UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of	:	
NANCY ANN CLARK STILLIANS,	:	Case No. 87-2100-C
Debtor.	:	
	:	Adv. No. 87-0251
VICTORIA L. HERRING,	:	
Plaintiff,	:	Chapter 7
v.	:	
NANCY ANN CLARK STILLIANS,	:	
Defendant.	:	

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ORDER - TRIAL ON COMPLAINT TO DETERMINE DISCHARGE AND DISCHARGEABILITY OF DEBT

On June 13, 1988, a trial was held on the complaint to determine discharge and dischargeability of debt. John F. Sprole appeared on behalf of Defendant and Plaintiff appeared pro se. At the conclusion of said trial, the Court took the matter under advisement upon a briefing deadline of June 30, 1988. 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)(I) and (J). The Court, upon review of the pleadings, arguments of counsel, evidence presented, and briefs, now enters its findings and conclusions pursuant to Fed. R. Bankr. P. 7052.

FINDINGS OF FACT

1. Plaintiff is a judgment creditor of Defendant, having obtained a judgment against Defendant on April 15, 1987, in the amount of $24,497.24, plus interest and costs.

2. Defendant filed a voluntary Chapter 7 petition on August 21, 1987. Plaintiff was scheduled as a creditor having an unsecured claim in the amount of $24,500.00 as a result of the judgment.

3. Defendant was granted a discharge on November 25, 1987.

4. Defendant was employed by the Iowa Arts Council and engaged Plaintiff in March 1985 to perform legal services when Defendant was not a finalist for the position of director of said council. Plaintiff and Defendant agreed that Plaintiff would work at an hourly rate and would be reimbursed expenses.

5. Defendant's employment by the Iowa Arts Council was terminated on June 3, 1985, by said council and the scope of Plaintiff's employment expanded. Defendant did not regain employment until May 1986.

6. Plaintiff engaged associate counsel in October 1985, and associate counsel commenced work at at lesser hourly rate on Plaintiff's and Defendant's behalf.

Defendant met with associate counsel on many occasions and knew of her employment by Plaintiff. Defendant also knew that she would be billed for the cost of that employment.

7. Plaintiff billed Defendant on a monthly basis and at first Defendant was able to stay current with her bill. Defendant paid Plaintiff approximately $5,000.00.

8. In November 1985, Defendant expressed concerns about the size of the bill with Plaintiff. Both Plaintiff and Defendant reexamined their positions and Plaintiff continued as Defendant's attorney. Both parties knew that it would be difficult to present Defendant's case in such a manner as to be convincing and that it would take a great deal of work to accomplish this goal.

9. Defendant actively participated and was closely involved and associated with the preparation and presentation of all aspects of her case.

10. Defendant received an adverse decision in January 1986, and Defendant indicated that she wished to appeal this decision. The parties again reevaluated their respective positions. Defendant's dissatisfaction with the amount of fees was again expressed.

11. Plaintiff discontinued her representation of

Defendant in April 1986.

12. The parties attempted to settle their differences, and arbitration was also suggested but never used. Attempts at settlement continued into June 1986.

13. Defendant commenced employment in Kansas City, Missouri, on May 12, 1986.

14. Plaintiff commenced an action against Defendant in the Iowa District Court for Polk County on August 21, 1986. This action was based on the theories of contract and open account. Plaintiff obtained summary judgment against Defendant on April 15, 1987, for $24,497.24, plus interest and cost.

15. Defendant has an interest in her residential real estate in Polk County, Iowa. She also has an interest in an old school and two acres in Montgomery County, Iowa.

16. Defendant was unemployed from June 3, 1985 until May 1986. During this period, Defendant's family and friends provided her support.

