IN THE UNITED STATES BANKRUPTCY COURT FOR THE NORTHERN DISTRICT OF IOWA

IN RE:)
) Chapter 7
GERALD J. SKILLEN)
)
Debtor.) Bankruptcy No. 03-00100
---------- SHERYL SCHNITTJER)
) Adversary No. 03-9118
Plaintiff,)
)
vs.)
)
GERALD J. SKILLEN)
)
Defendant.)

ORDER RE: OBJECTION TO DEBTOR'S DISCHARGE

The above-captioned matter came on for trial on March 9, 2004 on Trustee Sheryl Schnittjer's objection to Debtor Gerald Skillen's discharge. Trustee appeared in person with Attorney Brian Fagan. Debtor appeared in person with Attorney Janice McCool. After the presentation of evidence, the Court took the matter under advisement. The time for filing briefs has now passed and this matter is ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(J).

STATEMENT OF THE CASE

Trustee objects to Debtor's discharge under 11 U.S.C. §§ 727(a)(4)(A) and 727(a)(2), asserting Debtor provided a false oath or account, concealed assets, and transferred or removed assets. Debtor asserts that his actions were based upon innocent misunderstandings and that he did not have the requisite intent to support Trustee's allegations. In addition, Debtor argues that the asset allegedly transferred or removed was not property of the Debtor or the bankruptcy estate.

FINDINGS OF FACT

Debtor Gerald Skillen ("Debtor") filed a Chapter 7 petition on January 13, 2003. Erin Enterprises, Inc. ("Erin Enterprises") was an Iowa S-corporation created on May 28, 1996. It published magazines as a marketing and advertising firm. Debtor was Erin Enterprises' President and sole board member. While he was listed as the sole shareholder of Erin Enterprises' 10,000 shares, no stock certificates were ever issued. Debtor disclosed no stock or interests in incorporated businesses on his bankruptcy schedules. Debtor's former residence was listed with the Iowa Secretary of State as Erin Enterprises' corporate office. After his dissolution with his ex-wife, Debtor moved to an apartment and operated Erin Enterprises from that location, although he did not update the corporate address. Erin Enterprises' sole asset was a US Bank checking account ("US Bank account").

In his statement of financial affairs, Debtor indicated that Erin Enterprises began operating on June 6, 1996, and ceased operations in 2002.

Debtor's bankruptcy schedule of current income and employment, however, stated that Erin Enterprises was still "in the process of closing." In response to subsequent interrogatories, Debtor admitted that business in Erin Enterprises' name did not cease until May 3, 2003.

At the § 341 meeting of creditors on February 18, 2003, Trustee asked Debtor whether he had a bank account. Based on Debtor's response under penalty of perjury that he did not have a "personal account," Trustee inquired further and first discovered the US Bank account.

On February 19, 2003, Trustee sent a letter to Debtor instructing him that funds in the US Bank account were "not to be spent, transferred, or withdrawn." Debtor testified that he was out of town for a few days and received the letter after he had already written outstanding checks.

Even after those checks had cleared, however, Debtor continued to use the US Bank account for both personal and business expenses. When Debtor filed bankruptcy on January 13, 2003, the US Bank account had a balance of $8,682.76. By the February 18, 2003 § 341 meeting of creditors, the balance had diminished to roughly $2,850. On February 26, 2003, the account balance was $1,811.76. By May 21, 2003, only $12.24 remained. By July 31, 2003, the account was empty.

In addition to paying corporate expenses out of the US Bank account, Debtor also used it as his personal checking account. Debtor withdrew cash and wrote checks to pay his rent, car payments, insurance and taxes, utility and phone bills, cable and DSL bills, personal medical expenses, and credit card bills from the US Bank account. When questioned as to his continued use of the US Bank account for personal expenses throughout his bankruptcy, Debtor stated that he had no other checking account.

CONCLUSIONS OF LAW

Plaintiff Trustee seeks denial of Debtor's discharge under 11 U.S.C. §§ 727 (a)(4)(A) and 727(a)(2). In an action objecting to discharge, Trustee must prove each element by a preponderance of the evidence. In re Sendecky, 283 B.R. 760, 763 (B.A.P. 8th Cir. 2002)

Trustee alleges three counts of fraud: (1) Debtor made a false oath in his schedules and statement of financial affairs; (2) Debtor concealed his stock ownership from the Trustee; and (3) Debtor transferred or removed money from the US Bank account post-petition.

