In the United States Bankruptcy Court

for the Northern District of Iowa

MABEL LOUISE CONLEY	Bankruptcy No. 95-62047KW
Debtor.	Chapter 7

ORDER RE MOTION TO AVOID LIEN AND OBJECTION TO EXEMPTION

This matter came on for trial before the undersigned on June 27, 1996 on Motion to Avoid Lien and Objection to Exemption filed in the captioned bankruptcy case and Complaint Objecting to Discharge of Debtor filed in adversary case Sauer v. Conley, Adv. No. 95-6195KW. Debtor/Defendant Mabel Conley appeared in person with her attorney A. J. Flickinger. Plaintiff/Objector Lester Sauer appeared with his attorney Kenneth F. Dolezal. After the presentation of evidence and arguments of counsel, the Court took the matter under advisement. The time for filing briefs has passed and this matter is now ready for resolution. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(B, I, J, K).

STATEMENT OF THE CASE

Plaintiff Lester Sauer holds a judgment against Debtor entered in Iowa District Court in Cedar County on August 4, 1995. In the judgment, that court stated "Defendant [Debtor] has breached her fiduciary and confidential relationship duties owed Plaintiff [Sauer] . . , that she has wrongfully and fraudulently" caused certain Cedar Bluffs real estate to be titled in her name and taken possession of a Chevy station wagon. The court entered judgment of $3,500 against Debtor, which constitutes rental value of the Cedar Bluffs real estate while Debtor was wrongfully in possession, and ordered Debtor to convey title and possession of the real estate and the Chevy to Plaintiff.

Plaintiff asserts that this judgment is nondischargeable under § 523(a)(4) as arising from fraud or defalcation while acting in a fiduciary relationship. He asserts that he has not received the abstract for the real estate and that he has been unable to find the Chevy. Debtor has not listed these items as property on her schedules.

Debtor argues that the judgment is for rent and is dischargeable. She states that she has done everything necessary to transfer the real estate and Chevy to Plaintiff. She explains that she did not schedule the real estate and Chevy as property in her bankruptcy case because Judge Havercamp's judgment awarded Plaintiff sole ownership of this property.

Plaintiff also asserts that Debtor failed to disclose a transfer of real estate which occurred weeks before she filed her petition and concealed other property, i.e. the Chevy station wagon, rental deposit relating to the Cedar Bluffs property and the abstract of title for that property. He argues that discharge should therefore be denied under § 727(a)(2)(A). Debtor asserts that she did disclose at the meeting of creditors that she sold her Cedar Rapids homestead and applied the proceeds to purchase her Hazelton homestead in June 1995. She states that she did not list the other property because Judge Havercamp's order determined it was property of the Plaintiff.

Plaintiff asserts that his judgment constitutes a pre-acquisition debt regarding Debtor's homestead. Debtor asserts that her Hazelton property meets the requirements of sec. 561.20 as a new homestead acquired with the proceeds of the sale of her prior homestead in Cedar Rapids. She requests that Plaintiff's judgment lien be avoided under § 522(f)(1)(A) as impairing her homestead exemption.

FINDINGS OF FACT

In May of 1993, Debtor moved into Plaintiff's house to become his "housekeeper". Plaintiff had earlier suffered a stroke and he suffered another one between the time Debtor moved in and July 1, 1993. On July 1, Plaintiff executed a power of attorney in favor of Debtor, giving her authority to take care of his financial matters. In August 1993, Debtor arranged for financing in Plaintiff's name to purchase certain vehicles and real estate in Cedar Bluffs, Iowa which Debtor had titled in her own name. Plaintiff terminated Debtor's power of attorney in October 1993. At that time, Plaintiff left the residence and Debtor remained in possession until ordered to vacate in August 1995 by the Iowa District Court.

Before Debtor moved in with Plaintiff, she resided in a duplex she owned in Cedar Rapids. She eventually rented out both halves of the duplex. In June, 1995, Plaintiff sold the Cedar Rapids duplex and purchased a house in Hazelton. She received net proceeds of the sale of the duplex of $12,251.80. Of this amount, she applied $8,000 to the purchase of the Hazelton house. When Debtor vacated Plaintiff's house as ordered by the Iowa District Court, she moved directly to the Hazelton house. Debtor testified that while she lived in Plaintiff's house she kept her place in Cedar Rapids and considered it her home.

