In the United States Bankruptcy Court

for the Northern District of Iowa

ROBBINS FISCHER Debtor.	Bankruptcy No. 96-61088-W Chapter 7
ELMER J. SCHETTLER Plaintiff vs. ROBBINS W. FISCHER Defendant.	Adversary No. 96-5137-W

RULING

On April 30, 1997, the above-captioned matter came on for trial pursuant to assignment. Plaintiff Elmer J. Schettler appeared in person with his attorney, Kay Dull. Debtor/Defendant Robbins W. Fischer appeared with his attorney, Larry Cohrt. Evidence was presented after which 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)(F), (H), (J).

STATEMENT OF THE CASE

Debtor filed his Chapter 7 Petition on May 17, 1996. On August 9, 1996, Plaintiff filed this complaint to determine dischargeability. Plaintiff objects to Debtor's discharge pursuant to 11 U.S.C. § 727(a)(2)(5)(7); 11 U.S.C. § 523; 11 U.S.C. § 544; 11 U.S.C. § 547; and Iowa Code sec. 684.4(a)(b)(2)(d), (e), (h), (i) and (j). In its simplest terms, Plaintiff's complaint asserts that Debtor sold real estate located in Monona County, Iowa prepetition and dispersed the net proceeds in a series of preferential and/or fraudulent transfers.

FINDINGS OF FACT

Plaintiff Elmer Schettler (Schettler) lives in Carroll, Iowa and has known Debtor almost 25 years. Schettler is in the food business with a primary interest in a corporation known as Devon Soy Farms. He has been involved in other businesses including a seed corn operation and farming.

About 1990, Schettler had discussions with Debtor Robbins Fischer (Fischer) concerning an opportunity to invest in stock in a corporation known as Miller Farms, Inc. The business purpose of this corporation arose out of a process of making soy milk from soybeans. At that time, Fischer was President of the corporation.

Schettler became involved as a shareholder. When the corporation needed more capital, Schettler became financially involved and entered into various agreements to borrow money. He became a

guarantor on certain loans which are memorialized in Plaintiff's Exhibit 1, dated March 1, 1991. In this agreement, both Fischer and Schettler are mutually responsible for the obligations if debts were not repaid by Miller Farms. Eventually, the total debt by Miller Farms increased to $250,000. The obligations were not paid and, in the summer of 1992, the Bank called the notes.

Schettler requested a financial statement from Fischer shortly before he entered into the agreement to guarantee the loans which were made and guaranteed in Schettler's Exhibit 1. At the time of the making of the financial statement, Fischer reflected a net worth of approximately $750,000. However, when Schettler asked for reimbursement two years later, Fischer was unable to pay his portion of the obligation. Schettler made an oral demand of Fischer to pay his half of the obligation and, subsequently, a written demand through counsel was also made. Fischer claimed inability to pay his half of the obligation at that time and the total amount was paid by Schettler.

Fischer testified that he had a substantial loss of net worth between 1991 and 1996. His listed value for Miller Farm stock had been in excess of $100,000. When this business was lost, however, the stock had no value. He testified that he lost in excess of $100,000 in stock value arising out of a business association whose purpose was to build a factory in Nigeria. He testified that the financial statement he provided to Schettler was an accurate reflection of his net worth at the time. However, because of the various business reversals, his subsequent inability to pay was based on his financial condition at that time.

After payment of the obligation, Schettler commenced civil litigation in Iowa District Court, in and for Carroll County, in October 1994. This litigation was set for trial in October of 1995. The matter was continued prior to trial and was reset for trial on March 12, 1996. At trial, the jury awarded Schettler $149,960. This amount equaled one-half of the original debt by Miller Farms to various lending institutions plus interest.

Fischer had owned real estate in Monona County since 1947 or 1948. Schettler was aware Fischer owned this farm ground since the 1970's when he met Fischer. Schettler testified that he was not aware that Fischer intended to sell the property and did not learn of the actual sale until after Fischer filed his Chapter 7 Petition in May of 1996. Schettler testified that he subsequently became aware of other transfers of property by Fischer prior to the filing of his Petition.

