UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

Case No. 88—608—C

EUGENE PAUL MORRISON,

Chapter 7

Debtor.

THOMAS J. REILLY LAW FIRM, P.C.,

Adv. No. 88-0132

Plaintiff,

V.

EUGENE PAUL MORRISON,

Defendant.

ORDER--TRIAL ON COMPLAINT TO OBJECT TO OR REVOKE DISCHARGE

On April 10, 1989, a trial was held on the complaint to object to or revoke discharge. The following attorneys appeared on behalf of their respective clients: William J. Schadle for Plaintiff Thomas J. Reilly Law Firm, P.C. (hereinafter "Plaintiff"); and Gregory A. Skinner for Debtor/Defendant Eugene Paul Morrison (hereinafter "Debtor"). At the conclusion of said trial, the Court took the matter under advisement upon a briefing deadline. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b) (2) (J). The Court, upon review of the pleadings, arguments of counsel, evidence admitted and briefs submitted now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. On July 9, 1987, Debtor sought the services of Plaintiff in relation to a dissolution of marriage. Plaintiff subsequently represented Debtor in the dissolution action which was tried on November 20, 1987, in the Iowa District Court for Jasper County, and the Decree was issued December 18, 1987.

2. On January 7, 1988, Plaintiff forwarded to Debtor a statement for services rendered in the amount of $7,210.33. None of this amount has been paid by Debtor.

3. Debtor was not satisfied with his legal representation in the dissolution of marriage proceeding. He thought that his attorneys, Plaintiff, let him down in that proceeding. Debtor thought that the 33-year marriage to his 53 year old, physically impaired, minimally educated, minimally employed ex-wife should be terminated without any continuing financial obligations upon himself. Debtor is gainfully employed with attractive medical, savings and retirement benefits.

4. On March 21, 1988, Debtor filed a voluntary Chapter 7 petition and listed Plaintiff on schedule A-3 as holding an unsecured claim of $7,200.00.

5. On his Statement of Financial Affairs for Debtor Not Engaged in Business (hereinafter "Statement"), Debtor answered "None" when asked under No. 4(a) whether he had financial accounts held in his name within two years preceding the filing of his petition. During the trial, Debtor admitted having a checking account during that period of time at First National Bank in

Colfax, Iowa, and a savings account at John Deere where he was employed.

6. When asked under No. 4(b) of the Statement whether he had a safe deposit box during the same two—year period, Debtor answered "None." During the trial, Debtor admitted having a lock box at the Colfax Bank containing approximately $10,000.00 in cash. Debtor further testified he used some of the money in violation of the dissolution court's order although he also stated he did not use the $10,000.00 he was ordered not to touch. Debtor also testified that prior to his dissolution, he concealed funds from his spouse in a shed.

7. Pursuant to the terms of the dissolution decree, Debtor was awarded, in part, the following assets with established values as follows: 1) boat, motors and trailer — $4,700.00; 2) homemade trailer — $400.00; 3) John Deere tractor — $2,500.00; 4) air compressor — $189.00; 5) electric generator — $800.00; 6) snowblower — $350.00; 7) rototiller —$300.00; 8) tools/fishing gear — $1,500.00; 9) guns — $250.00; 10) chicken house - $1,000.00; and 11) gas grill — $100.00.

8. Under No. 12(b) of the Statement, Debtor described an "even up" trade with his father of the boat, motors, trailer, John Deere tractor, and a snowblower for a 1982 1/2 ton truck and topper. Debtor claimed said truck as exempt on his schedule B-4. The boat, motors, trailer, John Deere tractor, and snowblower have a total value of $7,550.00. The 1982 1/2 ton truck with topper has a value of $4,000.00.

9. Debtor failed to list on his schedule B—2 the following pieces of property awarded to him under the dissolution decree and valued as follows: movable chicken house ($1,000.00), air compressor ($189.00), rototiller ($300.00), gas grill ($100.00), guns ($250.00), tools and fishing gear ($1,500.00). Under No. 12 of the Statement, Debtor stated he had neither made any gifts of property to family members during the year prior to filing his petition nor transferred any of the above property during that same period.

10. Debtor still has the chicken house, rototiller, gas grill, tools, and fishing gear. He sold the air compressor in January, 1989, and gave most of the guns to his father.