When Debtor filed her Chapter 7 petition in October 1995, she did not disclose the June 1995 sale of her Cedar Rapids duplex. She did tell the Trustee about this transfer at the § 341 meeting.

Title to the real estate and the Chevy have now been transferred to Plaintiff. Therefore, only the dischargeability under § 523(a)(4) of the $3,500 judgment ordered by the Iowa District Court is in issue in the adversary case, along with the issue of denial of discharge under § 727(a)(2)(A). The question to be determined in the bankruptcy case is whether the lien arising from this judgment is avoidable under § 522(f).

DENIAL OF DISCHARGE, § 727(a)(2)(A)

Sec. 727(a) states, in pertinent part, as follows:

> 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 officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed --
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> A. property of the debtor, within one year before the date of the filing of the petition.

For a discharge to be denied under this section, it must be shown that there has been an intentional untruth in a matter material to the bankruptcy case. 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 purposefully and with fraudulent intent. In re Topping, 84 B.R. 840, 842 (Bankr. M.D. Fla. 1988). However, the court should not deny a debtor a discharge under this section where matters or property omitted are of a trivial nature or of a low value. In re Montgomery, 86 B.R. 948, 956 (Bankr. N.D. Ind. 1988); In re Simone, 68 B.R. 475, 478-79 (Bankr. W.D. Mo. 1983). Also, the court should not deny discharge if the untruth is a result of mistake or inadvertence of the debtor. In re Joslin, No. X88-01209S, Adv. No. X89-0012S, slip op. at 10 (Bankr. N.D. Iowa April 13, 1990); In re Cook, 40 B.R. 903 (Bankr. N.D. Iowa 1984).

In order to prevail in a § 727(a)(2) claim, the Plaintiff must prove the existence of the following elements: (1) that a transfer or concealment of property has occurred; (2) that the property was owned by the debtor; (3) that the transfer or concealment occurred within one year of filing bankruptcy and (4) that the debtor had, at the time of the transfer, the intent to hinder, delay or defraud a creditor. In re Schroff, 156 B.R. 250, 254 (Bankr. W.D. Mo. 1993); In re Penner, 107 B.R. 171, 174 (Bankr. N.D. Ind. 1989). Before a court can refuse a discharge under § 727(a)(2)(A), it must be shown that there was an actual transfer or concealment of valuable property which reduced assets available to creditors and which was made with fraudulent intent. In re Garcia, 168 B.R. 403, 407 (D. Ariz. 1994).

> Section 727's denial of discharge is construed liberally in favor of the debtor and strictly against those objecting to discharge. Accordingly, discharge of debts may be denied under section 727(a)(2)(A) only upon a finding of actual intent to hinder, delay, or defraud creditors. Constructive fraudulent intent cannot be the basis for denial of a discharge. However, intent "may be established by circumstantial evidence, or by inferences drawn from a course of conduct."

Ellingson, 63 B.R. at 279 (citations omitted).

Case law has developed factors denominated "badges of fraud" which by circumstantial evidence help determine whether an actor possessed actual intent. In re Cohen, 142 B.R. 720, 728 (Bankr. E.D. Pa. 1992). These factors include:

1. lack or inadequacy of consideration;
2. the family, friendship or close associate relationship between the parties;
3. the retention of possession, benefit or use of the property in question, although title exists in another entity;
4. the financial condition of the party sought to be charged both before and after the transaction in question;
5. conveyance of all of the debtor's property;
6. secrecy of the conveyance;
7. existence of a trust or trust relationship between the debtor and the person to whom the property was conveyed;
8. the existence or cumulative effect of a pattern or series of transactions or a course of conduct after the incurring debt, onset of financial difficulties, or pendency or threat of suit by creditors;
9. the instrument affecting the transfer suspiciously states it is in fact bona fide;
10. the debtor makes a voluntary gift to a family member; and
11. the general chronology of events and transactions under inquiry.

