UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of

HARRY M. KIRSCHER AND
BONNIE J. KIRSCHER,

Debtors.

Case No. 87-2460-C H

Chapter 7

UNITED STATES OF AMERICA,

Plaintiff,

Adv. 88—0062

V.

HARRY M. KIRSCHER AND
BONNIE J. KIRSCHER,

Defendants.

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

On November 7, 1988, a trial was held on the complaint to determine dischargeability of debt and discharge. The following attorneys appeared on behalf of their respective clients: Charles A. Coppola for Debtors/Defendants Harry and Bonnie Kirscher (hereinafter "Defendants") and Kevin R. Query, Assistant United States Attorney, for Plaintiff United States of America/Farmers Home Administration (hereinafter "Plaintiff"). At the conclusion of said hearing, 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) (I) and (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. Defendants filed a joint Chapter 7 petition on October 2, 1987.

2. At the commencement of this case, Plaintiff held a claim against Defendants in the total principal sum of $413,620.27. Said claim arose from loans initially extended to Defendants on November 21, 1977, and extending through October 4, 1985. The loans are evidenced by written promissory notes executed by Defendants.

3. Plaintiff's claim is secured by a perfected security interest in Defendants': 1) personal property, including crops, farm machinery and equipment, livestock, and all increase; and 2) real estate under various mortgages initially executed November 21, 1977 through March 26, 1984.

4. Defendants scheduled Plaintiff as a secured creditor in the total amount of $473,304.61. Defendants also scheduled $2,500.00 as personal taxes owing for 1986 and $180.00 as an unsecured claim without priority.

5. On March 25, 1988, Plaintiff, on behalf of the Farmers Home Administration (hereinafter "FmHA"), filed a complaint against Defendants. Said complaint was filed in four counts. Count I, as amended, is to determine the dischargeability of a debt pursuant

to 11 U.S.C. §523(a)(6); Count II was dismissed upon motion of Defendants at the time of trial; Count III is to determine an objection to discharge pursuant to 11 U.S.C. §727(a) (2); and Count IV is to determine an objection to discharge pursuant to 11 U.S.C. §727 (a) (5).

6. Defendants have three children: Deborah, age 19; Larry, age 16, b. 8/17/72; and Carrie, age 12. Larry and Carrie continue to live with their parents.

7. Defendants moved to their present farmstead in January 1974. They first purchased 140 acres on contract and in 1977 purchased an additional 220 acres. FmHA provided the needed financing in 1977.

8. In 1984, Defendants obtained financing from FmHA which permitted Defendants to consolidate the claims of their outstanding business creditors.

9. Defendants produced some corn and beans but they have been primarily livestock producers with emphasis on hog production.

10. FmHA has provided the financing for Defendants' operation since 1977. Supervised bank accounts have been established with FmHA as a designated party on the account.

11. FmHA provided the operating loans until the spring of 1986. On or about March 17, 1986, Defendants met with FmHA and were advised that FmHA could not provide the operating loan as Defendants' operation would not cash flow. At the time, Defendants reported to FmHA that they had 395 market hogs and 52 sows and

gilts on hand, and projected the marketing of 624 market hogs during 1986.

12. Defendants were further advised at said meeting that FmHA would release proceeds from the farm operation——sales of market hogs and grain——for Defendants' use in their farm operation and for living expenses. A voluntary liquidation was discussed and in that way Defendants would be relieved of the expense of raising live-stock. Defendants were not authorized to transfer or liquidate their breeding stock. FmHA continued to insist upon the use of the supervised bank acccount whereby Defendants deposited all receipts into the account and withdrew funds with a release from FmHA.

13. FmHA released Defendants names to the local sales barns in 1986 as chattel loan borrowers who had a chattel debt in which FmHA had a blanket security interest.

14. In 1986, Defendants suffered a hail storm which virtually wiped out their crops. Defendants had to buy nearly all their feed.

15. Commencing in July 1986, market or butcher hogs were sold in Larry's name. Debtor, Harry N. Kirscher (hereinafter " Marvin Kirscher") received the price quotes and delivered the hogs. After July 7, 1986, Marvin Kirscher ordered that payment for the hogs was to be in Larry's name. Prior to July 7, 1986, the market hogs which were sold were in Marvin Kirscher's name; thereafter they were in Larry's.

16. Defendants stopped depositing funds in the supervised bank account sometime after the March 17, 1986, meeting with FmHA.

This was against the prior instructions of FmHA and was done without their consent.

17. Larry has been a full-time student and active in 4-H and FFA activities. He has been active in 4-H activities since he was 10 years of age.

18. Larry was 13 years of age on his birthday in 1985. Larry testified he owned 6 pigs in 1985, and his father owned the breeding stock.