17. Commencing in August 1986 through February 1987, Defendant made various payments to her father, John Clark, her sister, Mary Brubaker, her ex-husband, Bruce Stillians, Marlene Olson, a friend, Hank Haugen, a lawyer, Tom Farr, a lawyer, A. Reis, a lawer, and several businesses for work performed for her and on the property

in Montgomery County. These payments were modest sums and no one payment exceeded $1,500.00. Defendant transferred her only automobile to Marlene Olson in August or September 1986. Defendant had paid $1,900.00 for this motor vehicle and Defendant testified that she executed the transfer as partial settlement of her debt to Marlene Olson.

18. On March 21, 1987, Defendant mortgaged her homestead and the property in Montgomery County to Mary Brubaker for a loan of $3,500.00.

19. The property in Montgomery County was purchased in 1965 for $1,000.00. It is located in a rural area and does have electricity but no plumbing. It is used by Defendant, her family and friends for camping purposes and a retreat area.

20. Defendant values this real estate at $1,000.00 per an amendment to Schedule B-1 filed on June 10, 1988. There are no other values given to this tract of real estate.

21. Defendant scheduled her homestead in Schedule B-1 as her only real estate. This real estate was not claimed as exempt in Schedule B-4 until she filed an amendment to said schedule on June 10, 1988.

22. On her schedule B-2, Defendant scheduled "Thoreau's Journals" with a value of $80.00 and 13

pictures with a value of $5.00 each for a total value of $65.00. Defendant testified these pictures were originally purchased for prices in the $100-$200 range each, but they do not have a present resale value in excess of the scheduled valuation. There is no other evidence as to the value of these pictures.

23. Defendant originally scheduled Mary Brubaker on schedule A-3 as an unsecured creditor having a present claim of $1,700.00 for a personal loan incurred from 1985-1987. On June 10, 1988, Defendant amended Schedule A-2 and listed Mary Brubaker as a secured creditor. The amount of the claim remained at $1,700.00, although Defendant testified the debt is approximately $5,200.00. This transaction was listed as occurring on March 21, 1987, as security for a personal loan. The value of the security was listed as $19,520.00.

24. Most of the above transfers occurred after Plaintiff and Defendant terminated their attorney-client relationship. Some of the transfers occurred after Plaintiff sued Defendant in Iowa District Court. However, the transfers were not gratuitous but were for existing debt.

25. Defendant is now employed as a free-lance writer. Defendant is familiar with the world of literature and art but has limited ability in the

business world.

26. Plaintiff gave her legal representation of Defendant her best effort in a very difficult proceeding. Defendant cooperated fully in the preparation of the litigation.

27. Plaintiff filed the complaint herein on November 24, 1987. Plaintiff objects to the discharge of the debt owed to Plaintiff and to Defendant's discharge.

DISCUSSION

Plaintiff has presented a number of grounds under sections 523 and 727 of the Bankruptcy Code for denying Defendant discharge on some or all of her debts. The Court will address each ground individually.

A. Section 523(a)(2)(A)

Bankruptcy Code section 523 lists ten exceptions to discharge and provides in relevant part:

> (a)A discharge under §727...does not discharge an individual debtor from any debt--
>
> ...
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by--
>
> (A)false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition....

11 U.S.C. §523(a)(2)(A). To prevent discharge because of fraud under section 523(a)(2)(A), a plaintiff must prove

actual fraud, not fraud implied in fact. In re Simpson, 29 B.R. 202, 209 (Bankr. N.D. Iowa 1983). The elements of actual fraud include: (1) the debtor made false representations; (2) at the time the representations were made the debtor knew they were false; (3) the debtor made the representations with the intent to deceive the creditor; (4) the creditor relied upon such representations; and (5) the creditor sustained the alleged loss and damages as a proximate result of the false representation. Matter of Van Horne, 823 F.2d 1285, 1287 (8th Cir. 1987); Simpson, 29 B.R. at 209.

The plaintiff has the burden of proving each of the elements of actual fraud by clear and convincing evidence. Id. Regarding the evidence presented, the Eighth Circuit has stated that it:

> must be viewed consistent with the congressional intent that exceptions to discharge be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the Code. These considerations, however, "are applicable only to honest debtors."

Van Horne, 823 F.2d at 1287 (citations omitted).

The first two elements of actual fraud are self-explanatory. Concerning a third element, intent to deceive the creditor, the Eighth Circuit recently stated:

> Because direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred. When the creditor introduces circumstantial evidence proving the debtor's intent to deceive, the debtor "cannot overcome [that] inference with an unsupported assertion of honest intent." The focus is, then, on whether the debtor's actions "appear so inconsistent with [his] self-serving statement of intent that the proof leads the court to disbelieve the debtor."

Id. at 1287-88 (citations omitted).

Although intent to deceive may be inferred from the circumstances of the case, such a finding of intent generally requires a showing that the defendant knew or should have known of the falsity of his or her statement. In re Valley, 21 B.R. 674, 679-80 (Bankr. D. Mass. 1982). In assessing the defendant's knowledge and liability for fraud, the court will scrutinize the acumen and experience of the defendant. Matter of Newark, 20 B.R. 842, 857 (Bankr. E.D. N.Y. 1982).

The fourth element of actual fraud is that the creditor relied upon the debtor's false representation. The Eighth Circuit has held that a creditor need not prove his or her reliance was reasonable, but rather only that he or she did rely upon the debtor's false representation. In re Ophaug, 827 F.2d 340, 343 (8th

Cir. 1987).

The fifth and final element, proximate cause, requires that the debtor's action was the act, without which the plaintiff would not have suffered the alleged loss and damages. Van Horne, 823 F.2d at 1288-89.

A number of cases are directly on point with the case at bar wherein a debtor's former attorney sought to have his or her debt declared nondischargeable on the ground that debtor fraudulently induced the attorney to provide legal services which the debtor had no intention of paying. In re Woerner, 66 B.R. 976 (Bankr. E.D. Pa. 1986); In re Emery, 52 B.R. 68 (Bankr. E.D. Pa. 1985); In re Overmeyer, 30 B.R. 127 (Bankr. S.D. N.Y. 1983). In all three cases, the court held the debt was dischargeable because the attorney failed to meet his or her burden of proof concerning the debtor's fraudulent intent.

In Emery, the court found the debtor had breached his contract to pay his attorney but stated, "[t]he mere breach of contract by the debtor does not, without more, imply the existence of actual fraud." Id. at 70. In Woerner, the court stated "[a] broken promise does not constitute a fraudulent misrepresentation without proof that the promisor never intended to perform when the promise was made." Id. at 976 (quoting Overmeyer, 30 B.R. at 132).

In the case at bar, the Court finds Plaintiff has not met her burden of proof under section 523(a)(2)(A) concerning Defendant's fraudulent intent. As a result, the Court concludes Defendant's debt owed to Plaintiff is not excepted from discharge under section 523(a)(2)(A).

B. Section 523(a)(6)

Section 523(a)(6) provides:

> (a)A discharge under §727...does not discharge and individual debtor from any debt--
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> ...
>
> (6)for willful and malicious injury by the debtor to another entity or to the property of another entity.

The Bankruptcy Code does not define "willful and malicious." As a result, a split of authority exists on the interpretation of said phrase. In re Cecchini, 37 B.R. 671, 674 (B.A.P. 9th Cir. 1984). Some courts interpret the phrase to require an injury-causing intentional act, while other courts require an act performed with the intent to cause injury. Id at 674-75. The Eighth Circuit has adopted the second line of reasoning and has ruled that under section 523(a)(6), a debt based upon liability for injuries is non-dischargeable if the debtor intentionally inflicted the injury. Cassidy v. Minihan, 794 F.2d 340, 343-44 (8th Cir. 1986); see In re Long, 774 F.2d 875, 881 (8th Cir. 1985).

In the case at bar, the Court finds Defendant did not intentionally inflict any injury upon Plaintiff. As a result, the Court concludes Defendant's debt owed to Plaintiff is not excepted from discharge under section 523(a)(6).