Id.; Schroff, 156 B.R. at 254-55.

Plaintiff asserts that Debtor should be denied discharge under § 727(a) because she failed to disclose the sale of the Cedar Rapids duplex and purchase of her Hazelton home and failed to list the Chevy, a rental deposit and the abstract for Plaintiff's real estate as personal property. The Court concludes that Plaintiff has failed to prove that Debtor possessed actual fraudulent intent. Her statement of affairs discloses her down payment on the Hazelton house occurring June 26, 1995. None of the badges of fraud appears to be present in this case. The Chevy, abstract and rental deposit were ordered returned to Plaintiff and thus were not actually property of Debtor at the time she filed her petition. Listing them in her schedules would not have increased the assets available to creditors. Plaintiff has failed his burden to prove the elements of § 727(a)(2)(A) by a preponderance of the evidence. Therefore, Debtor will not be denied her general discharge.

FIDUCIARY FRAUD OR DEFALCATION

Under § 523(a)(4), a debt for "fraud or defalcation while acting in a fiduciary capacity" is excepted from discharge. Two issues are presented in a challenge to dischargeability under § 523(a)(4): (1) whether the debtor was acting in a fiduciary capacity and (2) whether fraud or defalcation occurred. In re Kondora, 194 B.R. 202, 208 (Bankr. N.D. Iowa 1996); In re Wilson, 127 B.R. 440, 443 (Bankr. E.D. Mo. 1991). The term "fiduciary" in that section applies only to trustees of express or technical trusts. In re Long, 774 F.2d 875, 878 (8th Cir. 1985). Courts look to nonbankruptcy law to determine if such a trust exists. In re Smith, 72 B.R. 61, 62 (N.D. Iowa 1987).

The second issue requires the Court to determine whether Debtor's actions constitute fraud or defalcation. Defalcation is evaluated by an objective standard. Kondora, 194 B.R. at 208; In re Ellis, Adv. L88-0119W, slip op. at 6 (Bankr. N.D. Iowa May 1, 1989) (Melloy, J.). It is construed broadly and does not necessarily involve misconduct. Smith, 72 B.R. at 63. "'Negligence or ignorance may be defalcation.' No element of intent or bad faith need be shown." Id. (citations omitted). Under the objective standard, neither ignorance of the law nor subjective mental state is relevant. Kondora, 194 B.R. at 208. "Fraud" under § 523(a)(4) may only be satisfied by "fraud in fact, involving moral turpitude or intentional wrong, rather than implied or constructive fraud." In re Bryant, 147 B.R. 507, 510 (Bankr. W.D. Mo. 1992).

This Court considered but refused to decide whether a power of attorney created an express or technical trust sufficient to constitute a fiduciary relationship under § 523(a)(4) in In re Millington, Adv. No. L-91-0078C, slip op. at 25 (Bankr. N.D. Iowa Feb. 10, 1992), aff'd, No. C92-126 (N.D. Iowa Feb. 17, 1994). Judge Melloy stated as follows:

> Normally, an expressed trust must be present to establish the requisite relationship; a constructive or implied trust is not sufficient. The class of fiduciary contemplated under § 523(a)(4) is a special class which includes guardians, administrators, executors, public officers, or trustees of an expressed trust, but does not normally include agents, bailees, brokers, factors, or partners.
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> Bankruptcy Courts have split on whether an agent, such as a person holding a power of attorney, is a fiduciary for purposes of § 523(a)(4). This split results from the varying ways in which state laws define powers of attorney. Some bankruptcy courts have found that in particular situations mere agency relationships can still meet the requirements of "fiduciary capacity" under § 523(a)(4).

Id. at 23-24 (citations omitted); see In re Burgess, 106 B.R. 612, 620 (Bankr. D. Neb. 1989) (concluding that scope and nature of agency relationship based on power of attorney established fiduciary relationship under § 523(a)(4)).

