In the United States Bankruptcy Court

for the Northern District of Iowa

- Appealed 12/30/94;
- Appeal Dismissed by D.C. 3/17/95

GARY HYLAND
Debtor.

Bankruptcy No. 93-41580XM
Chapter 7

FIRST STATE BANK, GREENE, IOWA
Plaintiff

vs.

GARY HYLAND
Defendant.

Adversary No. 93-4199XM

DECISION AND ORDER

The matter before the court is the complaint of First State Bank, Greene, Iowa objecting to the discharge of debtor Gary Hyland and seeking a determination that Hyland's debt to bank is nondischargeable. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I) and (J). Trial was held November 30 and December 1, 1994, in Mason City, Iowa. Patrick G. Vickers appeared for First State Bank (BANK); Ann M. Troge appeared for Gary Hyland (HYLAND) or DEBTOR). The court now issues its decision which includes findings of fact and conclusions of law pursuant to Fed.R.Bankr.P. 7052.

Determination of Dischargeability

Bank contends that Hyland's debt to it, to the extent of $100,000.00, should be determined to be nondischargeable under 11 U.S.C. § 523(a)(2)(B) because Hyland intentionally gave Bank a materially false financial statement in order to obtain a $100,000.00 extension of credit for Riverside Auto Sales, Inc., a company in which Hyland owned half the shares of stock. Hyland had guaranteed corporate debt to the Bank. Bank says it reasonably relied on Hyland's personal financial statement in extending an additional line of credit to the corporation. The corporation subsequently drew on the line of credit in the amount of $100,000.00.

Hyland gave his personal financial information orally to Bank officer John Barth on April 29, 1992. Barth put the information on the Bank's form financial statement, and Hyland signed it. Bank claims the information was materially false for several reasons.

The statement showed Hyland owned $150,000.00 worth of real estate comprising four parcels. Hyland did not own two of the parcels--a house in Charles City and lots in Floyd, Iowa. The Charles City property was owned by Hyland's in-laws, August and Viola Ehlke. Hyland testified that he listed the property on the statement because he believed his wife would inherit it or that he would get some part of the proceeds when it was sold. Hyland says he told Barth this. Barth denies being told. The Floyd lots were owned by Hyland's wife and son. He says he listed them because he believed he had an interest in the property despite how it was titled. He says he told Barth as much. Again, Barth denies he was so informed.

Bank says the financial statement falsely listed $34,000.00 in cash. Bank said this figure wrongfully included a $12,000.00 to $14,000.00 account due Hyland from Hyland's corporation. There is now no record of the account. The cash listing also included a credit union deposit account of $13,000.00 which belonged to Hyland's wife Joanne. Hyland testified that he told Barth the true facts about these assets and that Barth knowingly included them in the cash portion of the assets. Barth denies this.

The assets also included $27,000.00 in cash value of life insurance. The policy's cash surrender value at the time was around $6,000.00. Hyland says he discussed the cash value with Barth. Hyland says he mistakenly estimated the policy's cash surrender value by multiplying what he believed to be the investment portion of the annual premium for the preceding 20 years and adding seven per cent interest 59 the 20 years. He says Barth knew this was the basis of the estimate. Barth denies this.

Bank obtained two state court judgments against Hyland--one for $195,280.57 based on Hyland's guaranty of corporate debt (exhibit 26) and a second in the amount of $8,050.99, based on a promissory note given by Hyland to the Bank about six months after he gave it his financial statement (Judgment, exhibit 27).

Bank asks that Hyland's debt to it be determined to be nondischargeable to the extent of $100,000.00, the amount which it loaned Hyland's corporation in reliance on the false financial statement. To prevail, Bank must prove by a preponderance of evidence that Hyland gave Bank a materially false written statement concerning his financial condition, that he gave the statement with an intent to deceive the Bank and that the Bank reasonably relied on the statement in extending credit. 11 U.S.C. § 523(a)(2)(B).

The Bank has failed to meet its burden of proof. Because of the misstatements above described, the statement was materially false. But Hyland says he indicated fully the nature of the assets to Barth when the statement was filled out. If this is so, then Bank did not rely on the statement, because Barth would have known it was inaccurate. J. C. Penney Co., Inc. v. Bonefas (In re Bonefas), 41 B.R. 74, 79 (Bankr. N.D. Iowa 1984). And if Hyland gave the correct information, there was no intent to deceive.