19. Larry testified in 1986 he owned an estimated 9 or 10 head of pigs and his father continued to own the breeding stock. Larry exhibited 6 market hogs at the fair and retained the gilts, number unknown.

20. Marvin Kirscher testified that in 1987 Larry took over the farming operation with Marvin helping out. This included the farm planning, planting and harvesting, livestock production, and purchase of feed for the livestock. Marvin testified that it was not necessary for Larry to secure financing for this operation. Larry was 15 years of age on his birthday in 1986, to-wit: August 17, 1986, and a freshman in high school.

21. FmHA accelerated the loans on May 6, 1987.

22. A checking account was opened in Larry's name on May 9, 1987, with a $6,000.00 deposit. This account was opened at the instigation of Defendants. Marvin accompanied Larry to the bank because Larry did not have a driver's license and could not lawfully drive a motor vehicle to the bank.

23. Marvin and Larry testified that the $6,000.00 deposit came from Larry's savings from summer work, money from hog sales at fairs, and some from Larry's grandparents. However, there is evidence that the opening of Larry's checking account occurred shortly after a sale of market hogs.

24. Money from Larry's checking account was used in part to pay farm expenses, make improvements upon the real estate, and for payment of utility bills, medical insurance secured by Defendants, and motor vehicle insurance upon vehicles owned by Defendants. Some of the checks were written out by Defendants and signed by Larry.

25. Defendants filed income tax returns for the 1986 calendar year. They show livestock sales in the amount of $38,683.00. Defendants advise that no income was received from the farm operation in 1987, as the farm was leased to Larry and no rent remains unpaid.

26. Prior to the 1987 calendar year, Larry never filed a tax return. Larry filed income tax returns for the 1987 calendar year for the first time. Larry's 1987 tax return shows sales of livestock for 1987 in the amount of $38,801.00.

27. Larry is a sophomore in high school during the 1988-1989 school year. He is taking a full course load and is active in concert band, jazz band, football, FFA, and 4-H. Football practice began a couple of weeks before school started in the fall and continued every night after school during the football season for a couple of hours.

28. Defendants' legal and tax work had been done by a law firm in Osceola since 1977 and continuing through the 1986 tax year. In 1987, Larry's and Defendant's tax returns were prepared by another tax practitioner for the very first time.

29. On September 28, 1987, a farm lease was filed in the Clarke County Recorder's office. Defendants' real estate was leased by H. M. Kirscher, A/K/A Marvin Kirscher, to Larry M. Kirscher for $10.00 per acre for 200 tillable acres. Said lease was dated April 30, 1987, but was signed by H. N. Kirscher and Larry M. Kirscher before a notary public on September 28, 1987.

30. Hogs, which constituted breeding stock, were sold at a local sale barn on January 20, 1987, and April 14, 1987. The sale on April 14, 1987, occurred when Larry was in school. Marvin Kirscher admits that 7 hogs sold at the sale on April 14, 1987, were his, but he testified that he turned them over to Larry because Larry had fed them.

31. Defendants participated in the 1985 and 1986 price support and production adjustment programs administered by the local ASCS office. To be eligible for these programs, the signing person must have control of the property and crops for which a person wishes to participate in a farm program. Control must be in the form of a leasehold or ownership interest.

32. On June 22, 1987, Defendants signed a contract to participate in the 1987 price support and production adjustment program. In this contract, Defendant represented that he was the operator/producer of 360 acres of farmland, with 226 acres of

cropland, for the 1987 crop year. Proceeds from this contract were deposited into Larry's checking account by Defendants. Marvin Kirscher now acknowledges that the proceeds from this farm program must be turned over to the Trustee.

33. On or about October 22, 1987, FmHA officers visited Defendants' farm and discovered that approximately 150 market hogs and 42 sows and gilts remained on the farm. Marvin Kirscher advised the FmHA officers that he held no ownership in the hogs, sows or gilts.

DISCUSSION

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

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. Cob. 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 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.

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); 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.

A transfer of property by a debtor to his children followed by his continued use and enjoyment of the property can be grounds for a denial of discharge under §727(a)(2)(A). McNamara, supra; Roberts, supra. In Roberts, the court denied the debtor his discharge under, among other grounds, §727(a)(2)(A) where he transferred his medical practice to his sons for no consideration two months following the entry of a $1.6 million dollar civil judgment against him. Id. at 379-80. In McNamara, the court denied the debtor his discharge under, among other grounds, §727 (a) (2) (A) where he sold secured collateral, paid the proceeds to his 14 year old son, and used his children's bank accounts to channel household money. Id. at 652-53.