A fiduciary relationship may exist where trust-type obligations are imposed pursuant to statute or common law. In re Van De Water, 180 B.R. 283, 289 (Bankr. D.N.M. 1995). The requisite fiduciary capacity may exist in an agency relationship created by a power of attorney as a matter of common law. Id. Courts look at the amount of control the principle has over the agent and the capability of the principle to monitor management of business affairs. Id. at 290; In re Johnson, 174 B.R. 537, 542 (Bankr. W.D. Mo. 1994).

The Iowa Supreme Court recently stated that a person holding a power of attorney is required, as a fiduciary, to act in the best interests of the person who granted the power of attorney. In re Estate of Crabtree, ___ N.W.2d ___, 1996 WL 333136, at *3 (Iowa June 19, 1996). The Iowa District Court's ruling creating the judgment in favor of Plaintiff states as follows:

> A power of attorney is an instrument in writing by which one person, as principle, appoints another as his agent and confers upon him the authority to perform certain specified acts or kinds of acts on behalf of the principle. As such, it creates a fiduciary relationship.

Sauer v. Conley, No. LA 31679, Findings of Fact, Conclusions of Law and Judgment Entry, slip op. at 5 (Iowa District Court Aug. 4, 1995). The court found that at the time Plaintiff executed the power of attorney in favor of Debtor his stroke had somewhat diminished his faculties and his understanding of financial matters. Id. at 3. It concluded that the facts surrounding the real estate transaction wherein the Cedar Bluffs property was titled in Debtor's name are indicative of breach of Debtor's fiduciary responsibility and the fraud intrinsic in the transfer of assets from Plaintiff to Debtor. Id. at 6.

Based on the foregoing, this Court concludes that the circumstances of this case combined with the power of attorney granted by Plaintiff to Debtor establish that a technical trust existed between the parties under common law. At the time Plaintiff gave Debtor the power of attorney, his faculties were diminished by two recent strokes. Debtor exercised considerable influence over Plaintiff and made arrangements using Plaintiff's assets for her own benefit. Plaintiff was unable to control or completely monitor these business affairs. In these circumstances, the Court finds that Debtor was operating under a technical trust. This constitutes a fiduciary relationship under § 523(a)(4).

The Court further concludes that Debtor committed fraud and defalcation during her fiduciary relationship by titling the Cedar Bluffs real estate in her name and being involved in the other financial transactions set out in the Iowa District Court ruling. Therefore, the debt evidenced by the judgment against Debtor and in favor of Plaintiff is excepted from discharge.

NEW HOMESTEAD

The exemption for a new homestead is set forth in Iowa Code sec. 561.20:

> Where there has been a change in the limits of the homestead, or a new homestead has been acquired with the proceeds of the old, the new homestead, to the extent in value of the old, is exempt from execution in all cases where the old or former one would have been.

The burden of proof in establishing that an exemption is not properly claimed is on the objector. Bankr. R. 4003. Courts liberally construe the homestead exemption in the debtor's favor. Berner v. Dellinger, 222 N.W. 370, 372 (Iowa 1928); Chariton Feed and Grain, Inc. v. Kinser, 794 F.2d 1329, 1331 (8th Cir. 1986). The purposes of the exemption statutes should not be defeated by narrow construction, American Savings Bank v. Willenbrock, 228 N.W. 295, 297 (Iowa 1929), but it is not within a court's province to enlarge or extend the exemptions established by the legislature. Iowa Methodist Hosp. v. Long, 12 N.W.2d 171, 175 (Iowa 1943).

Iowa Code sec. 561.20 provides for a transfer of exemption rights when there is a change of homestead. See In re Ersepke, No. 2-92-00541D, slip op. at 4 (Bankr. N.D. Iowa Nov. 30, 1993). If a debtor's first homestead is exempt from sale for a particular debt, the second homestead is also exempt. In re Streeper, 158 B.R. 783, 788 (Bankr. N.D. Iowa 1993); Bills v. Mason, 42 Iowa 329 (1876).