The determination of the issue depends on the court's view of the credibility of witnesses Hyland and Barth. I do not find Hyland to be a very credible witness. But I find John Barth to be no more credible. He was uncertain in his testimony. Although a banker for 23 years, he had little experience with small business loans outside farm lending. The evidence tended to show little if any reliance on the financial statement. Barth asked few questions of Hyland regarding the information given. He took it all at face value and did no investigation of any of the information, including the cash deposits which would have been in his own Bank. By his own admission, in 23 years, he never independently investigated any information given to him by a Bank customer for a financial statement. Indeed, according to Daniel Castle, the Bank's chief executive, Bank did not check on the information in financial statements because, in his view, it would be cost prohibitive and would irritate the customers. Also, Barth took no notes when meeting with Hyland. When asked under cross-examination whether he had told Hyland that the financial statement was to please the Bank examiners, he at first said he did not remember, but then said, "I would say no." Barth could not remember facts he ought to have remembered such as the nature of certain Bank lending policies. Based on the content of his testimony and his uncertain demeanor, I find him to be a less than credible witness, no more credible than Hyland. Bank's success depends greatly on Barth's testimony. Accordingly, I find that Bank has not met its burden in proving it relied on the financial statement or that Hyland intended to deceive the Bank.

Discharge

A.

The remaining division of Bank's complaint is an objection to Hyland's discharge. Bank claims that Hyland gave false testimony in a deposition taken in this proceeding and that he submitted false schedules and written statements in this case. Either would prevent discharge under 11 U.S.C. § 727(a)(4). That subsection provides that discharge may be denied where "the debtor knowingly and fraudulently, in or in connection with the case -- (A) made a false oath. . . ."

As to the false testimony, the court finds there is insufficient evidence to show that Hyland lied under oath at his deposition. The allegations relate to testimony as to what interest or expectancy Hyland might have had in the Charles

City property. The evidence did not provide much certainty as to the legal details of the transactions. The Hylands were apparently buying the Charles City property from Ehlkes. A bank had a "second mortgage." Hylands "got back" a farm they had sold on contract to a buyer who defaulted. Hyland testified they could not afford to carry the debt on both properties--the Charles City property and the farm. They decided to move to the farm. They "deeded" the Charles City property back to Ehlkes, who agreed to pay off "the second mortgage" held by a bank.

Hyland testified in his deposition that it was his understanding that if the house were sold by Ehlkes, Hyland and his wife would get some of the proceeds (Exhibit 2, page 69, lines 19-22). He also testified that he believed his wife would inherit the property, although he said his in-laws had never said that this was so (Exhibit 2, page 69, line 11).

Joanne Hyland and her parents, the Ehlkes, each testified that there was never an agreement or understanding that Ehlkes would leave the house to her or that they would give to her and Gary a portion of any sales proceeds. But Hyland's testimony in his deposition is not at odds with theirs. He testified that the matter of sales proceeds was once discussed, but he never said an agreement was reached. He stated his understanding of what would happen if there were a sale, but the basis of that understanding was not adequately probed in the deposition. He may have misunderstood. He clearly testified in the deposition that his in-laws never told him they would leave the property to Joanne. Bank has failed to prove that Hyland falsely testified in his deposition.

In its objection to discharge, Bank claims also that Hyland knowingly filed schedules and a Statement of Affairs that were materially false. The schedules and the debtor's Statement of Financial Affairs filed in a bankruptcy case are signed under penalty of perjury. A debtor declares that they are "true and accurate." Hyland did so in this case. Such bankruptcy schedules may be the subject matter of a false oath within the meaning of 11 U.S.C. § 727(a)(4). Comprehensive Accounting Corp. v. Morgan (In re Cycle Accounting Services), 43 B.R. 264, 273 (Bankr. E.D. Tenn. 1984); see also Palatine National Bank of Palatine, Illinois v. Olson (In re Olson), 916 F.2d 481, 484 (8th Cir. 1990) (failure to list interest in property in schedules was material misrepresentation barring discharge).

I find that Gary Hyland's bankruptcy schedules and his Statement of Financial Affairs were materially false in six particulars and that the false statements were intentional. I conclude that pursuant to 11 U.S.C. § 727(a)(4), Gary Hyland should not be granted a discharge.

[1]

Hyland was an officer and 50 per cent shareholder in Riverside Auto Sales, Inc., d/b/a Emerald Chevrolet, a Chevrolet automobile franchise in Greene, Iowa. Hyland was active in conducting its business; he was not a passive investor. Although the business apparently fell on hard times, as recently as January 1992, the corporation's operating report to GMC showed a net worth of $279,440.00. The business had significant, not nominal, assets and liabilities.

When Hyland filed his chapter 7 case on September 23, 1993, he did not list his stock in Riverside Auto Sales, Inc. as an asset. The appropriate place to have done so would have been at Schedule B-12. Hyland testified at trial that he did not list the stock because at the time he filed, he believed that it had been "repossessed" by the Bank. If this were so, the repossession of the stock should have been disclosed in the Statement of Affairs (STATEMENT) as a response to question 5, which required the debtor to list all property repossessed by a creditor within one year of filing. He did not. Hyland gave no explanation for such an omission. A misunderstanding by Hyland as to the meaning of "repossession" in question 5 is not a likely excuse. At trial, Hyland used the term "repossession" in giving his reason for not listing the stock. His lack of understanding of the term's meaning would not be a credible reason for failing to report the repossession. Omission of information as to the stock ownership or its repossession was material.

[2]

Hyland did not adequately disclose in his schedules his property interests in a Conservation Reserve Program contract with the Agricultural Stabilization and Conservation Service. The contract was providing annual income to Hyland and his wife in the amount of $2,964.00. Two post-petition payments have been made. Half of the 1993 payment went to the trustee. Joanne Hyland claims half of each payment. The contract relates to Hyland's 40-acre homestead property. The contract is a significant asset. It should have been disclosed at Schedule B-17; or if executory, it should have been disclosed in Schedule G. It was not disclosed in the schedules at all. It appears in one place in the debtor's Statement, at

question 1, in showing income from employment or the operation of a business. Debtor's response stated: "This year: 1993 Source: Emerald Chevrolet, CRP Amount: $1,982."

Although this may technically be a disclosure of a CRP contract as the source of some income in 1993, it in no way alerts a trustee or creditor of an owned asset. A creditor might construe the entry "Emerald Chevrolet, CRP" as being one source of income. There is nothing in the schedules to indicate the ownership of a continuing contract providing a stream of income to the debtor. The Statement was later amended to show income from the contract for 1991 and 1992, but the schedules were not amended. Hyland testified the reason he did not list the contract anywhere on the schedules was because he had listed it in the response to question 1 on the Statement and a further listing would have been duplicative. This is a poor explanation. The original response was so insufficient, a reasonable person could not construe it as a substitute for describing the asset in the schedules.

[3]

Hyland, as a sole proprietor, operated an automobile repair business under the trade name "Riverside North." As part of the business, he kept an inventory of "parts cars" which were damaged or junked vehicles from which he took parts to repair other autos. He purchased the parts cars at prices from $300 to $500 each. In the financial statement given to the Bank in April 1992, he valued the parts cars at $10,000.00. He did not list the parts cars as an asset on his bankruptcy schedules although at the time of filing, he owned at least 20. His explanation was that they had no value because he had ceased to operate his repair business at the time of filing. He reasoned that they had no value unless one was in a business which would make use of them, and they were not worth transporting. I do not find the explanation credible. But even if they might be thought to have had no value, Hyland was required to list them as such, not determine by himself they had no value and not list them at all. Such a determination and failure to list would preclude trustees from effectively assessing the value of estate property and liquidating it if a market existed. It was a material omission.

[4]

In July 1993, Hyland obtained a $4,000.00 loan on a life insurance policy which he owned and under which he was the insured. He put $1,500.00 of the loan proceeds in his wife's checking account. He did so he says to compensate her because she paid premiums on the policy. The transfer was not disclosed. He did not consider the repayment a gift. He did not list it as a transfer to a creditor because apparently he considered that he was giving her money back to her. The transfer to Joanne Hyland should have appeared on the Statement as a gift (question 7) or as a transfer to a creditor (question 3) or as a transfer to an insider (question 10). It did not appear at all, and its omission was significant. The trustee could have reasonably considered whether such a transfer was a preference or a return of the transferee's own money. Hyland should not have assumed the latter and omitted the information.

[5]

From the same insurance loan, Hyland paid attorney Roger Sutton to file the bankruptcy petition. The payment for the filing and the filing fee amounted to $550.00. That payment was disclosed in the debtor's response to question 9 of the Statement. What was not disclosed was that Hyland paid Sutton an additional $550.00 so that David Myers could also file a chapter 7 petition. Myers was the owner of the other 50 per cent of the stock in Riverside Auto Sales, Inc. Hyland explained that it was not a gift or loan, but just something that needed to be paid, and Myers could not pay it. This transfer was material and should have been disclosed. Also out of the insurance loan, Hyland paid Sutton an additional $900.00 for pre-petition legal fees. Hyland said he did not list the payment as part of his answer to question 9 in the Statement because it was not bankruptcy related. He did not list it anywhere else because he did not consider it an old, outstanding bill. The charges had been incurred during the period after February 1992. Information on this transfer was material. A trustee could have wanted to examine it to determine whether or not the payment was preferential. The court does not consider Hyland's explanation for the transfer's omission from the Statement to be credible.

[6]

When Hyland filed his petition, he was a creditor of Riverside Auto Sales, Inc. for goods or services provided to that corporation. He did not list the account because he believed it to be uncollectible. It is unclear what the amount of the account was, but in March of 1993, five months before Hyland filed bankruptcy, it was approximately $4,000.00

(exhibit 10, page 2). An account receivable of that magnitude should have been scheduled, notwithstanding Hyland's view of its value. The omission was material.

