separately stated.

IT IS ORDERED that each party shall bear his or her attorney fees and costs in these proceedings and separate judgment consistent herewith will be entered.

DATED this ______ day of _________________, 1990.

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C. E. LUCKEY
Bankruptcy Judge

cc: Danny H. Gerlt
Laura J. Walker