The Court must determine whether Debtor's duplex in Cedar Rapids qualified as her homestead at the time she sold it and applied proceeds of the sale to purchase her home in Hazelton. Plaintiff asserts that Debtor abandoned the Cedar Rapids duplex as her homestead prior to the purchase of the Hazelton home. In Iowa, whether a homestead has been abandoned is largely a matter of intent to be determined on the particular facts in each case. Charter v. Thomas, 292 N.W. 842, 843 (Iowa 1940). In In re McClain's Estate, 262 N.W. 666, 669 (Iowa 1935), The Iowa Supreme Court states that

> once the homestead character has attached, the owner may remove therefrom and the homestead character is preserved as long as [the owner] has an intention to return. In other words, intention to occupy in the future, while insufficient to establish a homestead originally, is sufficient to continue a homestead previously established.

Some Iowa cases hold that the rental of homestead property does not constitute an abandonment of the homestead. In In re Robinson, No. L-89-01776C, slip op. at 9 (Bankr. N.D. Iowa July 13, 1990), aff'd, No. C 90-2067 (N.D. Iowa Feb. 21, 1991), this Court considered such a situation where the debtors had rented their 40-acre parcel of farm land to a third party. The Court concluded that the entire 40-acre parcel qualified as the debtors' homestead. Id. It cited the following cases in considering whether the homestead was abandoned by the rental: In re Sueppel's Estate, 124 N.W.2d 154, 155 (Iowa 1963) (holding that the rental of farm land on a crop share basis was not an abandonment of the homestead rights in the farm land); Olsen v. Lohman, 13 N.W.2d 332, 340 (Iowa 1944) (holding that the owners did not abandon their homestead by leasing the first floor of their building for use as an office and showroom); Hatter v. Icenbice, 223 N.W. 527, 529 (Iowa 1929) (stating "[t]hat part of the homestead which is temporarily leased or from which profit from privilege other than the personal use of the soil by the homesteader is derived does not thereby lose its homestead character"); Kelley v. Williams, 81 N.W. 230 (Iowa 1899) (denying homestead exemption where the building in question had been rented to others for many years).

The following pertinent statement appears in In re Pope, 98 F. 722, 723 (S.D. Iowa 1900):

> In construing [the homestead exemption statute], it has been uniformly held by the supreme court of Iowa that a temporary removal from the homestead, and renting it to third parties, would not be deemed to be an abandonment of the homestead, if the party having the homestead right intended to return to the premises, and resume the occupancy thereof. (citations omitted).

Based on the record presented and the foregoing law, the Court concludes that Plaintiff has proved that Debtor is not entitled to claim her Hazelton home exempt from Plaintiff's judgment. Debtor testified that she kept her duplex in Cedar Rapids and considered it her home during the time that she lived in Plaintiff's home. However, the record belies this asserted intent. At some point after Debtor moved in with Plaintiff, she rented both halves of the Cedar Rapids duplex to third parties. She then sold the duplex before Plaintiff received his judgment in Iowa District Court.

Debtor claimed ownership of Plaintiff's Cedar Bluffs property where she resided from 1993 to 1995. The Iowa District Court found that she owed Plaintiff for 20 months rent while she occupied the Cedar Bluffs property after Plaintiff moved away. Breaching her fiduciary duty to Plaintiff, Debtor had that property titled in her own name. She made some repairs to the property. She claimed that the house was a gift to her from Plaintiff. Debtor still resided in the property at the time the August 4, 1995 state court judgment ordered her to vacate the property within 30 days. The record indicates that it was not until after this judgment was entered that Debtor moved into the Hazelton property. Based on these facts, the Court concludes that Debtor did not intend to return to the Cedar Rapids duplex to occupy it as her homestead.

The Court concludes that Debtor abandoned her homestead rights in the Cedar Rapids duplex before Plaintiff received his judgment. She did not establish her homestead rights in the Hazelton home until after the judgment. In order to become a homestead, the property must be occupied by the owner. Perez v. Pogge, 303 N.W.2d 145, 148 (Iowa 1981). It is not determinative that Debtor already owned the Hazelton property at the time the judgment was entered. "A homestead is 'acquired' when the homestead right attaches by actual use and occupation of the property as a homestead, not when a person acquires title to the property. Streeper, 158 B.R. at 788; Kramer v. Hofmann, 257 N.W. 361 (Iowa 1934) (stating that homestead right depends not only upon interest which is claimed, but also upon occupation of property pursuant to such claim); Fardal v. Satre, 206 N.W. 22 (Iowa 1925) (holding that existence of homestead right does not arise from mere intention; actual occupancy being necessary to create right).