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

Bankruptcy Code section 727(a)(2)(A) provides:

> (a) The court shall grant the debtor a discharge, unless--
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> ...
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> (2) the debtor, with intent to hinder, delay, or defraud a creditor or an office 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.

An action brought under section 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 section 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 excepting a debt from discharge under section 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.

The four elements a plaintiff must prove under section 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 defendant had, at the time of the transfer, the intent to hinder, delay, or defraud a creditor.

Id. 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. However, said intent may be proved by circumstantial evidence. Id; McCormick v. Security State Bank, 822 F.2d 806, 808 (8th Cir. 1987).

In the case at bar, the Court finds that while Defendant did transfer some of her property within one year of the date of filing her petition, she did not at the time of said transfers have any intent to hinder, delay or defraud Plaintiff. As a result, the Court concludes Defendant is not excepted from discharge under section 727(a)(2)(A).

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

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

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

The fundamental purpose of section 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 section 727(a)(4)(A), the plaintiff must establish that the debtor knowingly made a false statement under oath with the intent to defraud his or her creditors regarding the matter material to the administration of the estate. In re Chalik, 748 F.2d 616, 618 (11th Cir. 1984); In re Hooper, 39 B.R. 324, 329 (Bankr. N.D. Ohio 1984).

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 precludes 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 Accounting 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 at bar, the Court finds there was no showing that any false statements in Defendant's schedules were the result of anything other than a simple mistake or inadvertance. Thus, there is no showing that

Defendant's false statements were made knowingly and fraudulently. As a result, the Court concludes Defendant is not excepted from discharge under section 727(a)(4)(A).

E. Section 727(a)(7)

Plaintiff's final ground objecting to Debtor's discharge is section 727(a)(7) which provides:

> (a) The court shall grant the debtor a discharge, unless--
>
> ...
>
> (7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year of the date of filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider.

The plain language of section 727(a)(7) requires that the debtor committed some act in connection with another case under the Bankruptcy Code. In the case at bar, Plaintiff has neither alleged nor pointed out any other case under the Bankruptcy Code in which Defendant committed any specific act. As a result, the Court concludes section 727(a)(7) is inapplicable to the case at bar.

F. Attorney's Fees and Costs

Defendant's counsel argues Defendant is entitled to costs and fees for defending the action. Counsel's argument refers to section 523(d) which states:

> If a creditor requests a determination of dischargeability of consumer debt under section (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. §523(d) (emphasis added). The purpose of said subsection is to discourage creditors from bringing actions in hope of obtaining a settlement from an honest debtor anxious to save attorney's fees. Manufacturers Hanover Trust Co. v. Hudgins, 72 B.R. 214, 219 (N.D. Ill. 1987).

A creditor's position is "substantially justified" if the creditor produces some evidence in connection with each element upon which it has the burden of proof. Matter of Van Buren, 66 B.R. 422, 425 (Bankr. S.D. Ohio 1986). Once a creditor learns its position is not substantially justified, the creditor is not justified in continuing to pursue its case, even if the suit was originally filed in good faith. Manufacturers Hanover,

72 B.R. at 221.

In the case at bar, the Court concludes Plaintiff's position was substantially justified. The filing of the complaint caused Defendant to amend her schedules which increased the accuracy of her petition and the attached schedules. As a result, the Court concludes Defendant is not entitled to a judgment for attorney's fees or costs of this proceeding.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Plaintiff failed to meet her burden of proof on any of the exceptions to discharge of debt, pursuant to 11 U.S.C. §§523(a)(2)(A) and 523(a)(6), and on any of the exceptions to discharge, pursuant to 11 U.S.C. §§727(a)(2)(A), 727(a)(4)(A), and 727(a)(7).

IT IS ACCORDINGLY ORDERED that Plaintiff's complaint is dismissed, that Defendant's debt owed to Plaintiff is dischargeable, and that Defendant is entitled to a discharge of her debts.

Dated this _____ day of October, 1988.

_____
RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE