

In the United States Bankruptcy Court

for the Northern District of Iowa

WILLIAM H. WOOD

Bankruptcy No. 94-42088XM

Debtor.

Chapter 7

IOWA FALLS AG CENTER

Adversary No. 95-4086XM

Plaintiff

vs.

WILLIAM H. WOOD

Defendant.

DECISION RE: OBJECTION TO DISCHARGE

Iowa Falls Ag Center, an unsecured creditor, objects to debtor's discharge. Trial was held May 7, 1996 in Mason City. Michael D. Holt, Esq. represented Iowa Falls Ag Center (Ag Center). M. Wayne Oltrogge, Esq. represented William H. Wood. This is a core proceeding under 28 U.S.C. 157(b)(2)(J). I have jurisdiction under 28 U.S.C. 1334(b) and 157(a) and the District Court's order of referral.

Ag Center contends that Wood's discharge should be denied under any of four subsections of 727 of the Bankruptcy Code (Title 11). It alleges that Wood transferred his livestock with an intent to hinder, delay or defraud a secured creditor, the Alden State Bank (727(a)(2)); that Wood failed to keep or preserve records relating to his livestock operation

(727(a)(3)); that Wood has failed to explain satisfactorily the loss of livestock assets (727(a)(5)); and that he has knowingly and fraudulently made a false oath in the case (727(a)(4)). Debtor denies these assertions.

FINDINGS

William "Bill" Wood farmed from 1980 until the end of 1994. He is 34 years old, divorced, and has two children. He resides in Iowa Falls. In 1994, he had a farrow-to-finish feeder pig operation on an acreage outside Iowa Falls. He began his swine operation in 1989 or 1990. He also raised corn and beans. His operation was financed by the Alden State Bank (BANK) which had a perfected security interest in his livestock and various other assets, including crops and equipment. The Bank financed his operation for several years. On January 7, 1994, Wood gave Bank a financial statement which showed that he had on hand five boars and 83 sows as breeding stock and approximately 530 head of feeder pigs at various weights (Exhibit 3). Wood provided such financial statements about once a year. He says the livestock numbers were "rough" and not the result of an actual count.

Wood's farrowing and nursery operation was located at his acreage. He would attempt to sell his feeder pigs at the time they were ready to leave the nursery. If he could not, he would have the pigs custom fed at other locations, and he would market them as he was able.

During 1994, Wood sold livestock at at least four or five locations. At times, the buyer's checks would be made payable to Wood and the Bank. Wood says there was never an occasion when he needed the sales proceeds that the Bank refused to endorse such checks for his use.

On six occasions in 1994, Wood sold livestock in the name of one of his two daughters--Trisha or Stephanie. These sales aggregated \$2,435.72. The buyers' checks were endorsed by his daughters to him. They never had use of the money; Wood used it mostly to pay bills. He says he sold the livestock in their names to reduce his income taxes, as he understood that each child could have up to \$3,000 in income before she had to file a tax return. By selling livestock in their names, he would avoid taxes. He did not disclose any of these six transactions on his statement of affairs as transfers to his daughters, but he did disclose them at a creditors' examination subsequent to filing.

In November 1994, after Wood knew he was getting out of the livestock business, he sold butcher hogs in his father's name. The buyer's check, in the amount of \$1,148.86, was made payable to his father and was given to him. Wood said he had owed his father for pigs over the years and had been unable to pay. His father did not want repayment, so Wood thought that the only way his father would get any money was to have to take it in the form of a check made payable to him. Wood did not disclose this transfer in his statement of affairs, but did disclose it in the creditors' exam after filing. The statement was amended to show the payment on the debt to his father, and his father paid the money to Bank.

During 1994, Wood made at least two livestock trades with his neighbor Ron Hartkopp. Wood says that the two traded labor, services and goods over the years. Also in 1994, Wood bought swine from Hartkopp and paid Hartkopp when he had purchased vet supplies for Wood. Purchases were documented only by canceled checks.

The trades were not documented at all. The first 1994 trade by Wood was in late August. Wood had needed corn to feed his stock. Hartkopp bought some, and in July, he had 1,598.58 bushels delivered to Wood's grain bank account at the Ag Center. The grain had a value of \$3,117. Hartkopp also delivered 22 bred sows to Wood. Wood now values them at about \$200 each, but there is little evidence as to the parties' valuation at the time of delivery. Hartkopp says they were worth \$150 each. Wood received approximately \$6,117 to \$7,517 in value. Wood and Hartkopp were uncertain of the number of feeder pigs given by Wood in trade. Hartkopp says it was 130-150; Wood thought it was about 100. The two apparently did not set the exchange value of the feeder pigs. Hartkopp immediately resold the pigs to Gary Fuller at about \$38.00 a head. If Hartkopp made no profit on the pigs, then the value of Wood's pigs was about \$3,800.00.

Wood says the pigs did not fully satisfy what he owed Hartkopp on the trade. In October, Hartkopp delivered 22 more bred sows to Wood. He took more feeder pigs from Wood in exchange. Hartkopp says he got 80 or 90; Wood says it was 70 to 80. Wood says the price had dropped, and this appears so as Hartkopp again immediately resold those pigs and some of his own to Fuller. Fuller paid \$4,669.00 for 150 pigs or an average price of \$31.13 per pig. Again, exchange values were not set, or at least if they were, no one remembers. If the value of the bred sows was the same--\$3,300.00 to \$4,400.00--then Wood again was short on his end of the trade, as the value of the pigs on resale (assuming Hartkopp made no profit from the resale) was less than \$3,300.00. Even if one accepts Hartkopp's higher guess of 90 pigs, Wood would have given only \$2,801.70 in value. Wood says he

kept track of who was ahead and behind on his running transactions with Hartkopp, but that the little book in which he kept the information was thrown away when he cleaned out his truck.

Wood met with his banker, and it was agreed he would liquidate his swine operation. He did so, and by December 1, 1994, he had no livestock. On occasion during the liquidation of his stock, he cashed livestock proceeds checks and used the money to pay bills. He filed his chapter 7 bankruptcy petition on December 27, 1994. It is undisputed that Bank was an undersecured creditor on Wood's filing.

From his sales records, it is not possible to account for the disposition of all of Wood's swine. As Ag Center points out, as to sows, Wood began 1994 with 83, although Wood says this is a rough number not determined by an actual inventory. Wood obtained 44 bred sows from Hartkopp during 1994. He also purchased gilts from Hartkopp in January, March and May of 1994. The purchases aggregated 33. Gilts are adult female swine that have not yet been bred. A gilt is defined as "[a] young sow not yet farrowed." Webster's II New Riverside University Dictionary 530 (1984). If the gilts are included as part of the sow inventory, we have a total of 160. Wood's sales records show 92 sales of sows during 1994. At least 68 sows are unaccounted for.

Wood says they were sold, traded or are part of his herd's death loss. He testified that his facility was poor which led to higher than normal death losses and that he also had high death loss in 1994 due to disease which he discovered about mid-year. The death loss is not documented. However, Exhibit 5 shows Wood's purchases of vet supplies beginning in April. These purchases totaled nearly \$900.00. The evidence is insufficient to determine whether this figure was normal expense or was due to disease in the herd. Wood explained in the creditors' exam that at the time of the trades with Hartkopp, because he was short on his end of the trades, he would give Hartkopp older sows to sell. Hartkopp would keep the proceeds to make up for the difference in trade values. This explanation is not corroborated by Hartkopp who never mentioned receiving older sows from Wood despite repeated questioning on what he received in the trades. There is no documentation of Wood's supplementing the trades in this way.

DISCUSSION

Fraudulent Transfers 727(a)(2)(A)

The court shall grant a discharge to a debtor unless "the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred . . . property of the debtor, within one year before the date of the filing of the petition. . . ." 11 U.S.C.

727(a)(2)(A). Ag Center contends that Wood should be denied a discharge of his debts under this subsection because he sold livestock in his own name, in his relatives' names, and in Ron Hartkopp's name, all without applying the proceeds of sale to his debt to Alden State Bank. Ag Center says this evinces an intent to defraud the Bank.

If Ag Center's allegations are accurate, then the result is debtor's conversion of Bank's collateral. This court has long held that conversion of an undersecured creditor's collateral is not sufficient to deny discharge of all debts under

727(a)(2)(A). First National Bank of Oelwein v. Holtz (In re Holtz), 62 B.R. 782, 787 (Bankr. N.D. Iowa 1986). Other courts have held that if the debtor has no equity in property because it is fully encumbered, then the conversion of the secured creditor's property interest does not amount to a transfer of debtor's property within the meaning of 727(a)(2)(A). Keller Farms v. Ellefson (In re

Ellefson), 54 B.R. 16, 17 (Bankr. W.D. Wis. 1985); Murfreesboro PCA v. Harris (In re Harris), 8 B.R. 88, 90-91 (Bankr. M.D. Tenn. 1980). If the secured creditor cannot base a fraudulent transfer objection to discharge on evidence of conversion of collateral, then much more an unsecured creditor, who is a stranger to the collateral, cannot. Discharge will not be denied on Count I of the Complaint.

False Oath 727(a)(4)

Ag Center argues that Wood's discharge should be denied because he "knowingly and fraudulently, in . . . the case . . . made a false oath." 11 U.S.C. 727(a)(4). Debtor's answers to the questions posed in the required Statement of Affairs are executed under penalty of perjury and are considered by the court to be answers under oath. Question 3(b) asks the debtor to disclose any transfers to insider creditors within one year prior to filing. Debtor's payment to his father was such a transfer, but it was not disclosed in the statement. Question 7 requires the debtor to list gifts to family members made within one year unless they aggregate less than \$200 per family member. If the sales of livestock in the daughters' names were transfers, they should have been listed.

For discharge to be denied under 727(a)(4), Ag Center must prove by preponderance of the evidence that Wood made a false statement, under oath, with intent to defraud creditors or the trustee, and that the statement materially related to the case including debtor's financial status or transactions. Montey Corp. v. Maletta (In re Maletta), 159 B.R. 108, 112 (Bankr. D. Conn. 1993).

Clearly the transfer to the debtor's father was material to the debtor's bankruptcy, and its omission from the debtor's statement made his answer false. The critical question is whether Wood knew it was false and intended by his answer to deceive his creditors or the trustee. The "debtor's disclosure of information previously omitted . . . is some evidence of innocent intent, but this inference is 'slight where the debtor has . . . amended his schedules after the trustee or creditors have already discovered what the debtor sought to hide.'" Id., citing Matter of Kilson, 83 B.R. 198, 203 (Bankr. D. Conn. 1988).

The debtor's disclosure of the transfer to his father came at the examination by counsel for the Bank and Ag Center (Exhibit 9, pages 14-15). The content of the examination does not show anything but a voluntary disclosure of the truth. There is nothing in the exam or in the evidence at trial to show that the creditors or the trustee had discovered the falsity of the statement so that it could be inferred that debtor was only telling the truth after the obvious discovery of a lie. I find and conclude that debtor did not omit the transfer to his father with intent to deceive his creditors or the trustee.

As to the sales in the daughters' names, I conclude that they were not transfers to the daughters of any of the debtor's property. Nothing was transferred to the daughters, not livestock or proceeds of the sales. A more accurate interpretation of the transaction was that debtor at all times retained his interest in the livestock and lied to the buyer as to the true identity of the seller to avoid income tax consequences. As I conclude the true nature of the transaction was not a transfer, it was not fraudulent to omit it from the answer. Moreover, again the disclosure came voluntarily at the examination, without evidence that debtor was merely admitting what was known. So even were the sales actual transfers, I would find no intent to defraud creditors or the trustee. Discharge will not be denied under 11 U.S.C. 727(a)(4).

Failure to Keep or Preserve Books or Records -- 727(a)(3)

Failure to Satisfactorily Explain Loss of Assets -- 727(a)(5)

Ag Center argues that Wood has not kept adequate records of his livestock transactions and, therefore, his discharge should be denied. Also, Ag Center contends that Wood has not given a satisfactory explanation of his disposition of sows, and for that reason, discharge should be denied.

A bankruptcy court has the discretion to deny discharge if the debtor has not kept or preserved books and records from which the debtor's financial condition or his business transactions might be ascertained, unless debtor's actions in that regard are substantially justified under all the circumstances. 11 U.S.C.

727(a)(3). "The adequacy of a debtor's books and records, however, must be gauged on a case-by-case basis, according to the special characteristics of the debtor's background, occupation, business and personal financial structure." United Mortgage Corp. v. Mathern (In re Mathern), 137 B.R. 311, 317 (Bankr. D. Minn. 1992), *aff'd*, 141 B.R. 667 (D. Minn. 1992).

Debtor maintained no books. He did keep some sales documents on sales of his swine, but not all sales are documented. He introduced no purchase documents for swine; he had no documentation of trades or death loss. His books were clearly inadequate to permit a reasonably accurate determination of the condition of his livestock operation or the nature of his livestock transactions. A creditor or a trustee could not obtain reasonably complete information on debtor's swine business by looking at the documents he did keep.

The inadequacy of Wood's records must be viewed in light of the factors mentioned in Mathern. There is no evidence that Wood has anything more than a high school education. There is no evidence he received any more training or education in the livestock business than what he learned "on the job" or from his father who is also a farmer. He is not sophisticated in business. Although it may sound like a harsh assessment, his operation could be colloquially termed "penny ante." It was a minor and unsuccessful business. Its absence from the world will have little impact on anyone but Wood and his few creditors. I make these assessments because they do have a bearing on the quality of the record keeping. It would seem that as Wood operated over the years, the only ones with an interest in how he kept his records or ran his business were himself, the Bank and the federal and state taxing authorities. His records were apparently sufficient to permit him to produce annual tax returns, however correct or incorrect they might be. Importantly, the Alden State Bank, a small state bank in a small rural town, apparently had little interest in how Wood kept his records. To please himself, Wood kept records as he did, and it was poorly, but it met his own limited business needs. As I say, if the manner in which he kept records allowed him not to run afoul of his lender or the taxing authorities, he obviously was satisfied. Given Wood's training and sophistication, the complexity of his operation, its importance in the agricultural world and the limited number of entities he needed to please, I do not find his failure to keep adequate records, standing alone, sufficient reason to deny Wood's discharge. I find this is so despite my belief that competent small farmers with similar operations would keep better and more complete records.

Ag Center's last objection is that Wood has failed to explain satisfactorily the loss of sows. Debtor has explained the discrepancies in the numbers. As stated, the starting point is 83 sows on hand in January 1994. He traded for 44 with Hartkopp. He purchased 33 gilts from Hartkopp. Records show he sold 92. The discrepancy is 68 sows. Wood gives three explanations for the discrepancy. He says the starting point may be off as the number was given to the bank on the financial statement without an actual count, and may be excessive by as many as 15 sows. Second, he said he had death loss from a disease called PRRS and from the insufficiency of his facility to protect his sows from the elements. Third, he gave some of his old sows to Hartkopp to make up for his shortfall in the two trades.

The issue is whether the debtor's explanation is credible and "satisfactory." The latter term is not defined in 727(a)(5). It has been written that "[v]ague and indefinite explanations of losses that are based upon estimates uncorroborated by documentation are unsatisfactory." Chalik v. Moorefield (In re Chalik), 748 F.2d 616, 619 (11th Cir. 1984). The burden is on the debtor to make a satisfactory explanation. Id. "To be satisfactory, 'an explanation' must convince the judge." Id.

If I find the explanation unsatisfactory, even if it might be reasonable and true, because it is uncorroborated, the debtor is denied discharge because of his poor record keeping. In this case, for this debtor, I have already found the lack of records is justifiable under the circumstances.

I find the explanation is reasonable and believable. A poor starting number, death, sales, and the supplementation of the trades could well account for the 68-sow discrepancy. Do I believe it? It seems to me that the debtor is not an obvious liar. There was nothing in his demeanor or in the way he answered questions that led me to believe he was not forthcoming, to the best of his abilities. It was disturbing how little he recalled about historical events in his operation. I attribute that to poor memory and his general lack of competence.

All in all, however, I am left with a decision as to Wood's nature. Is Wood a schemer whose inadequate records and concocted explanations further his sales of collateral out of trust? Or is he merely an average fellow who poorly managed a barely subsistence level swine operation? I believe it is the latter, although I am not without doubts. Nonetheless, I accept as satisfactory Wood's explanation of the discrepancy or loss of assets. Ag Center has failed to prove its objection to discharge. Fed.R.Bank.P. 4005. Giving the debtor the benefit of my doubts not only places the burden of proof where it belongs, but also construes discharge exceptions liberally in favor of the debtor. Ag Center's complaint will be dismissed, and discharge will be granted.

IT IS ORDERED that the complaint of Iowa Falls Ag Center against William H. Wood is dismissed. Judgment shall enter accordingly.

SO ORDERED THIS 20thDAY OF SEPTEMBER 1996.

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: M. Wayne Oltrogge, Michael Holt and U.S. Trustee.