The file reflects that Debtor was still residing in the Cedar Bluffs property at the time the judgment was entered and before she purchased the Hazelton property. It is irrelevant whether Debtor used proceeds from the sale of the Cedar Rapids duplex to purchase the Hazelton property because the Cedar Rapids duplex did not qualify as her homestead at the time it was sold. The Hazelton property does not qualify as an exempt "new homestead" under Iowa Code sec. 561.20 because Debtor had abandoned the Cedar Rapids duplex as a homestead prior to applying its proceeds to the purchase of the Hazelton property.

LIEN AVOIDANCE

Debtor's motion to avoid lien relies on § 522(f) which states:

> Notwithstanding any waiver of exemptions, the debtor may avoid the fixing of a lien on an interest of the debtor in property to the extent that such lien impairs an exemption to which the debtor would have been entitled under subsection (b) of this section, if such lien is -
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> 1. a judicial lien . . .

According to § 522(b), "an individual debtor may exempt from property of the estate . . . any property that is exempt under . . . State or local law . . . ." Iowa has opted out of the federal exemption scheme.

Iowa Code § 627.10; In re Wooten, 82 B.R. 84, 85 (N.D. Iowa 1986). Under Iowa law, "the homestead of every person is exempt from judicial sale where there is no special declaration of statute to the contrary." Iowa Code § 561.16. This homestead exemption is subject to several restrictions. Iowa Code sec. 561.21(1) operates as an exception to the Iowa homestead exemption, stating:

> The homestead may be sold to satisfy debts of each of the following classes:
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> 1. Those contracted prior to its acquisition, but then only to satisfy a deficiency remaining after exhausting the other property of the debtor, liable to execution.

Iowa Code § 561.21(1).

In determining whether Debtor is entitled to avoid Plaintiff's judgment lien, the Court must query "not whether the lien impairs an exemption to which the debtor is in fact entitled, but whether it impairs an exemption to which he would have been entitled but for the lien itself." Owen v. Owen, 500 U.S. 305, 111 S. Ct. 1833, 1834 (1991); Streeper, 158 B.R. at 786. The manner in which to apply § 522(f) is to "ask first whether avoiding the lien would entitle the debtor to an exemption, and if it would, then avoid and recover the lien." Owen, 111 S. Ct. at 1837.

Debtor did not acquire homestead rights in the Hazelton property until she actually occupied it, sometime within 30 days after the judgment. As discussed above, the Hazelton property does not qualify as a "new homestead" which would be exempt from debts if her previous homestead was exempt. Plaintiff's judgment entered August 4, 1995 is a preacquisition debt as to the Hazelton property. Therefore, the Hazelton property is not exempt from the judgment under Iowa Code sec. 561.21(1). Debtor would not be entitled to an exemption if Plaintiff's judgment lien arising from this preacquisition debt is avoided. Therefore, Debtor's Motion to Avoid Lien must be denied and Plaintiff's Objection to Exemption must be granted.

WHEREFORE, Debtor's general discharge is not denied under § 727(a)(2)(A).

FURTHER, the debt to Plaintiff Lester Sauer is excepted from discharge under § 523(a)(4) as arising from fraud or defalcation while acting in a fiduciary capacity.

FURTHER, Plaintiff's Objection to Exemption is GRANTED.

FURTHER, Debtor's Hazelton property is not exempt as her homestead as to Plaintiff's preacquisition judgment lien.

FURTHER, Debtor's Motion to Avoid Lien is DENIED.

FURTHER, Plaintiff's judgment lien arises from preacquisition debt for which Debtor's Hazelton property is liable.

SO ORDERED this 15th day of July, 1996.

Paul J. Kilburg
U.S. Bankruptcy Judge