[7]

Bank has raised two other omissions from the schedules which it contends were fraudulent: (1) failure to list three monthly payments made by Hyland on his 18-year-old son Jason's car loan in the year prior to filing, and (2) a transfer of $5,912,28 to his wife so that she could purchase a condominium for Jason. These transactions do not enter into the court's determination to deny discharge. As to the car payments, the court accepts debtor's explanation that he did not think of them as gifts but as family expenses. Inasmuch as the son was at the time an 18-year-old college student still dependent on his parents, this explanation is believable. As to this omission, the court finds no fraudulent intent. As to the transfer of funds to Joanne Hyland, its omission in the Statement is not a false statement because the official questions require the debtor to disclose transfers within a year of filing. Hyland sent the check to the First State Bank on or about September 2, 1992, for transmittal to the agent representing Joanne Hyland in the purchase. She was purchasing the condominium in her name to provide a place for their son to live while he attended college. The Bank transferred the funds to the agent on approximately the same day. Despite the fact that the closing on the purchase did not take place until October 1992, there is no evidence to indicate that Hyland's transfer to his wife was not completed in early September, outside the one-year disclosure period.

B.

For a discharge to be denied under 11 U.S.C. § 727(a)(4), it must be shown that there has been an intentional untruth in a matter material to the bankruptcy case. Federal Land Bank of Omaha v. Ellingson (In re Ellingson), 63 B.R. 271, 276 (Bankr. N.D. Iowa 1986). Where assets of substantial value are omitted from the schedules, the court may conclude that they were omitted purposely and with fraudulent intent. Crews v. Topping (In re Topping), 84 B.R. 840, 842 (Bankr. M.D. Fla. 1988); see also In re Mascolo, 505 F.2d 274, 276 (1st Cir. 1974) (court may infer fraudulent intent from unexplained false statement). The court should not deny discharge under the section where matters or property omitted are of trivial nature or of a low value. American State Bank v. Montgomery (In re Montgomery), 86 B.R. 948, 956 (Bankr. N.D. Ind. 1988). Courts should also not deny discharge if the untruth is a result of a mistake or inadvertence by the debtor. Bologna v. Cutignola (In re Cutignola), 87 B.R. 702, 706 (Bankr. M.D. Fla. 1988).

In order for discharge to be denied, the plaintiff need not show detriment to creditors or intent to injure creditors. Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 618 (11th Cir. 1984).

The debtor has an obligation to tell the truth. "A discharge is a privilege and not a right and therefore the strict requirements of accuracy is a small *quid pro quo*. The successful functioning of the Bankruptcy Code hinges upon the bankrupt's veracity and his willingness to make full a disclosure." Hillis v. Martin (In re Martin), 124 B.R. 542, 547-48 (Bankr. N.D. Ind. 1991), quoting Britton Motor Service, Inc. v. Krich (In re Krich), 97 B.R. 919 (Bankr. N.D. Ill. 1988). Full disclosure is a prerequisite to obtaining a discharge. Montgomery, 86 B.R. at 956, citing Secretary of Labor v. Hargis (In re Hargis), 50 B.R. 698, 700 (Bankr. W.D. Ky. 1985).

In this case, Hyland made six material omissions of information from his Statement of Affairs and schedules. He omitted information that was critical to a trustee doing an effective job in administering the estate. This is so even if Hyland were correct that some of the assets omitted truly had little value, or even if it were true that some of the undisclosed transfers would not have been recoverable. Hyland had a duty of candor which he did not fulfill. Perhaps if only one item of information were missing, any one of Hyland's excuses might have been more believable. However, the omission of six significant items from his statement and schedules, either transfers or assets, leads this court to infer believe that Hyland was attempting to conceal critical information from the trustee and creditors. When viewed in the context of six events, Hyland's individual reasons for omitting the six items become less believable. The court concludes that in filing his Statement of Affairs and schedules, debtor Gary Hyland made a false oath and that his discharge should be denied pursuant to 11 U.S.C. § 727(a)(4). Accordingly,

ORDER

IT IS ORDERED that judgment shall enter that pursuant to 11 U.S.C. § 727(a)(4), Gary Hyland shall not be granted a discharge.

IT IS FURTHER ORDERED that First State Bank's claim under 11 U.S.C. § 523(a)(2)(B) is dismissed.

SO ORDERED ON THIS 14th DAY OF DECEMBER, 1994.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on _____ I mailed a copy of this order and a judgment by U.S. mail to: U. S. Trustee, Patrick Vickers and Ann Troge.