When Fischer was unable to pay his share of the underlying obligations for the Miller Farm operation, Schettler paid off the entire debt. Upon payment of the debt, he took an assignment of the underlying obligations. He filed a replevin action and took over all the business assets of the Miller Farm operation. These assets were eventually liquidated with no public notice of sale. Fischer testified that he was given no credit for the liquidation toward his underlying obligation. Schettler testified that he had advanced a total of $750,000 and received less than $100,000 from the foreclosure and the sale of Miller Farm assets. Schettler also testified that he has not received any proceeds from the sale of the Monona farm in January of 1996.

Fischer is a resident of Cedar Falls, Iowa and is retired. He is married and has three daughters; Barbara Fischer, Dorothy Fischer and Martha Denton. Fischer testified that he owned the real estate in Monona County since 1947 or 1948. Because of business difficulties, Fischer was having trouble making the mortgage payments on the farm since 1993. The mortgage payments were due annually on January 1. On January 1, 1995, Fischer was not able to make the mortgage payment. Under threat of foreclosure, he listed the property for sale in January, 1995 with Reed Realty in Monona, Iowa. The initial listing was for six months. When the property did not sell, he relisted it in August of 1995. By June, 1995, the annual payment had not been made and Norwest Bank began foreclosure proceedings.

When the foreclosure commenced, Fischer borrowed $6,000 from each of his daughters on six month term notes with interest. With this $18,000, he made the 1995 payment on the farm mortgage. At the time his daughters loaned the money to him, Fischer did not have the money to make the mortgage payment. He was not able to pay off the notes until the property was sold.

Fischer testified that, at the time the property was listed, a demand had been made on him for payment by Schettler but he had not made any payment toward that obligation. At the time he listed the property, he was aware that Schettler had filed a civil action in Carroll County, Iowa in October of 1994. Fischer testified that he did not list the property for sale in order to put the proceeds out of the reach of creditors. He testified that at the time of the sale, he did not feel that he would lose the lawsuit involving Schettler. Additionally, the sale of the property was a business decision made in order to save the equity in the farm to pay off creditors.

The realtor attempted to find as many offers as possible. The only viable offer was made by Jack and Ruth Jordan and Jack and Carol Werner. Fischer testified that the listing through Reed Realty was public and was well advertised throughout the community. The Jordan/Werner offer was accepted in November, 1995. Closing occurred on January 2, 1996. Fischer testified that it was the best offer that he could get on the property and was, in fact, the only serious offer which was made. Neither the Jordan's nor the Werner's are relatives. Mr. Jack Jordan is a personal friend of Fischer. The sale of the farm ground included the sale of equipment valued at approximately $7,000 in 1991.

Fischer was aware of the demand made by Schettler at the time of the sale and had been aware of this for two years. He was also aware of the lawsuit in Carroll County at the time of the sale as the lawsuit had been on file for approximately 15 months.

The sale price for the property was $243,750. Out of this sum, the existing mortgage was paid to Norwest Bank in the approximate amount of $127,000. In addition, Debtor paid overdue interest to the lender, Norwest Bank, of approximately $14,000. The Realtor was paid a 5% commission totaling $12,000. Also, the standard expenses of revenue stamps, abstracting and attorney's fees were paid totaling another $825. The specific amounts are set forth in seller's closing statement introduced into evidence as Plaintiff's Exhibit 2. The net proceeds to Fischer after the deduction of all of the foregoing costs was $89,251.39.

Out of the proceeds of sale, Fischer reserved $66.00 for attorney's fees to prepare and examine the title documents and a $901 repayment which was due in the fall of 1996 to the CCC. The net proceeds remaining were approximately $88,000. Of this, $34,500 was transferred into what is known as the RWF account and $54,500 was transferred into the JNF account. Both of these are joint accounts of Fischer and his wife and apparently have been joint accounts for a considerable period of time. Fischer generally writes checks out of the RWF account and his wife generally writes checks from the JNF account. From January through April of 1996, funds were dispersed directly from these two accounts. Additionally, funds were transferred to an account called the IBA account also known as the International Business Associates account. This was a checking account located at Firstar Bank and was a business account for International Business Associates; a business of Fischer's. Also involved was an account set up through the John Deere Credit Union and is shown on the records as JNF-JD account which stands for J. Noreen Fischer-John Deere account.

Between January and April, 1996, funds were variously transferred between these accounts. Funds were also dispersed. As reflected in Plaintiff's Exhibit 4, $88,000 was available from the farm sale and was transferred into the RWF and the JNF account. Through various transfers and dispersals, a total

of $88,982.05 was dispersed. While all of the funds appear to be accounted for, the issue is whether certain of the transfers made were preferences or otherwise objectionable.

Schettler observes and takes exception to the fact that Fischer made no listing of the $6,000 payments to his daughters in the bankruptcy schedules. Schettler also notes that payments to McLeod are not reflected in the schedules nor are payments to Rasmussen Construction for the installation of a flat roof on Fischer's domicile. The schedules also do not reflect a payment to MBNA for $4,700.

Fischer testified that the payments to his three daughters were reimbursements for the six month loans which he had accepted to forego foreclosure of the farm. He testified that he paid his daughter, Martha Denton, after the sale of the property. He testified that he paid his daughter, Dorothy Fischer, on April 5, 1996 and his daughter, Barbara Fischer, on January 29, 1996. He testified that these payments were payments for legitimate business expenses and for the loans which he had taken well in advance of the bankruptcy petition. He testified that payments were made to McLeod in January, February and April of 1996. He testified that the McLeod company provided phone service for his business offices as well as his home. He testified that it was important to continue service, both for his remaining business activities and his personal phones because of health concerns. He testified that he had been notified that the phone service would be terminated if the bill was not brought current. He testified that all payments made were for past due accounts and, eventually, payments were made for services when rendered.

He testified that he made various payments to Rasmussen Construction for roof repairs to his older home. He testified that the roof had last been replaced in 1957 and that it was leaking badly. He testified that all payments were for repairs to the roof. He testified that the contract to repair was entered into before the entry of judgment against him and in favor of Schettler. He testified that the first payment was partly in advance in order to allow Rasmussen to acquire materials. The remainder of the payments were made on a periodic basis as the roofing was completed.

He testified that payments were made to MBNA on a credit card account. He testified that the credit card is used primarily for business and for some personal expenses. He testified that he often uses the credit card to pay for medical bills at pharmacies because of severe asthma and other health related reasons. He testified that he felt the credit card to MBNA had particular benefits, that it was a necessity for him and that it was for past due accounts which were brought current. He testified that the payment to MBNA was merely to pay an account that was in arrears and was not done to defraud creditors.

Fischer testified that on April 5, 1996, he made a payment to the IRS in the amount of $14,000. He testified that the capital gains tax on the sale of the farm had been estimated and it was estimated that the total capital gains would be approximately $16,000. He testified that this amount would be owing as capital gains and decided to make a partial payment toward this tax.

Finally, he made a payment to the law firm of Swisher & Cohrt. He testified that this was in the amount of $1,000 and was a partial payment for legal services which had already been accrued and billed.

SCHETTLER'S CLAIMS

Schettler raises the following Code sections in his complaint: 11 U.S.C. § 727(a)(2), (5), (7), § 523, § 544, § 547, and Iowa Code sec. 684.4(a)(b)(2)(d), (e), (i) and (j). Based on the complaint, the pre-trial statement, Schettler's trial brief and the evidence presented, the Court finds that the only claims

actually asserted by Schettler are: 1) denial of discharge § 727(a)(2) (fraudulent transfer) and § 727(a)(5) (failure to explain loss of assets) and 2) avoidance of fraudulent transfer under Iowa Code sec. 684.4 through § 544(b).

Schettler has not identified any provision of § 523 which would entitle him to have his claim excepted from discharge. Schettler may not use § 547 to avoid a preferential transfer. This action is available only to trustees. In re Feldhahn, 92 B.R. 834, 836 (Bankr. S.D. Iowa 1988). Almost a year ago, Trustee Michael Dunbar indicated an intent "to pursue preferences to 3 daughters in amount of $6,000 each" in his application for approval to employ an attorney. Trustee has not filed an adversary complaint to assert this claim and has not participated in Schettler's action. Therefore, Trustee is not a part of this action and this claim is inappropriately brought by Schettler.

Schettler has not presented any grounds for applying § 727(a)(7) to deny Fischer's discharge in this case. That section concerns activity by a debtor in connection with another bankruptcy case concerning an insider. Schettler has not identified any other case concerning an insider which would make § 727(a)(7) applicable here.

DENIAL OF DISCHARGE, § 727(a)

Schettler asserts Fischer should be denied a discharge pursuant to § 727(a)(2)(A) or § 727(a)(5). Sec. 727(a) states, in pertinent part, as follows:

> a. The Court shall grant the debtor a discharge, unless --
>
> . . . .
>
> 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 --
>
> A. property of the debtor, within one year before the date of the filing of the petition.
>
> . . . .
>
> 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.

"Section 727's denial of discharge is construed liberally in favor of the debtor and strictly against those objecting to discharge." In re Ellingson, 63 B.R. 271, 279 (Bankr. N.D. Iowa 1986). Schettler has the burden to prove the elements of § 727(a) by a preponderance of the evidence. In re Boughner, 173 B.R. 406, 409 (Bankr. S.D. Iowa 1994); Grogan v. Garder, 498 U.S. 279, 287 (1991).

FAILURE TO EXPLAIN LOSS OF ASSETS

To prevail on a § 727(a)(5) claim, the creditor must prove that the debtor at one time owned identifiable assets and that the assets are no longer available to the debtor's creditors. ITT Commercial Fin. Corp. v. Walz, 115 B.R. 353, 357 (Bankr. N.D. Fla. 1990).

> Once the plaintiff demonstrates a loss of assets, the burden of proof shifts to the debtor to explain the loss. If the debtor's explanation is too vague, indefinite, or unsatisfactory then the debtor is not entitled to a discharge. Debtor must also "explain his losses or deficiencies in such a manner as to convince the Court of good faith and businesslike conduct."

In re Schroff, 156 B.R. 250, 256 (Bankr. W.D. Mo. 1993) (citations omitted). Debtor's explanation must be reasonable and credible, leaving the creditor no cause to wonder where the assets went. In re Farouki, 133 B.R. 769, 777 (Bankr. E.D. Va. 1991), aff'd 14 F.3d 244 (4th Cir. 1994). A satisfactory explanation is one that induces a mental attitude of contentment in the court's evaluation of the debtor's explanation. In re Johnson, 80 B.R. 70, 75 (E.D. La. 1987). The court should gauge the debtor's credibility in light of all surrounding circumstances. In re Losinski, 80 B.R. 464, 470 (Bankr. D. Minn. 1987).

Having considered the evidence and applying the appropriate legal principals, the Court concludes that Schettler has failed to establish his § 727(a)(5) claim by a preponderance of the evidence. Fischer has provided a sufficiently reasonable explanation for the disposition of most, if not all, of the proceeds from the sale of his farm real estate. He testified about several disbursements and offered documentation for most of them. Overall, his testimony appeared credible and is largely unrebutted by Schettler. Under such circumstances, the Court must conclude that Fischer should not be denied a discharge under § 727(a)(5).

TRANSFER WITH INTENT TO DEFRAUD

In order to prevail in a § 727(a)(2) claim, Schettler must prove the existence of the following elements: (1) a transfer or concealment of property has occurred; (2) the property was owned by the debtor; (3) the transfer or concealment occurred within one year of filing bankruptcy and (4) the debtor had, at the time of the transfer, the intent to hinder, delay or defraud a creditor. Boughner, 173 B.R. at 410. Before a court can deny 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).

> 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); Boughner, 173 B.R. at 410.

The first three elements of § 727(a)(2)(A) are evident in the record. Fischer transferred the proceeds from the sale of his farm within one year prior to filing his bankruptcy petition. The sale occurred in January 1996. Fischer made transfers from the proceeds between January and April 1996. He filed his Chapter 7 petition on May 3, 1996. The remaining element requires Schettler to prove that when Fischer made these transfers he had "the intent to hinder, delay or defraud a creditor." 11 U.S.C. § 727 (a)(2). This element will be more fully discussed in relation to Schettler's remaining claim to avoid a fraudulent transfer.

AVOIDANCE OF FRAUDULENT TRANSFER

The Eighth Circuit has stated that an unsecured creditor has no standing to invoke the avoidance power of § 544(b) to pursue a fraudulent transfer action. Nebraska State Bank v. Jones, 846 F.2d 477, 478 (8th Cir. 1988). This holding may not apply regarding a secured creditor. In re Mathiason, 129 B.R. 173, 178 n.6 (Bankr. D. Minn. 1991), aff'd 170 B.R. 662 (D. Minn. 1992), aff'd 16 F.3d 234 (8th Cir. 1994).

> [T]he scope of [Jones] does not appear to be so broad as to preclude standing of a creditor to sue, where the creditor claims an interest in the subject property superior to the transferred interest sought to be avoided. Thus, where a lien claimant . . . seeks to avoid a conveyance as an obstruction to the recognition or enforcement of its lien on the subject property, it would seem that the lien claimant clearly has standing to sue.

Id. The court points out that the interests of the lien creditor and the trustee are not the same, giving them differing motives concerning the avoidance of a transfer of the property. Id.

Schettler holds a judgment lien against Fischer which arose in March 1996. Fischer sold his real estate in January 1996. Schettler asserts the sale was a fraudulent transfer. If the transfer is avoided, Schettler's judgment lien could attach to the property through the operation of Iowa law. Through his judgment lien, Schettler arguably has an interest in the real estate which is superior to general creditors which would be represented by Trustee. Because of these circumstances, the Court will assume without conclusively deciding that Schettler has standing to attack the sale of Fischer's real estate as a fraudulent transfer under Iowa Code sec. 684.4 through the utilization of the avoidance powers of § 544(b).

Section 684.4(1)(a) states that a transfer is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer, if the debtor made the transfer "[w]ith actual intent to hinder, delay or defraud any creditor of the debtor." As with Schettler's § 727(a)(2) claim, this element of intent is the fighting issue. Eleven factors appear in sec. 684.4(2) for use in a determination of actual intent. These are similar to the common law "badges of fraud" applicable to the intent element of § 727(a)(2). See Cohen, 142 B.R. at 728.

Schettler argues the following factors apply in this case to support a finding of Fischer's actual intent to hinder, delay or defraud a creditor:

> d. Whether, before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit.
> e. Whether the transfer was of substantially all the debtor's assets.
>
> . . .
>
> h. Whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred.
> i. Whether the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred.
> j. Whether the transfer occurred shortly before or shortly after a substantial debt was incurred.

Iowa Code § 684.4(b)(2)(d), (e), (h), (i) and (j).

The record proves that the sale of the farm and transfers of the proceeds by Fischer occurred while Schettler's state court action was pending. Fischer lists total assets of $59,288.40 on his summary of schedules. The sale of the farm in which he had approximately $89,000 in equity does not at first glance constitute a sale of substantially all of his assets. Nothing in the record indicates that the sale price was less than the value of the farm. Fischer satisfactorily explained the transfers of the sale proceeds. From Fischer's bankruptcy schedules, Fischer appears to have been insolvent four months after the sale of the farm. No evidence of his insolvency on January 1, 1996, the date of the farm sale, appears in the record. The sale of the farm and transfers of the sale proceeds did occur shortly before a judgment was entered in Schettler's state court proceeding.

Based on the foregoing, the Court concludes that Schettler has failed to prove Fischer possessed actual intent to hinder, delay or defraud in connection with his sale of the farm and transfers of the sale proceeds. Schettler has not produced proof by a preponderance of the evidence regarding Fischer's intent. Proof of actual intent to defraud is necessary for both the fraudulent transfer claim and the denial of discharge claim under § 727(a)(5). Only two of the statutory badges of fraud are applicable to the evidence in the record. This is too little proof to allow the Court to set aside the farm sale and transfers of proceeds or to deny Fischer his Chapter 7 discharge.

WHEREFORE, Fischer will not be denied his discharge based on § 727(a)(2) or (5).

FURTHER, Schettler has failed to prove all the elements of his fraudulent transfer claim under § 544 (b) and Iowa Code sec. 684.4.

FURTHER, judgment shall enter for Debtor/Defendant Robbins W. Fischer and against Plaintiff Elmer J. Schettler.

SO ORDERED this 27th day of June, 1997.

Paul J. Kilburg
U.S. Bankruptcy Judge