§ 727(a)(4)(A): FALSE OATH OR ACCOUNT

A debtor who "knowingly and fraudulently, in or in connection with the case . . . made a false oath or account" may be denied a discharge. 11 U.S.C. § 727(a)(4)(A). To prove a false oath, Trustee must show by a preponderance of the evidence that (1) Debtor made a statement under oath; (2) that statement was false; (3) Debtor knew the statement was false; (4) Debtor made the statement with fraudulent intent; and (5) the statement related materially to the Debtor's bankruptcy case. 11 U.S.C. § 727(a)(4)(A); In re Tripp, 224 B.R. 95, 97-98 (Bankr. N.D. Iowa 1998).

The Eighth Circuit Bankruptcy Appellate Panel has held that "a debtor's signatures, under penalty of perjury, on a bankruptcy petition, schedules of assets and liabilities, and the statement of financial affairs are written declarations which have the force and effect of oaths." In re Bren, 303 B.R. 610, 613 (B.A.P. 8th Cir. 2004). An omission

"concern[ing] discovery of assets . . . or the existence and disposition of the debtor's property" is material. Mertz v. Rott, 955 F.2d 596, 598 (8th Cir. 1992). In return for the fresh start of a discharge, Debtor has a duty to disclose any and all interests he may have. Bren, 303 B.R. at 614.

To deny Debtor's discharge for making a false oath, Trustee must show that Debtor "knowingly and fraudulently" omitted his interest in Erin Enterprises and its accurate operating dates from his bankruptcy schedules. As a debtor is not likely to admit to fraudulent intent, the debtor's course of conduct and surrounding circumstances may establish actual intent. In re Gray, 295 B.R. 338, 344 (Bankr. W.D. Mo. 2003). If Debtor does not provide a credible explanation for his omission, fraudulent intent may be inferred. In re Baldridge, 256 B.R. 284, 291 (Bankr. E.D. Ark. 2000); In re Mech, No. 97-
9157S, slip op., at 4 (Bankr. N.D. Iowa Mar. 2, 1999).
Section 727's denial of discharge, however, is construed liberally in favor of the debtor, and consequently "courts are often understanding of a single omission or error resulting from innocent mistake." Bren, 303 B.R. at 614; In re Ellingson, 63 B.R. 271, 279 (Bankr. N.D. Iowa 1986).

Debtor signed his petition and submitted his bankruptcy schedules and statements as accurate under penalty of perjury. Schedule B12 specifically addresses stock ownership. Debtor did not disclose his ownership of 10,000 shares of Erin Enterprises. Debtor's statements concerning Erin Enterprises' dates of operation were also inconsistent. The bankruptcy schedules stated that Erin Enterprises ceased operations in 2002, but at the § 341 meeting of creditors in February 2003, Debtor stated that Erin Enterprises was still in the process of closing. Thereafter, Debtor admitted to continuing business in Erin Enterprises' name until May 3, 2003. In these respects, Debtor's schedules and statement of financial affairs were false.

Debtor's failure to disclose his stock ownership and the operation of Erin Enterprises affected Trustee's investigation of Debtor's property available for creditors. Debtor claims that the inconsistencies in his bankruptcy schedules were accidental, not fraudulent. Debtor testified that his non- disclosure "was an oversight." Although Debtor is listed as sole shareholder of Erin Enterprises, no stock certificates were ever issued. Debtor testified that this led him to believe he did not actually own any stock in Erin Enterprises.
Debtor also testified that Erin Enterprises was "dormant" for a short period of time and later began operations again before ceasing operations on May 3, 2003.

While misunderstanding is no excuse for non-disclosure, Debtor's candidness about Erin Enterprises and the US Bank account during Trustee's examination coupled with the fact that Erin Enterprises was mentioned in his bankruptcy schedules lends credence to Debtor's explanation for the

omission. Trustee has not demonstrated by a preponderance of the evidence that Debtor had a fraudulent intent under § 727(a)(4)(A).

§ 727(a)(2): FRAUDULENT CONCEALMENT, TRANSFER, OR REMOVAL OF ASSETS

Section 727(a)(2) states that:

(a) The court shall grant the debtor a discharge, unless–

...

(2) the debtor, with intent to hinder, delay, or defraud . . . an officer of the estate charged with custody of property under this title, has transferred, removed, . . . or concealed . . .

(A) property of the debtor, within one year before the date of the filing of the petition; or

(B) property of the estate, after the date of filing of the petition.

11 U.S.C. § 727(a)(2).

FRAUDULENT CONCEALMENT OF ASSETS

Under § 727(a)(2), Trustee must prove by a preponderance of the evidence that (1) Debtor concealed his ownership of Erin Enterprises stock; (2) the stock was property of the bankruptcy estate; (3) Debtor concealed the stock either within one year of filing bankruptcy or at any time post- petition; and (4) Debtor concealed the stock with the intent to hinder, delay, or defraud Trustee. 11 U.S.C. § 727(a)(2).

