

544(b)
727(a)

France v. Ray (In re Ray), No. OR-91-1208 VAsO (9th Cir BAP
OR-91-1290 VAsO
OR-91-1411-VAsO
4/20/92 BAP reversing J. Luckey unpublished

The standard of proof in actions seeking to avoid a fraudulent conveyance under § 544(b) is a preponderance of the evidence. The same standard applies in actions objecting to the debtor's discharge under § 727. The trial court improperly applied a "clearly erroneous" standard, and erred in finding that the debtor satisfactorily explained the failure to keep records of or account for the disposition of a large amount of cash.

NOT FOR PUBLICATION

FILED

APR 20 1992 *ed*

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U.S. BKCY. APP. PANEL
OF THE NINTH CIRCUIT

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE NINTH CIRCUIT

In re)	BAP Nos. OR-91-1208-VASO
)	OR-91-1290-VASO
WILLIAM W. and CATHI L. LAWLER,)	OR-91-1411-VASO
)	(Consolidated)
Debtors.)	BK No. 389-34301-P7
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WESTERN WIRE WORKS, INC.,)	Adv. No. 89-3384
FRANZ KROELL, DONALD H.)	89-3351
HARTVIG, U.S. Trustee,)	90-3001
Appellants,)	
v.)	<u>MEMORANDUM</u>
WILLIAM W. and CATHI L. LAWLER,)	
OWEN SIMON and MAUREEN MENGIS,)	
Appellees.)	

Argued and Submitted on November 21, 1991
at Portland, Oregon

Filed - APR 20 1992

Appeal from the United States Bankruptcy Court
for the District of Oregon

Honorable C. E. Luckey, Bankruptcy Judge, Presiding

Before: VOLINN, ASHLAND, and OLLASON, Bankruptcy Judges.

P92-11(10)

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OVERVIEW

The trustee and two creditors appeal FRCP Rule 41 (b) dismissals of their consolidated fraudulent transfer cases. The two creditors also appeal the dismissal of their objections to the discharge of the debtor pursuant to various claims under 11 U.S.C. § 727. The appeal centers on whether the trial court erred by ruling that the plaintiffs had to meet their burden of proving their claims by clear and convincing rather than by a preponderance of the evidence. We reverse.

FACTUAL AND PROCEDURAL BACKGROUND

A. Relationships of Parties

The impetus for each of the proceedings derives from the sale of William and Cathi Lawlers' real property, which included their prior residence, to one Owen Simon. The latter was an itinerant auto mechanic who had frequently sought employment with a used car dealer named Delbert Williams, who was Cathi Lawler's uncle. Acting as an agent, Simon purchased the property for one Maureen Mengis for whom he had, on occasion, repaired automobiles. Mengis at times prior to the sale held herself out to be the wife of C. Dennis Williams, the father of Cathi Lawler. C. Dennis was a seller on consignment of used cars from the premises of the aforesaid Delbert, his brother.

1 B. The Sale and Acquisition of Funds by Lawler

2 In early 1988, a fire did considerable damage to the Lawler
3 residence. Later that year the couple collected on an insurance
4 claim in connection with the fire. Although the property was
5 listed for sale at \$117,000 in the spring of the same year, the
6 Lawlers agreed to sell to Simon at \$70,000. By August 1988, the
7 combined insurance proceeds and cash from the sale enabled the
8 Lawlers to accumulate a checking account balance in excess of
9 \$120,000. By the time of the bankruptcy filing about one month
10 later, on September 19, 1988, the Lawlers claimed to have less
11 than \$100.00.

12 The parties all agree that Cathi Lawler routinely cashed two
13 checks daily, for either \$4300 or \$5000, during the early August
14 to mid-September period except for one occasion in early
15 September when she withdrew in excess of \$36,000.00. Cathi
16 Lawler testified that she spent the bulk of the money on her
17 children, although she kept no records of her expenditures. In
18 addition she testified that she spent \$10,000.00 on a vacation
19 for herself and her husband. She provided no documentation to
20 support the latter assertion. We note, however, that since she
21 and her husband conducted a conveyor services business and she
22 was a licensed realtor, she presumably was aware that
23 documentation and record keeping usually attended receipt and
24 disbursement of funds.