11. On his schedule A-3, Debtor listed debts of $249.14 owed to J. C. Penney and $1,348.25 owed to Montgomery Ward. Pursuant to the terms of the dissolution decree, Debtor's ex—wife Carolyn was ordered to assume responsibility for said debts.

12. On his schedule B-2, Debtor denied he owned stocks or interests in any companies.

13. As part of the John Deere Employee Stock Ownership Plan, the following contributions were allocated to Debtor's plan account: 1985 — $198.85; 1986 — $140.93.

DISCUSSION

Plaintiff has objected to Debtor's discharge on two separate grounds——ll U.S.C. §§727(a) (2) and (4). The Court will separately address each ground.

A. Section 727(a)

Bankruptcy Code §727(a) sets out ten non—exclusive grounds upon which the court can deny a debtor's discharge. 11 U.S.C. §727(a). An action brought under §727 is the most serious non-criminal action a creditor can bring against a debtor in bankruptcy. In re Schermer, 59 B.R. 924 (Bankr. W.D. Ky. 1986). Discharge under §727 "is the heart of the fresh start provisions of the bankruptcy law." In re Nye, 64 B.R. 759, 762 (Bankr. E.D. N.C. 1986) (Quoting H.R. Rep. No. 595, 95th Cong., 1st Sess. 384 (1977), U.S. CODE CONG. & ADMIN. NEWS 1978, pp. 5787, 6340). Consequently, objections to discharge are construed liberally in favor of debtors and strictly against the objecting creditor. In re Schmit, 71 B.R. 587, 590 (Bankr. D. Minn. 1987); In re Usoskin, 56 B.R. 805, 813 (Bankr. E.D. N.Y. 1985).

The burden of proof in objecting to discharge rests with the party objecting to discharge. Fed. R. Bankr. P. 4005. The grounds for denying a debtor's discharge under §727 must be established by clear and convincing evidence. In re Martin, 88 B.R. 319, 321 (D. Colo. 1988); In re Ford, 53 B.R. 444, 449 (W.D. Va. 1984), aff'd 773 F.2d 52 (9th Cir. 1985). If the party objecting to discharge does prove a ground by clear and convincing evidence, the burden of going forward with the evidence then shifts to the debtor. Ford, 53 B.R. at 449.

1. Section 727(a) (2) (A)

Section 727(a) (2) (A) provides the court shall grant the debtor a discharge unless:

> (2) the debtor, with intent to hinder. delay. or defraud a creditor or an officer of the estate charged with custody or property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed——
>
> (A) property of the debtor, within one year before the date of filing the petition.

11 U.S.C. §727(a)(2)(A) (emphasis added). The four elements a plaintiff must prove under §727(a) (2) (A) are:

1. A transfer of property has occurred;
2. It was property of the debtor;
3. The transfer was within one year of the date of filing the petition; and
4. The debtor had, at the time of the transfer, the intent to hinder, delay, or defraud a creditor.

Ford, 53 B.R. at 446. The first three elements are self-explanatory. The fourth element, intent to hinder, delay or defraud, requires an actual fraudulent intent or actual intent to hinder or delay as opposed to constructive fraudulent intent. In re Adeeb, 787 F.2d 1339, 1342—43 (9th Cir. 1986); Ford, 53 B.R. at 449. Since a debtor will not voluntarily testify that his intent was fraudulent, the court may infer fraudulent intent by circumstantial evidence. In re McNamara, 89 B.R. 648, 651 (Bankr. N.D. Ohio 1988) (citations omitted); In re Roberts, 81 B.R. 354,

379 (Bankr. W.D. Pa. 1987) (citations omitted). In addition, the court can rely upon "badges of fraud" to establish the necessary actual intent to defraud including:

1. the lack or inadequacy of consideration;
2. the family, friendship or close associate relationship between the parties;
3. the retention of possession, benefit or use in the property in question;
4. the financial condition of the party sought to be charged both before and after the transaction in question;
5. the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring debt, onset of financial difficulties, or pendency or threat of suits by creditors, and
6. the general chronology of events and transactions under inquiry.

McNamara, 89 B.R. at 651 (citing In re Kaiser, 722 F.2d 1574, 1582 (2nd Cir. 1983)); see Roberts, 81 B.R. at 379. While the presence of more than one badge is usually necessary, the court may find actual fraudulent intent if only one badge is established. In re May, 12 B.R. 618, 627 (N.D. Fla. 1980).