The omission of information from Debtor's bankruptcy schedules may constitute a concealment. Baldridge, 256 B.R. at 291. As in Trustee's false oath allegation, however, the element at issue is whether Debtor had the requisite intent. Circumstantial evidence may be used to show fraudulent intent. In re Lambert, 280 B.R. 463, 466 (Bankr. W.D. Mo. 2002).

In this case, the circumstantial evidence analyzed to determine the issue of fraudulent intent is identical to that relied upon to analyze the false oath allegation. For the reasons discussed above in connection with Trustee's claim for false oath, the Court concludes Trustee has not proven by a preponderance of the evidence that Debtor's omission of the stock from his bankruptcy schedules was a fraudulent concealment under § 727(a)(2).

FRAUDULENT TRANSFER OR REMOVAL OF ASSETS

Under 11 U.S.C. § 727(a)(2), denial of discharge is warranted if Trustee proves by a preponderance of the evidence that Debtor transferred or removed property of Debtor or of the estate post-petition with the intent to hinder, delay, or defraud Trustee. 11 U.S.C. § 727(a)(2). The elements at issue are ownership of the US Bank account and Debtor's intent.

Debtor argues that the US Bank account was a corporate account. As corporate property, Debtor claims that the US Bank account cannot be reached by his creditors or the bankruptcy estate. Trustee argues that the extent to which Debtor commingled his personal and business financial affairs warrants a reverse piercing of the corporate veil.

Piercing the corporate veil is a question of state law in the Eighth Circuit. Stoebner v. Lingenfelter, 115 F.3d 576, 579 (8th Cir. 1997). Although shareholders generally do not own corporate property such as the US Bank account, "the corporate device cannot in all cases insulate the owners from personal liability." Briggs Transp. Co. v. Starr Sales Co., 262 N.W.2d 805, 810 (Iowa 1978). Iowa law permits veil piercing when:

> (1) the corporation is undercapitalized; (2) it lacks separate books; (3) its finances are not kept separate from individual finances, or individual obligations are paid by the corporation; (4) the corporation is used to promote fraud or illegality; (5) corporate formalities are not followed; or (6) the corporation is a mere sham.

In re Marriage of Ballstaedt, 606 N.W.2d 345, 349 (Iowa 2000) (emphasis added). While veil piercing typically creates individual liability for corporate debts, in this case reverse piercing is appropriate "to show the individual behind the corporation received value which can be attached by the individual's creditors." Stoebner, 115 F.3d at 579.

As with providing false oaths and concealment of assets, Debtor's intent to hinder Trustee may be inferred from his course of conduct and from circumstantial evidence. See, e.g., Lambert, 280 B.R. 463; Mech, No. 97-9157S, slip op. at 5. If Debtor does not provide a credible and sufficient explanation for his failure to obey Trustee's instructions not to draw down the US Bank account, intent may be inferred. See Baldridge, 256 B.R. at 292.

The US Bank account was extensively intertwined with Debtor's individual finances. Debtor treated his corporate and personal finances as one and the same. He not only drew cash from the US Bank account, but also paid his rent, car payments, insurance and taxes, utility and phone bills, cable and DSL bills, personal medical expenses, and credit card bills from the US Bank account. By Debtor's own admission, the US Bank account was his sole checking account and he used it to pay for personal expenses. Although Debtor eventually opened a personal checking account, he did so only after the US Bank account had been completely drained.

For these reasons, it is appropriate to disregard the corporate entity. The US Bank account is property of the bankruptcy estate and accessible to creditors.

The US Bank account had a positive balance of $8,682.76 at the petition date and of about $2,850 at the time of the § 341 meeting of creditors. Debtor received Trustee's February 19, 2003 letter instructing him not to spend money from the US Bank account. Debtor admits that he continued to make withdrawals from the US Bank account until the balance reached $0 in July 2003 despite having received Trustee's instructions. As an explanation, Debtor states that he had no other personal checking account. This is an insufficient explanation for ignoring Trustee's explicit instructions and continuing to diminish an asset of the estate.

CONCLUSION

While Trustee failed to prove intent under the false oath and concealment of stock allegations, Trustee has proved by a preponderance of the evidence that Debtor transferred or removed property of the estate post-petition with fraudulent intent. While denial of discharge is a serious remedy, only "deserving debtors receive a 'fresh start.'" Bren, 303 B.R. at 614. Debtor's blatant, unexplained disregard for Trustee's clear instructions demonstrates a fraudulent removal or transfer of assets warranting denial of discharge.

WHEREFORE, Trustee's complaint to deny Debtor Gerald Skillen's discharge is GRANTED.

FURTHER, Debtor Gerald Skillen's discharge is denied under § 727(a)(2).

SO ORDERED this 26th day of March, 2004.

_____ PAUL J. KILBURG
Chief Bankruptcy Judge