25 Prior to the bankruptcy, Appellant Western Wire Works filed
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1 an action in state court against the debtors in which the court
2 announced its ruling against debtors on September 19, 1988, the
3 date debtors filed bankruptcy. Thereafter, a judgment of
4 \$111,963.40 was entered on October 20, 1988, against William and
5 Cathi Lawler. On November 7, 1988, the same court entered a
6 Judgment and Decree in favor of Western Wire Works and Franz
7 Kroell against William Lawler and Lawler Conveyor Systems for
8 \$30,757.40.

9 Prior to the entry of the judgments, the Lawlers transferred
10 title to their real property to Owen Simon by a Statutory
11 Warranty Deed. Cathi Lawler executed the Deed on September 1,
12 1988, and William Lawler executed the Deed the following day.
13 Recording of the transfer from Lawler to Simon occurred on
14 September 20, 1988, the day after the Lawlers filed for
15 bankruptcy under Chapter 11. Thereafter, Simon's transfer of
16 the deed to Mengis was recorded.

17 Subsequent to the recording, Western Wire Works and Kroell
18 commenced a state court action to set aside the transfer as
19 fraudulent. Mengis intervened in the state court action and
20 later removed the case to bankruptcy court. At about the same
21 time, the U.S. Trustee, Donald Hartvig, contending that the
22 fraudulent transfer claim belonged to the estate, commenced an
23 adversary proceeding to set aside the transfer as fraudulent.
24 The trustee contended, inter alia, that the transfers from
25 Lawler to Simon (and Mengis) were invalid by virtue of 11 U.S.C.
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1 § 544 (b). The bankruptcy court consolidated the two cases.

2 In addition, Western Wire Works and Kroell, based on the
3 circumstances surrounding the same transfer of real property,
4 objected to the discharge of their claims against the Lawlers
5 under § 727 (a):

- 6 (2) (A) [intent to defraud, transfer of property within one
7 year before the filing of the bankruptcy petition];
8 (3) [concealment and failure to keep records];
9 (4) (A) [false oath or account]; and
10 (5) [failure to explain loss of assets]

11 In their complaint in the state court action filed on November
12 18, 1988, the two plaintiffs indicated that they had garnished
13 Lawlers' bank accounts and payroll checks, but had not received
14 any part of the two judgments.

15 In the consolidated matter the Lawlers moved for a F.R.C.P.
16 Rule 41 (b) involuntary dismissal on the ground that the
17 plaintiffs had shown no right to relief. After hearing
18 testimony on both sides, the Court concluded that the plaintiffs
19 had not shown a fraudulent transfer by clear and convincing
20 evidence:

21 "[T]he Court must find that the case as to the fraudulent
22 transfer of the property has not been proven by clear and
convincing evidence." (Transcript 703) (emphasis added)

23 He then granted the motion.

24 Although the trial court had before it evidence on each of
25 the four § 727 allegations, it addressed only in general terms
26 the (a) false oath and (b) failure to explain loss of assets

1 allegations, concluding that Appellants had not met their burden
2 of proof. In discussing the concealment charge the court
3 articulated its application of the clear and convincing
4 standard.

5 The Court cannot, in view of the substantial case
6 law, imposing the burden of proof on the Plaintiff in the
7 Section 727 case, and the strong policy of
8 dischargeability for a fresh start in the absence of clear
9 proof of concealment, deny that discharge. [emphasis
10 added] (Transcript 915)

11 Although not stated with specificity, by inference the same
12 standard appears to have governed the court's ruling on the
13 failure to keep records charge.

14 Under all the circumstances, the court cannot find that
15 there has been adequate, sufficient proof to establish
16 that the failure to keep books and records, considering
17 the testimony of which indicates reasonable basis that
18 there was an expenditure of money sufficient to
19 overcome any conclusion of intentional withholding,
20 actual concealment of the property, to justify the
21 denial of discharge. (Transcript 916)

22 After concluding that Western Wire Works and Kroell had not
23 met the burden, the court denied the objection to discharge on
24 the two state court judgments. Western Wire Works, Kroell and
25 the trustee have appealed three rulings: (1) the dismissal of
26 the two consolidated fraudulent transfer actions and (2) the
dismissal of the objection to discharge.

ISSUE PRESENTED

The issues before us are (1) whether the trial court erred in

1 requiring that the Appellants prove their cases by clear and
2 convincing evidence and (2) whether Appellees presented a
3 credible or justifiable explanation of the rapid disposition of
4 cash and failure to keep any record of such expenditures.
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6 STANDARD OF REVIEW

7 Issue (1) involves a conclusion of law relative to burden of
8 proof which is subject to de novo review. In re Marquam
9 Investment Corporation, 942 F.2d 1462, 1465 (9th Cir. 1991).

10 Issue (2), relative to a finding of justification for not
11 keeping records, a factual finding, involves the clearly
12 erroneous standard. Bankruptcy Rule 8013; In re Cox, 904 F.2d
13 1399, 1401 (9th Cir. 1990).
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15 DISCUSSION

16 Appellants' claims in the actions below all rest on
17 allegations that the Lawlers engaged in fraudulent behavior; in
18 summary that the Lawlers acting in concert with relatives and
19 associates, through a series of undocumented cash receipts and
20 transfers fraudulently diverted assets from the reach of
21 creditors. The trial court indicated some question as to the
22 testimony of Cathi Lawler, and therefore a difference in the
23 quantum of proof was most important.¹ In Grogan v. Garner, 111
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25 ¹"It is clear that if in fact the Court has been deceived
26 by the Defendants in this case and their claims of honest
disposition of funds and property, there are possible later

1 S.Ct. 654 (1991), the Court held that in a § 523 action the
2 plaintiff must prove fraud by a preponderance rather than a
3 clear and convincing standard. At issue in the case was the
4 treatment of a fraud judgment against the debtor. The trial
5 court had applied the preponderance standard, but the appellate
6 court held that the clear and convincing standard applies in §
7 523 actions. A fair reading of the Supreme Court's opinion
8 leads to the inference that the preponderance standard applies
9 in all bankruptcy proceedings grounded in allegations of fraud.
10 Specifically, the Court noted:

11 Because the preponderance-of-the-evidence standard
12 results in a roughly equal allocation of the risk of error
13 between litigants, we presume that this standard is
14 applicable in civil actions between private litigants
"unless particularly important individual interests or
rights are at stake." [citation omitted]

15 Grogan at 659.

16 We think it unlikely that the Congress, in fashioning
17 the standard of proof that governs the applicability of
18 these [nondischargeability] provisions, would have favored
the interest in giving perpetrators of fraud a fresh start
over the interest in protecting victims of fraud.

19 Id. at 659.

20 There is a question, since this is an action against the
21 debtor's discharge, whether Grogan applies in a proceeding under
22 § 727. Here, as in Grogan, two sets of interests are at stake:

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24 consequences; if there are violations of the bankruptcy code or
25 perjury, of which I trust the defendants are well aware."
26 Transcript at 914. This would indicate that the court's finding
as to the debtors' state of mind was qualified.

1 (1) even more strongly, the issue of a fresh start and (2) the
2 need for the legitimate claims of creditors not to be frustrated
3 by fraudulent or fraudulent behavior of the debtors. There may
4 be an additional factor which involves the honesty or overall
5 propriety of the debtors' conduct. In a subsequent circuit
6 level case involving fraud in the context of § 727, the Tenth
7 Circuit reasoned:

8 It would be incongruous to apply a "preponderance of
9 the evidence" standard to § 523(a) and a "clear and
10 convincing" standard to § 727 (a)(2). Such would
be clearly at odds with the rationale in Grogan.

11 First National Bank of Gordon v. Serafini, 938 F.2d 1156, 1157
12 (10th Cir. 1991). We are likewise of the view that the
13 preponderance standard should apply in both dischargeability
14 cases under § 523 and discharge cases under § 727.

15 Although they had the ultimate burden of persuasion, once
16 Appellees had presented evidence below of concealment, failure
17 to keep records, false oath or account, and failure to explain
18 loss of assets, the burden shifted to Appellants to provide a
19 credible explanation. In re Martin, 698 F.2d 883, 887 (7th Cir.
20 1983). Cathi Lawler, on the basis of the record before us, in
21 our view did not furnish such an explanation. She indicated
22 that she was unaware of any need to keep business or personal
23 records. Yet she was personally involved in the operation of a
24 business and was a licensed realtor. We cannot accept the
25 notion that despite her business background, limited though it
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1 may have been, she would, in so short a time, profligately
2 dispose of large sums without providing or retaining some
3 scintilla of evidence as to those expenditures. Therefore we
4 cannot accept the court's finding that there was justification
5 or excuse for not keeping records. See Anderson v. Bessemer
6 City, 470 U.S. 564, 573 (1985)("[A] finding is 'clearly
7 erroneous' when although there is evidence to support it, the
8 reviewing court on the entire evidence is left with the definite
9 and firm conviction that a mistake has been committed."
10 Quoting, United States v. United States Gypsum Co., 333 U.S.
11 364, 395 (1948)).

13 CONCLUSION

14 We conclude that the trial court placed an incorrect and
15 excessive burden of proof on Appellants as to the claim under §
16 544 (b) and as to all the claims under § 727. The burden should
17 have been preponderance rather than clear and convincing
18 evidence. We further conclude that the debtor has not provided
19 a credible explanation or justification for the accelerated
20 disposition of substantial cash sums without any record or
21 documentation thereof. Accordingly, we REVERSE AND REMAND for
22 further proceedings consistent herewith.

OFFICE OF THE CLERK
United States Bankruptcy Appellate Panel
of the Ninth Circuit

NOTICE OF ENTRY OF JUDGMENT

A separate Judgment was entered in this case on APR 20 1992.

Motions for Rehearing

A motion for rehearing may be filed within 10 days after entry of the judgment. (Bankruptcy Rule 8015).

The motion shall be submitted on 8½ by 11 inch paper, shall not exceed 15 pages in length, and shall comply with rules governing service and signature. An original and three copies shall be filed.

A motion for rehearing may toll the time for filing a notice of appeal to the Court of Appeals. See Bankruptcy Rule 8015.

Bill of Costs

Bankruptcy Rule 8014 provides that costs on appeal shall be taxed by the Clerk of the Bankruptcy Court. Cost bills should be filed with the Clerk of the Bankruptcy Court from which the appeal was taken. Also see, Federal Rules of Appellate Procedure 39.

Issuance of the Mandate

The mandate, a certified copy of the judgment addressed to the Clerk of the Bankruptcy Court from which the appeal was taken, will be issued 21 days after entry of the judgment unless otherwise ordered by the Panel. A timely motion for rehearing will stay issuance of the mandate until 7 days after disposition of the motion, unless otherwise ordered. See Bankruptcy Rule 8017 and Federal Rules of Appellate Procedure 41.

Appeal to Court of Appeals

An appeal to the Ninth Circuit Court of Appeals is initiated by filing a notice of appeal with the Clerk of this Panel. The Notice of Appeal should be accompanied by payment of the \$100 filing fee. Checks may be made payable to the U.S. Court of Appeals For The Ninth Circuit. See Federal Rules of Appellate Procedure 4 and the corresponding Rules of the United States Court of Appeals for the Ninth Circuit for specific time requirements.