A lack of fraudulent intent is not fatal to a complaint under §727(a)(2)(A). In re Schmit, 71 B.R. 587, 591 (Bankr. D. Minn. 1987). A finding that the debtor had actual intent to hinder or delay creditors is sufficient. Id. The court can make such a finding if the existence of a scheme or pattern of conduct demonstrates the debtor's actual intent to hinder or delay a creditor's collection efforts. Id.

A debtor's conversion of non—exempt property to exempt property on the eve of bankruptcy is not sufficient to deny discharge even if the debtor's motivation is to place those assets beyond the reach of creditors. Norwest Bank Nebraska. N.A. v. Tveten, 848 F.2d 871, 874 (8th Cir. 1988); Schmit, 71 B.R. at 590. However, when the conversion is accompanied by extrinsic evidence establishing an intent to hinder, delay or defraud a creditor, discharge is properly denied under §727(a)(2)(A). Id.

In the case *sub judice* the Court finds the first three elements under §727 (a) (2) (A) are clearly met. Pursuant to the terms of the dissolution decree issued December 18, 1987, Debtor was awarded assets which included a boat, motors, trailer, John Deere tractor, and a snow blower. The Debtor filed his voluntary Chapter 7 petition on March 21, 1988 and asserted on his Statement that he traded said boat, motors, trailer, John Deere tractor and snow blower to his father in an "even-up" trade for a 1982 1/2 ton truck and topper. The Debtor therefore transferred the said property owned by him within one year of filing his voluntary Chapter 7 petition and meets the first three elements of the §727(a) (2) (A) test.

Concerning the fourth element, intent to hinder, delay or defraud, the Court finds that various badges of fraud are evident in the Debtor's transfer of the property to his father for the 1982 1/2 ton truck and topper. First, the Debtor's transfer was to a family member, one of the badges of fraud cited in McNamara.

Second, the total established value of the boat, motors, trailer, John Deere, tractor and snow blower is $7,550.00, while the total established value of the 1982 1/2 ton truck and topper is only $4,000.00. The transfer was thus made for inadequate consideration.

Finally, the general chronology of events, transactions and conduct establishes a badge of fraud. Plaintiff represented Debtor in a dissolution action in which a decree was issued December 18, 1987. Debtor was not satisfied with his legal representation by Plaintiff in the dissolution of marriage proceeding. He thought that his attorneys, Plaintiff, let him down in that proceeding. On January 7, 1988, Plaintiff forwarded to Debtor a statement for services rendered in the dissolution proceeding in the amount of $7,210.33. Prior to filing a voluntary Chapter 7 petition March 21, 1988, Debtor transferred personal property with a total established value of $7,550.00 to his father in exchange for a 1982 1/2 ton truck and topper with a total established value of only $4,000.00. On the March 21, 1988, voluntary Chapter 7 petition, Debtor claimed the 1982 1/2 ton truck and topper exempt on his schedule B-4 and listed Plaintiff on schedule A-3 as holding an unsecured claim of $7,200.00. Plaintiff’s claim of $7,200.00 accounts for 80 percent of the amount of unsecured claims accurately listed on Debtor’s schedule A—3 of creditors having unsecured claims without priority. This chronology of events, transactions and conduct establishes the Debtor’s intention to decrease the size of his estate in order to reduce the distribution

to the Plaintiff, an unsecured creditor with a claim that accounts for 80 percent of the amount of the unsecured claims correctly listed on schedule A-3.

In conclusion, based on the existence of various badges of fraud, the Court concludes that Debtor did transfer property of the estate with the intent to hinder, delay or defraud Plaintiff in violation of §727(a) (2) (A).

2. Section 727(a) (4) (A)

Section 727(a) (4) (A) provides:

> (a) The court shall grant the debtor a discharge, unless --
>
> (4) the debtor knowingly and fraudulently, in or in connection with the case-—
>
> (A) made a false oath or account.

The fundamental purpose of §727(a) (4) (A) is to ensure that dependable information is supplied to the administrators of the debtor's estate on which they can rely without the need for the trustee or other interested parties to dig out the true facts in examinations or investigations. Matter of Hussan, 56 B.R. 288, 290 (Bankr. E.D. Mich. 1985); In re McDonald, 50 B.R. 255, 259 (Bankr. D. Mass. 1985).

To sustain an objection to discharge under §727 (a) (4) (A), the plaintiff must prove two elements:

1) the debtor knowingly and fraudulently made a false oath; and

2) it was related to a material fact.