In the case ***sub judice*** the Court finds the first three elements under §727(a)(2)(A) are clearly met. Defendants' hogs were transferred to Larry in 1987 as evidenced by the fact that in 1986 Larry owned 9 or 10 non-breeding stock pigs while in 1987 Larry filed an income tax return for the first time ever and reported $38,101.00 of livestock sales. In addition, Marvin Kirscher sold breeding stock pigs on April 14, 1987, and admitted that 7 hogs were his but that he turned them over to Larry because Larry had fed them. These transfers took place less than one year before Defendants filed their Chapter 7 petition on October 2, 1987.

Concerning the fourth element, intent to hinder, delay or defraud, the Court finds that various "badges of fraud" are evident from Defendants' actions. Defendants' transfers of hogs were made

to their son Larry for little or no consideration. The proceeds from the hog sales were deposited into Larry's checking account which was opened shortly after a sale of market hogs had occurred. Defendants retained the benefit and use of these proceeds because money from Larry's checking account was used in part to make improvements upon the real estate, and for the payment of utility bills, medical insurance secured by Defendants, and motor vehicle insurance upon vehicles owned by Defendants. Some of the checks were written out by Defendants and signed by Larry. Further, the whole pattern of events in transferring the farm operation and hogs to Larry in order to escape FmHA's reach did not begin until after FmHA accelerated Defendants' loans on May 6, 1987.

In addition to the existence of "badges of fraud", Defendants' actions are very similar to those found in McNamara where the court denied a debtor's discharge under §727(a)(2)(A) because he sold secured collateral, paid the proceeds to his 14—year—old son, and used his children's bank accounts to channel household money. McNamara, 89 B.R. at 652—53. In the case ***sub judice,*** Defendants' hogs (FmHA's secured collateral) were sold, the proceeds were deposited into their son Larry's account, and checks were written on that account to pay for Defendants' real estate improvements, utility bills, and medical and auto insurance.

Defendants engaged in a scheme to sell the market hogs in their son's name and failed to report and account for the sale proceeds. There was a deliberate concealment of the sale of

collateral. Defendants did not make any loan payments during this period of time and were delinquent on their loans with FmHA by 1986.

Defendants had a long relationship with FmHA, were experienced grain and livestock farmers, and knew what was required by FmHA. The marketing of hogs using Larry's name, the channeling of farm income through their son's checking account, the lease of real estate for minimal rent, and the continued use and enjoyment of the proceeds by Defendants, show an intent by Defendants to defraud FmHA.

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

2. Section 727(a)(5)

Section 727(a) (5) provides that a debtor shall be granted a discharge unless:

> (5) the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities.

11 U.S.C. §727(a)(5) (emphasis added). This section grants the court broad discretion to deny a discharge if a debtor fails to satisfactorily explain a loss of assets. McNamara, 89 B.R. at 654 (citing In re Martin, 698 F.2d 883, 886 (7th Cir. 1983)). Although what constitutes a "satisfactory explanation" has not been definitively stated, In re Hendren, 51 B.R. 781, 788 (Bankr. E.D.

Tenn. 1985), the bottom line is that the debtor's explanation must convince the judge. In re Chalik, 748 F.2d 616, 619 (11th Cir. 1984); see In re Reed, 700 F.2d 986, 993 (5th Cir. 1983) ("vague and indefinite explanations of losses . . . based upon estimates uncorroborated by documentation are unsatisfactory."); Hendren, 51 B.R. at 789 (The court must determine "it is dealing with more than an unreliable remake of reality, custom—made to comport with current exigencies."); Slocum v. Wheeler, 38 B.R. 842, 846 (Bankr. E.D. Tenn. 1984) ("The standard . . . [is] one of reasonableness or credibility.").

In the case ***sub judice*** Defendants reported to FmHA on March 17, 1986, that they had 395 market hogs and 52 sows and gilts. FmHA then authorized Defendants to use the proceeds from, among other things, the sale of market hogs but did not authorize Defendants to transfer or liquidate their breeding stock. Prior to July 7, 1986, market hogs were sold in Marvin Kirscher's name but after July 7, 1986, Marvin Kirscher ordered that payment for hogs would be in Larry's name. On October 22, 1987, FmHA officers discovered approximately 150 market hogs and 42 sows and gilts on Defendants' farm, but Marvin Kirscher advised FmHA he held no ownership interest in them. This explanation is not convincing and the Court finds Marvin Kirscher has failed to satisfactorily explain the loss of the hogs in violation of §727(a) (5).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Plaintiff has met its burden of proof in objecting to Defendants' discharge under §727(a) (2) (A) and §727(a) (5).

FURTHER, the Court concludes said result renders Plaintiff's objection to dischargeability of debt under §523(a) (6) moot.

IT IS ACCORDINGLY ORDERED that Defendants' discharge is denied.

Dated this 8th day of May, 1989.

RUSSELL J. HILL
U.S. BANKRUPTCY JUDGE