In re McNamara, 89 B.R. 648, 654 (Bankr. N.D. Ohio 1988); In re Roberts, 81 B.R. 354, 380 (Bankr. W.D. Pa. 1987).

The materiality of a false oath does not require that the creditors were prejudiced by the false statement; rather, the question of materiality depends on whether the false oath is pertinent to the discovery of the debtor's assets or past transactions concerning the disposition of debtor's property. Chalik, 748 F.2d at 618; Matter of Brooks, 58 B.R. 462, 667 (Bankr. W.D. Pa. 1986); In re Bailey, 53 B.R. 732, 735 (Bankr. W.D. Ky. 1985). As a result, a false oath regarding worthless assets constitutes a material omission and may preclude discharge. In re Robinson, 506 F.2d 1184, 1188 (2nd Cir. 1974); In re Mascolo, 505 F.2d 274, 277—78 (1st Cir. 1974).

A false oath may consist of a false statement or omission in the debtor's schedules or statement of affairs, or a false statement by the debtor at an examination during the proceedings. In re Bobroff, 58 B.R. 950, 953 (Bankr. E.D. Pa. 1986); In re Irving, 27 B.R. 943, 945 (Bankr. E.D. N.Y. 1983); see In re Cycle Accountincg Services, 43 B.R. 264, 273 (Bankr. E.D. Tenn. 1984). If the debtor omits a material fact, the court may infer from the circumstances that the debtor acted "knowingly and fraudulently." Martin, 88 B.R. at 323; Bobroff, 58 B.R. at 953. A simple mistake or inadvertance is not sufficient to prove that a false oath was made "knowingly and fraudulently." Brooks, 58 B.R. at 467; see Cycle Accounting, 43 B.R. at 273. However, the requisite intent is established when the cumulative effect of all falsehoods

together indicates a pattern of "reckless and cavalier" disregard for the truth. Bobroff, 58 B.R. at 953; In re Ligon, 55 B.R. 250, 253 (Bankr. M.D. Tenn. 1985); Cycle Accounting, 43 B.R. at 273.

In the case *sub judice* the Debtor knowingly and fraudulently made a false oath that was related to a material fact in violation of §727 (a) (4) (A). The false oath made by Debtor consists of numerous omissions and false statements in the Debtor's schedules and Statement including: 1) Debtor failed to list on his schedule B-2 a movable chicken house, air compressor, rototiller, gas grill, guns, tools and fishing gear awarded to him under the dissolution decree and owned by him on the date he filed his voluntary Chapter 7 petition; 2) Debtor answered "None" when asked under Statement 4—A whether he had financial accounts held in his name two years preceding the filing of his petition, while during the trial Debtor admitted having a checking account during that period of time at First National Bank in Colfax, Iowa, and a savings account at John Deere where he was employed; 3) Debtor answered "None" when asked under 4-B of the Statement whether he had a safety deposit box during the same two-year period, while admitting at trial to having a lock box at the Colfax Bank containing approximately $10,000.00 in cash; 4) Debtor listed debts owed to J.C. Penney and Montgomery Ward on his Schedule A-3 which, pursuant to the dissolution decree, were the responsibility of Debtor's ex-wife Carolyn; and 5) Debtor denied he owned stocks or interests in any company on his schedule

B-2, but the Debtor had contributions allocated to his John Deere employee stock ownership plan account in 1985 and 1986.

The cumulative effect of these false statements and ommissions in the Debtor's schedules and Statement indicates a pattern of "reckless and cavalier" disregard for the truth which establishes that Debtor knowingly and fraudulently made the false statements and omissions.

Finally, the Debtor's false statements and ommissions related to a material fact. The Debtor's schedules and Statement should be the primary source of dependable information about the Debtor's assets and past transactions available to the administrators of the Debtor's estate, and the Debtor's creditors. Thus, a false statement or omission on the schedules or Statement is clearly pertinent to the discovery of the Debtor's assets and past transactions and is related to a material fact.

In conclusion, based on the false statements and omissions on the Debtor's schedules and Statement, the Court concludes that the Debtor knowingly and fraudulently made a false oath that was related to a material fact in violation of §727(a) (4) (A).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Plaintiff has met its burden of proof in objecting to Debtor's discharge under §727(a) (2) (A) and 727(A) (4) (A).

IT IS ACCORDINGLY ORDERED that Debtor's discharge is denied.

Dated this 5th day of July, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE