

In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

BRUCE AND TERRI PAGE
Debtor(s).

Bankruptcy No. 97-02975S
Chapter 7

WIL L. FORKER Trustee
Plaintiff(s)

Adversary No. 98-9013-S.

vs.

BRUCE RUSSELL PAGE and
TERRI JEAN PAGE
Defendant(s)

FARMERS STATE BANK
Lake View Iowa,
Plaintiff(s),

vs.

Adversary No. 98-9011S

BRUCE RUSSELL PAGE and
TERRI JEAN PAGE,
Defendant(s).

Order RE Complaint Objecting to Discharge and Order RE Complaint to Determine Dischargeability

On January 8, 1998, Farmers State Bank, Lake View, Iowa ("Bank" or "FSB"), filed a complaint, Adv. No. 98-9011-S, objecting to the discharge of its claim under 11 U.S.C. § 523(a)(6). Wil L. Forker, Chapter 7 Trustee, filed a complaint, Adv. No. 98-9013-S, on January 8, 1998 and an amended complaint on July 31, 1998, objecting to the debtors' discharges on grounds under 11 U.S.C. § 727(a). The Trustee's claims relate to the disposition of debtors' 1997 crop and the debtors' failure to keep records. By the court's order of September 15, 1998, the cases were consolidated for purposes of discovery and trial. Final trial was held on February 22, 1999, and March 19, 1999. Debtors Bruce Page and Terri Page were represented by James W. McCarthy. A. Frank Baron appeared for the Bank, and the Trustee appeared for himself. The court now issues its findings of fact and conclusions of law as required by Fed.R.Bankr.P. 7052. This is a core proceeding under 28 U.S.C. § 157(b)(2)(I) and (J).

FINDINGS OF FACT

The Pages filed a Chapter 7 bankruptcy petition on September 26, 1997. They live in Lake View, Iowa. Bruce Page is employed full time as a laborer at AMPC, Inc. in Lytton, Iowa. He has worked there since 1984. Terri Page, age 33, is not presently employed outside the home. The Pages have been married 11-1/2 years and have two children ages 8 and 5.

The Pages were formerly engaged in farming. Their last year of farming was 1997. Bruce had farmed since 1982 or 1983. They had a cow-calf operation, raised hogs farrow-to-finish, and grew corn and soybeans. Their operation remained essentially the same over the years. They always had livestock and crops. At the peak of their farming activity, in 1995 or 1996, the Pages had about 30-40 sows, three or four boars, 30-40 cows and one or two bulls. They own no real property. Beginning in 1982, Bruce annually rented 120 acres of farm land from Kathryn Herring, his grandmother. About 110 acres of the farm are tillable.

Terri kept the books for the farm operation. She did not keep a formal ledger, but recorded farm income on a sheet of paper throughout the year. The Pages kept receipts for farm expenses or canceled checks if they did not receive a receipt. When they received a bank statement, they reconciled the statement with their checkbook and then threw away the statement. They threw away the checks unless the check was for an expense for which they did not have a receipt. They used duplicate checks but threw the duplicates away. As soon as all the checks in a check register cleared the bank, they threw the check register away, keeping only the current one. A check register lasted a few months. After the end of the year, they took the income and expense information written on sheets of paper to their tax preparer. The Pages continued this manner of record keeping after they filed bankruptcy. On the date of filing, they had only two check registers, one for each of their two checking accounts. On the date of trial, the registers for 1996 and 1997 had been thrown away.

The Bank had financed the Pages' farm operation since 1989. The Pages had a course of dealing with the Bank under which they would sell livestock or crops and deliver the check to the Bank. If they then needed money, to pay a feed bill for example, they would borrow on their line of credit. On the date of filing, the Pages owed the Bank \$60,721.01. FSB Exhibits 5-17. The Bank had a lien on 1996 crop, livestock, equipment and motor vehicles. FSB Exhibits 1-4, 20-22. Because of a perfection problem, the Bank did not have a first lien on the 1997 crop.

Toward the end of 1996, the Bank determined that the Pages' operation was not generating enough cash flow for debt service. In 1994, the Pages owed the Bank \$20,000. FSB Exhibit 23 (financial statements). The debt increased to \$47,000 in 1995, to \$49,000 in May 1996, and to \$73,000 in July 1996. *Id.* On December 1, 1996, Steve Kettering, President of the Bank, told the Pages the Bank would no longer extend them credit. Prior to that date, the Bank had last made a loan to the Pages on November 4, 1996. FSB Exhibits 15, 17. On December 2 or 3, 1996, the Pages met with Kettering and Steve Tjaden, Vice President of the Bank, to discuss how the loans would be paid. Kettering and Tjaden suggested that the Pages might have to liquidate, but did not decide then that they had to do so.

On December 31, 1996, the Bank made its last loan to the Pages for \$6,300. FSB Exhibit 10. The evidence was conflicting as to the circumstances of making the loan. The note does not indicate the purpose of the loan. Bruce testified the Bank told him that it needed to get the Pages' loans squared away for bank examiners, and that he had to sign the note that day because it was the end of the year. Bruce said all of the money was applied to past due notes to the Bank. Two of the Bank's exhibits show note payments made on December 31, 1996. FSB Exhibits 5, 9. Tjaden testified that Bruce came in to the Bank to borrow money for feed. Tjaden agreed only after Bruce offered the titles to two vehicles. Tjaden believed that the loan would permit the Pages to pay their current feed bills in

full. Tjaden then told Bruce "bluntly" that the Bank would not lend the Pages any more money in the future. The Bank's security interest was noted on the vehicles January 7, 1997. FSB Exhibits 3, 4. The vehicles are a 1988 Chevy pickup and a 1988 Pontiac Grand Am. The court concludes that the use of the loan proceeds is not relevant to the claims against the Pages. The Pages do not dispute the amount of debt owed the Bank. The Bank always knew that livestock feed was a major ongoing expense of the Pages' farming operation.

At the end of December 1996, the Pages ran out of feed. Sometime that month, they sold an IH 856 tractor and paid a note at the Bank with the proceeds. In January 1997, they sold a John Deere planter to Bruce's father, Russell Page, for \$2,100 and used the money to pay a feed bill. The planter was listed on a financial statement as being worth \$1,500. See FSB Exhibit 23 (financial statement for July 24, 1996, "JD 7000" corn planter). The Pages sold some of their 1996 crop in January 1997. There was no evidence as to the disposition of the proceeds of the crop.

In March or April of 1997, Terri opened a joint bank account at Bank Midwest in Wall Lake, Iowa. At that time she was working for Iowa Select. She deposited her wages in the new account. The Pages began using the account to pay regular living and farm expenses.

Beginning in early 1997, the Pages sold livestock and received checks made out in their name only. They deposited the livestock checks in the new account and used the funds to pay farm expenses. When livestock checks were made out jointly to the Pages and the Bank, the Pages took the checks to the Bank. At trial, the Pages were not able to quantify either the number of checks or the total dollar amount of cattle proceeds that went into the new account.

The Pages had note payments of \$21,244.37 that came due in March 1997. The payments were not made. FSB Exhibits 6, 13, 14, 16. The Bank learned the Pages had opened a new bank account. Tjaden asked Bruce to come to the Bank. Bruce admitted they had sold some cattle and used the money. Tjaden did not ask how the money was spent; he said he trusted Bruce. Tjaden knew that Bruce had the ability to borrow about \$10,000 from his pension plan.

The Pages obtained 1997 crop inputs from Simplot on open account. They planted 48 acres of corn and 33 acres of soybeans. The rest of the land was in hay and pasture.

The Bank was examined in July, 1997. The examiners classified the Pages' loan as a "substandard" loan. The examiners rate bad loans, in order from best to worst, as "special mention," "substandard," "doubtful," or "write off."

In August or September, 1997, Bruce borrowed about \$16,000 from his 401(k) plan and deposited the funds in the new Wall Lake checking account. The Pages used almost all of the money for farm expenses. They paid \$1,000 to Simplot, spent \$1,200 to fix the transmission on their pickup, and paid Mrs. Herrig \$8,200 for the full year's farm rent. AMPC began deducting \$434.24 per month from Bruce's pay for the 401(k) loan. Trustee's Exhibit 1, Schedule I.

In 1997, the Pages were participating in a government farm program that paid them \$1,300 annually. In September they received the second half payment for the year and used it to pay expenses for the farm operation.

At various times, Tjaden requested the Pages to account for their livestock. On July 24, 1996, they gave the Bank a financial statement. FSB Exhibit 23. On May 8 and August 6, 1997, Terri Page brought hog checks in to the Bank and reported their current livestock numbers. FSB Exhibit 27 and

attachments 2, 3. Between those two dates, their number of feeder pigs went from 345 to 130. Id. They sold hogs several times in June. Id., attachment 7. The Pages reported livestock numbers again on September 6, 1997. Id. and attachment 4.

Tjaden and Kettering came out to the Pages' farm on September 10, 1997. By that date, the Pages were delinquent on note payments in the amount of \$48,803.96. FSB Exhibits 6-16. Tjaden, Kettering and Bruce Page walked around the farm and took an inventory. FSB Exhibit 19. The bankers asked Bruce to tell them how many animals there were, what equipment he had, and how much he thought items were worth. The three of them did not go into the pens with the stock to do an actual head count, but stood nearby and estimated the numbers. Bruce estimated one pen held between 50 and 80 head of hogs. The bankers wrote "80" on the inventory sheet. The handwritten inventory was typed up and made part of an agreement. FSB Exhibit 18. The Pages agreed to sell certain collateral by December 10, 1997, including their crops and all the swine, calves and cows. Id. Bruce signed the inventory agreement on September 18. Terri signed it the next day.

The value of the corn crop shown on the inventory was based on 46 acres at 120 bushels per acre times \$2.40 per bushel; soybeans were listed as 32 acres at 40 bushels per acre times \$6.00 per bushel. Id. Livestock was listed as 178 pigs, 24 sows, 2 boars, 11 cows, 12 calves, 1 bull. Id.; FSB Exhibit 27.

The Pages fed their hay crop to livestock but did not keep a record of the amount fed. They have never kept records of their yield from hay cuttings. They reported having 700 bales of hay on September 10. FSB Exhibit 18.

The Pages first met with an attorney about filing bankruptcy in March 1997. By the time they actually filed in September, they had known for several months that they would be filing a bankruptcy petition. The Pages listed the following personal property in their bankruptcy Schedule B:

| | |
|-----------------------------|--------------|
| Bank accounts | 125 |
| Household goods | 1,500 |
| Clothing | 500 |
| Insurance policies | 0 |
| 401(k) plan | 15,900 |
| 1988 Chevy pickup | 2,000 |
| 1988 Pontiac Grand Am | 300 |
| 1996 Dodge Grand Caravan | 16,000 |
| Misc. hog equipment | 5,000 |
| Livestock | 11,700 |
| Growing crops | 13,546 |
| Farm equipment & implements | <u>2,850</u> |
| TOTAL | \$69,421 |

Trustee's Exhibit 1. The Pages listed accounts at the Bank and Consumer Credit Union, Denison, but did not schedule the new checking account at Bank Midwest in Wall Lake. Id., item 1. The Pages

scheduled no hay. They estimated the value of their corn crop at 46 acres times 80 bushels per acre at \$2.30 per bushel, for a total value of \$8,464. Id., item 30. Beans were valued at 33 acres times 28 bushels per acre at \$5.50 per bushel, for a total value of \$5,082. Id. Crop yields were based on the number of bushels per acre guaranteed by their crop insurance.

The weekend before the Pages signed their schedules, Terri did an actual count of their livestock. They listed the following animals in Schedule B: 95 feeder pigs, 24 sows, 2 boars, and "12 cows and calves." Id., item 29. In its accounting, the Bank interpreted the last item as 12 cows and 12 calves. FSB Exhibit 27. No one disputed the matter.

The Pages scheduled two secured creditors: Chrysler Financial Corp., owed \$16,313.75 for the purchase of the 1996 Dodge; Farmers State Bank, owed \$60,000. Trustee's Exhibit 1, Schedule D. Their statement of intention filed pursuant to 11 U.S.C. § 521(2) indicated an intention to reaffirm both secured claims. The Pages listed no priority creditors. Their total unsecured debt was listed as \$56,771.71. Id., Schedule F. Unsecured claims included \$7,197.87 owed to Simplot for crop inputs, \$2,400 owed to Norwest Bank, and \$6,082.81 incurred in May 1997 for "farm supplies" from the Farmers Cooperative Elevator in Odebolt, Iowa. The remaining \$41,091.03 of unsecured debt was owed to 13 creditors on revolving charge accounts.

The Pages' Schedule G did not disclose their farm lease with Mrs. Herrig. Their statement of financial affairs did not disclose the payments to her or to Simplot, the sale of the IH 856 tractor, the sale of 1996 crop, the sale of the John Deere planter to Russell Page, or their giving financial statements to the Bank. Id., Statement of Financial Affairs, questions 3, 10, 17.

In the fall of 1997, before the Pages began harvesting, cattle got into their bean and corn fields. The Pages did not tell anyone about the damage or make a record of it at the time. At trial they were unable to quantify the damage.

The Pages began harvesting in October. They did not tell the Bank or the Trustee that they were harvesting; they had told the Bank where they would sell the grain and assumed the Bank would receive the crop. Bruce made silage from 10 acres of the corn. Russell Page custom harvested the rest of the corn and beans. Bruce used approximately 900 bushels of corn to feed the hogs. He estimated the volume from the number of wagon loads used and the capacity of each wagon. He delivered soybeans to Home Elevator in October and received settlement checks in November and February 1998. Trustee's Exhibit 4, 8; FSB Exhibit 24. Bruce delivered corn and beans to Farmers Coop in November 1997. The corn had to be dried. Trustee's Exhibit 9. Farmers Coop issued a settlement check in February 1998. Trustee's Exhibit 5; FSB Exhibit 25.

At the Pages' meeting of creditors in December 1997, they learned the Bank had not perfected its security interest in the 1997 crop. Proceeds in the amount of \$7,968.53 were turned over to the Trustee. This accounted for 763 bushels of beans and 1,519 bushels of corn.

The ASCS corn suitability rating for the Pages' land was 110 bushels per acre. Bruce did not calculate what he thought his 1997 crop yields were. He reported the following historical corn yields: 45 bushels per acre in 1993; 46 bushels per acre in 1995; and "in the hundreds" for 1996. Bruce did not refer to any documents which might have verified these figures. Bruce said his yield varied over the years according to how much money was spent on crop inputs. The Pages' tax returns show the following expenditures for seed, chemicals and fertilizer: 1994, \$9,067; 1995, \$7,330; 1996, \$15,462. Trustee's Exhibit 3, Form 1040, Schedule F. In 1997, the Pages obtained crop inputs through Simplot.

From the scheduled amount of Simplot's unsecured claim and the \$1,000 paid to Simplot from Bruce's 401(k) loan, the court finds that the Pages spent \$8,198 on crop inputs in 1997.

Post-petition, the Pages continued to sell livestock. They made a list of sales and gave proceeds checks totaling \$7,726.23 to the Bank. FSB Exhibit 27, attachments 7, 8. The Pages liquidated their swine herd between October and December, 1997. Id., attachment 7. Cows were sold in May and June, 1998. Id., attachment 8.

The Bank prepared the following chart to compare the Pages' accountings for numbers of livestock:

| <u>Date</u> | <u>Hogs</u> | <u>Sows</u> | <u>Gilts</u> | <u>Boars</u> | <u>Cows</u> | <u>Calves</u> | <u>Bull</u> |
|-----------------|-------------|-------------|--------------|--------------|-------------|---------------|-------------|
| 7-24-96 | 250 | 45 | | 3 | 26 | 48 | 1 |
| 5-8-97 | 345 | 0 | 30 | 2 | 14 | 12 | 0 |
| 8-6-97 | 130 | 23 | 15 | 4 | 14 | 12 | 0 |
| 9-6-97 | 130 | 23 | 15 | 4 | 14 | 12 | 0 |
| 9-10-97 | 178 | 24 | 0 | 2 | 11 | 12 | 1 |
| 9-26-97 | 95 | 24 | 0 | 2 | 12 | 12 | 0 |
| Post-pet. Sales | (54) | (38) | 0 | (2) | (10) | (1) | 0 |

Exhibit 27. The Bank noted the discrepancy between the number of hogs shown on the inventory taken September 10, which was 178 head, and the number in the Pages' bankruptcy Schedule B on September 26, which was 95 head, a difference of 83 hogs. The court finds that the number of hogs shown on the inventory was high. Only four days earlier, the Pages reported having 48 fewer hogs. Bruce was under the impression that the purpose of the inventory was to gather data for bank examiners. Whether he wanted the numbers to reflect well on the bank or on himself, he gave high estimates of the number of hogs. For one pen of animals, he gave a range for the number of head, and the bankers used the highest number in the range. The inflation of the hog numbers does not account entirely for the difference of 83 head. Bruce's estimates seemed reasonable to the bankers. Nevertheless, the Bank did not insist on an actual head count, and the number of hogs was high.

The Bank also notes the discrepancy between numbers of livestock on the date of filing and the number accounted for by post-petition sales. The Bank claims that the Pages have failed to account for the post-petition disposition of 41 hogs, two cows and eleven calves. FSB Exhibit 27.

The Bank received a check for the proceeds of one calf sold post-petition. Bruce sold the calf in January 1998 at auction in Denison. The sale price was \$10; the net after commission was \$1.74. Id., attachment 8. The same day they sold 10 calves to Russell Page for \$10 each. The calves were sick. Another calf died. The Pages still have the \$100 check for the ten calves.

Ten cows were sold four or five months after the Bank's complaint was filed. They brought an average net of \$231. Id.

The Pages suffered death loss of hogs, in addition to the death of the calf and their bull. Over a two-week period in November or December 1997, 38 pigs died from pneumonia and other illness. The Pages did not have money for a veterinarian. They paid National By-products to haul the carcasses away. They did not notify the Bank or the Trustee of the livestock deaths. The preponderance of the

evidence is that the Pages have accounted for the post-petition disposition of all but three of the hogs, either by sales or by death losses.

The Pages' accounting also shows the sale of 14 more sows than they actually had. FSB Exhibit 27. No one explained this discrepancy.

The Bank filed a claim in the amount of \$54,700.86. Subsequently it received \$2,306.08. See FSB Exhibit 27, attachment 8 (proceeds of cows sold May and June 1998). The Bank has a claim for \$52,394.78.

The Pages reported the following actual losses from farming, without taking into account deductions for depreciation: 1994, \$9,558; 1995, \$12,677; 1996, \$16,098; 1997, \$13,489. Trustee's Exhibit 3, Form 1040, Schedule F.

DISCUSSION

Bank's Nondischargeability Claim

The Bank seeks to except its claim from the Pages' discharges under 11 U.S.C. § 523(a)(6). It alleges that Pages converted collateral, which constituted a willful and malicious injury. The Bank has the burden of proving each of the elements of its claim by a preponderance of evidence. Grogan v. Garner, 111 S.Ct. 654, 659 (1991).

The Eighth Circuit has emphasized that the elements of willfulness and malice must be analyzed separately. Barclays American/Business Credit, Inc. v. Long (In re Long), 774 F.2d 875, 880-81 (8th Cir. 1985). "[W]illful' . . . means intentional or deliberate." Id. at 880. The Supreme Court has approved the Eighth Circuit's approach, which requires a claim under § 523(a)(6) to involve an actual intent to cause injury, and not merely an intentional act that causes injury. Kawaauhau v. Geiger, 118 S.Ct. 974, 977 (1998) (affirming Geiger v. Kawaauhau (In re Geiger), 113 F.3d 848 (8th Cir. 1997)). "[W]hat is required for nondischargeability is a deliberate or intentional injury, not merely a deliberate or intentional act. . . . [T]his means a deliberate or intentional invasion of the legal rights of another, because the word 'injury' usually connotes legal injury (*injuria*) in the technical sense, not simply harm to a person." Geiger, 113 F.3d at 852.

In Long, the Eighth Circuit applied the definition of malice in the context of an intentional breach of a security agreement. Debtors must be shown to have acted "with malice by intending or fully expecting to harm the economic interests of the creditor." Long, 774 F.2d at 882. The court may consider the objective likelihood of harm in determining whether the harm was inflicted intentionally. Id. at 881. To be malicious, the debtors' actions must have been "targeted at the creditor . . . at least in the sense that the conduct is certain or almost certain to cause financial harm." Id. The term "malice" applies "only to conduct more culpable than that which is in reckless disregard of creditors' economic interests and expectancies, as distinguished from mere legal rights. . . . [K]nowledge that legal rights are being violated is insufficient to establish malice, absent some additional aggravated circumstances" Id. "[D]ebts arising from recklessly or negligently inflicted injuries do not fall within the compass of § 523(a)(6)." Kawaauhau v. Geiger, 118 S.Ct. at 978.

The Bank contends that the Pages converted livestock, 1996 crop, and equipment. Consolidated Joint Pretrial Statement, Bank's Contentions of Fact, ¶ 5. The Pages admitted selling a John Deere planter and using the money to buy feed. There was no evidence that the Pages converted 1996 grain. Although the Pages said they sold 1996 crop in January 1997, there was no evidence as to the use of

the proceeds. The Pages fed their hay crop to the livestock. Feeding the hay in this manner may have been in conformance with the Pages' course of dealing with the Bank, especially in 1996 when the Bank was still financing the farm operation. Hay often is stored on the farm for continual feeding, and is not sold as is a grain crop. Moreover, there was no evidence whether any hay from 1996 cuttings still existed in 1997.

The Pages admitted selling livestock to buy hog feed. The livestock sales likely began in early 1997. The Bank had given the Pages a loan in November 1996. In December 1996, the Pages paid for feed by selling their planter and may have obtained funds from the Bank. By about March or April 1997, the Pages had sold some livestock and deposited the proceeds in their new checking account.

It is impossible to make an accurate finding of the number of animals sold. No one offered bills of sale or feed receipts in evidence; the documents may no longer exist. The Pages accounted for their livestock numbers at various times in 1997. They made a rough estimate inventory on September 10. The numbers listed in their bankruptcy schedules were based on an actual head count. Sales and death loss accounted for the post-petition disposition of all their livestock except two cows and three hogs. Error in counting may explain some of these animals. There appears to be some type of error in their accounting since the Pages reported selling 14 more sows than they had. The sum of the evidence leads the court to conclude that the Pages sold an unknown number of animals as needed to purchase hog feed between January 1997 and September 26, the date of filing the petition.

The Pages acted willfully in selling the Bank's collateral. They knew they were using the Bank's money. Their use of the proceeds of livestock and the planter to buy feed constituted a technical conversion of the property. The issue is whether the Pages acted with malice toward the Bank.

The Pages' stated intention was to preserve their farming operation in some form. They said their plan was to reaffirm their debt with the Bank and to continue with a hog operation. They maintained this hope until their meeting of creditors in December 1997 when they learned that the Trustee would receive the 1997 crop proceeds.

The Bank contends that the Pages' conversion of collateral was done maliciously. The Bank argues that the Pages blamed the Bank for putting them out of the farming business. The Pages' actions were in their own self-interest and not for the benefit of the Bank. The Bank further contends the Pages' explanation that they would be able to continue farming and repay the debt to the Bank was not credible.

The Pages argued that the Bank received more money on the liquidation of the hog herd toward the end of 1997 than if they had sold the animals in January, shortly after the Bank stopped financing them. There was no evidence to support this assertion. Bruce could not say what the market price of hogs was at either time. The court cannot find that the Pages benefitted the Bank by continuing to feed the animals, but a lack of altruism does not transform their conduct into malice toward the Bank.

The Pages wanted to continue farming. The Bank does not dispute that they were sincere in their hope to do so. Since the Pages did not want to liquidate their hog herd, they had to be able to buy feed. The Pages appeared to be focusing their actions toward that goal. The Bank has failed to prove that the Pages sold collateral with an intention or expectation that the Bank would suffer economic harm.

There was no evidence that the Pages used proceeds to enrich themselves personally. The most valuable non-farm items of property listed in their bankruptcy schedules were Bruce's 401(k) plan and a fully-encumbered 1996 vehicle. Bruce accrued his interest in the 401(k) plan over 14 or 15 years of

employment at AMPC. The Pages acquired the vehicle in April 1996, when the Bank was still financing the farm operation. Trustee's Exhibit 1, Schedule D. They did not use collateral to make their farm lease payments, but instead used an exempt asset.

The Pages wanted to reaffirm the debt with the Bank. By the date of filing, they had reduced their debt, albeit through sales of collateral. They estimated they had reduced their debt by about \$10,000 or \$12,000 by the time of filing their bankruptcy petition. The Pages were expecting that the debt would be further reduced by the proceeds of their 1997 crop. They still had sows and feeder pigs on their farm in December 1997, when they learned the Bank would not receive the crop money. FSB Exhibit 27, attachment 7. Their relationship with the Bank appeared not to be hostile. Tjaden said he trusted Bruce, even after he learned in March of 1997 that Bruce had sold collateral. The Pages owed the Bank more than \$20,000 in overdue note payments at the time, but the Bank did not move immediately to liquidate their herd. Tjaden may have assumed that Bruce had spent livestock proceeds to buy feed. Tjaden did not take any particular action in response to being told about the livestock sales. The Pages were delinquent on note payments in the amount of \$48,803.96 before the Bank came out to the Pages' farm in September 1997.

The Pages might have been better farmers; they might have kept better records, and they might have communicated better with the Bank about their farm operation. Nevertheless, the evidence does not support a finding of an intention or expectation of economic harm to the Bank. The Pages' plans may have been unrealistic, but the court finds that saving their farm operation was their goal. In the Long case, the debtor had spent \$35,000 of the creditor's collateral on attorney fees for an unsuccessful attempt to reorganize his corporation. The Eighth Circuit said that, although the effort soon collapsed, it was "not necessarily a sham or hopeless from the beginning." Long, 774 F.2d at 882. Similarly, although the Pages eventually were forced to liquidate their livestock, the preponderance of the evidence supports a conclusion that they acted with the goal of salvaging their hog operation rather than out of malice toward the Bank.

TRUSTEE'S OBJECTIONS TO DISCHARGE

The Trustee claims that the Pages are not entitled to a Chapter 7 discharge on grounds under §§ 727 (a)(2), (3), (4)(D), and (5). The Trustee contends that the Pages have failed to keep records or have withheld records from the Trustee as to their 1997 crop, that they have concealed part of the crop, or that they have failed to account for the crop or explain the loss of part of it. The Trustee further contends that the Pages should be denied their discharges for their general failure to keep books and records, including bank account records. See Joint Pretrial Statement, unnumbered page 2. The exceptions to discharge should be liberally construed in favor of the debtor. Matter of Juzwiak, 89 F.3d 424, 427 (7th Cir. 1996). The Trustee has the burden of proof of each of the elements of his claims by the preponderance of evidence. Fed.R.Bankr.P. 4005; Montey Corp. v. Maletta (In re Maletta), 159 B.R. 108, 111 (Bankr. D. Conn. 1993).

CLAIM UNDER § 727(a)(5)

A debtor who has "failed to explain satisfactorily, before determination of denial of discharge under [§ 727(a)], any loss of assets or deficiency of assets to meet the debtor's liabilities" is not entitled to a Chapter 7 discharge. 11 U.S.C. § 727(a)(5). A claim under § 727(a)(5) first requires proof that the debtor no longer has an asset he once had. Barristers Abstract Corp. v. Caulfield (In re Caulfield), 192 B.R. 808, 821 (Bankr. E.D.N.Y. 1996). If the plaintiff makes a prima facie case, the burden of production shifts to the debtor to provide a satisfactory explanation for the loss. Id. The court in Caulfield stated:

To be satisfactory, the explanation must convince the court that the debtor "has not hidden or improperly shielded assets," and "must convince the court of the debtor's business-like conduct and good faith and must appear reasonable such that the court 'no longer wonders' what happened to the assets." The Code does not require that the Debtor's explanation be meritorious, or "that the loss or other disposition of assets be proper; it only requires that the explanation satisfactorily account for the disposition."

Id., 192 B.R. at 821-22 (citations omitted).

The Trustee's claim of failure to explain loss of assets is based on the discrepancy between the estimates of 1997 crop yields made in September that year, and the yield accounted for post-petition. The court concludes that the Trustee has failed to meet his initial burden to prove that there was a significant loss of assets. The preponderance of the evidence shows that the estimates of the crop yield were not accurate. The grain the Pages fed to livestock and the proceeds paid over to the Trustee account for a yield that appears reasonable, taking into account the Pages' circumstances.

The Pages planted 33 acres of beans in 1997. They gave the Trustee the proceeds of 763 bushels of soybeans, accounting for a yield of 23 bushels per acre. They planted 48 acres of corn and made ten acres of it into silage. They fed 900 bushels of harvested corn to the hogs. The Trustee received the proceeds of 1,519 bushels. This accounted for a yield of 64 bushels per acre for corn (2,419 / 38).

There was no trial testimony explaining why the Bank or the Pages used yields of 120 bushels per acre of corn and 40 bushels per acre of beans on the inventory taken September 10, 1997. No one asked Tjaden if he thought the estimates were accurate. Bruce likely knew at the time that the figures were high. The corn yield estimate was higher than his yield in one of his best years. He knew his 1997 crop was adversely affected by the low amount he had spent on inputs. The Pages believed the Bank had a perfected security interest in the 1997 crop. Bruce was under the impression that the inventory was for providing information to bank examiners. He may have inflated the yield estimates to "make the Bank look good," as he said, or to satisfy the Bank that it had sufficient collateral. Regardless of the reason, the estimates are not a reliable basis for determining the amount of crop the Pages should have accounted for after harvest.

The yield estimates listed in the Pages' bankruptcy schedules were 80 bushels per acre of corn and 28 bushels per acre of beans. The Pages used these estimates for no other reason than that they were the yields guaranteed by their crop disaster insurance. There was no evidence explaining how the guaranteed amount was determined. The Pages' bankruptcy schedule estimates were higher than the amount actually accounted for by 16 bushels per acre of corn and 5 bushels per acre of beans. The Trustee has presented no basis for finding that the insurance guarantee figures were a more accurate measure of the Pages' actual yields. In 1997, the Pages spent about half as much on crop inputs as they had spent the year before. See Trustee's Exhibits 1 (bankruptcy Schedule F, debt of \$7,198 to Simplot) and 3 (Schedule F to Form 1040 for tax years 1996, 1997). In a previous year, spending less on inputs resulted in a low crop yield. The Pages were marginal farmers. They lost a total of \$51,822 in their last four years of farming. Bruce reported having had corn yields as low as 45 and 46 bushels per acre. The Trustee has not shown that the Pages ever had significantly more grain than the amount for which they accounted. His claim under § 727(a)(5) should be dismissed.

CLAIM UNDER § 727(a)(4)(D)

The Trustee claims that the Pages should be denied a discharge under 11 U.S.C. § 727(a)(4)(D) for withholding records relating to the 1997 crop. That section provides that a Chapter 7 debtor is not

entitled to a discharge who has "knowingly and fraudulently, in or in connection with the case ... withheld from an officer of the estate entitled to possession under [title 11], any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs." A debtor's discharge may be denied under § 727(a)(4)(D) for failure to cooperate with the trustee. Olsen v. Reese (In re Reese), 203 B.R. 425, 431 (Bankr. N.D. Ill. 1997).

The Trustee has not identified particular crop records which the Pages are alleged to have withheld from him. The Trustee received grain settlement sheets and settlement checks. Trustee's Exhibits 4, 5, 8, 9. The fact that the Pages did not have certain records will be discussed below in connection with the Trustee's claim under § 727(a)(3). The preponderance of the evidence is that the Pages turned over to the Trustee all the records they had in their possession relating to their 1997 crop. The claim under § 727(a)(4)(D) should be dismissed.

CLAIM UNDER §727(a)(2)

The Trustee claims that the Pages are not entitled to discharges under 11 U.S.C. § 727(a)(2) for concealment of part of the 1997 crop or for failure to account fully for the crop. Section 727(a)(2) provides that the debtor should be denied a discharge if "the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under [title 11], has transferred, removed, destroyed, mutilated, or concealed ... property of the estate."

The Pages explained that part of their crop was fed to livestock. As discussed above in connection with the Bank's claim under § 523(a)(6), the Pages fed crop to livestock with the intention of keeping their farm operation going. It was not an action to conceal the crop.⁽¹⁾ In discussion of the Trustee's claim under § 727(a)(5), the court found that the Pages have satisfactorily accounted for their crop. Therefore, the Trustee must fail in his claim that the Pages fraudulently hid part of the crop or failed to account for it. The claim under § 727(a)(2) should be dismissed.

CLAIMS UNDER § 727(a)(3)

The Trustee claims that the Pages have destroyed and failed to keep books and records, including bank account records and records relating to their 1997 crop. Amended Complaint, Counts I, V. A bankruptcy court has the discretion to deny a Chapter 7 debtor his discharge if--

the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case.

11 U.S.C. § 727(a)(3). The Code does not require the debtor to keep records in any particular form. Matter of Juzwiak, 89 F.3d 424, 428 (7th Cir. 1996). The purpose of § 727(a)(3) is to provide the trustee sufficient information to "ascertain the debtor's financial condition and track his financial dealings with substantial completeness and accuracy for a reasonable period past to present." Id. at 427. "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).

The Pages' system of record keeping for their farm operation was extremely informal. They kept no books. They merely accumulated receipts, canceled checks, and lists throughout the year, then gave

these items to their tax preparer. After the tax return was prepared, they kept a copy of the return, but not the documents supporting the figures on the returns. The Pages kept no bank records. They threw their bank statements away after reconciling them with their check book, threw their checks away unless they were needed as receipts for a farm expense, and threw check registers away after all the checks in the register had cleared. Because of the Pages' failure to keep books and records, the Trustee has been unable to trace their financial history and examine their material business transactions.

The court must determine whether the Pages' inadequate bookkeeping methods are justified in light of their particular circumstances. Mathern, 137 B.R. at 317; Miller v. Pulos (In re Pulos), 168 B.R. 682, 692 (Bankr. D. Minn. 1994) (court must consider "debtor's education, sophistication, and business experience, size and complexity of debtor's business, debtor's personal financial structure, and any special circumstances that may exist.")

The Pages are not sophisticated business people. There was no evidence that either Bruce or Terri had education beyond high school or had special training in accounting or bookkeeping. Nor was there any evidence that either had any special education or training in crop production or livestock management. Bruce came from a farming family and likely learned "by doing." The Pages' farming operation was a small, relatively simple business. In Iowa Falls Ag Center v. Wood (In re Wood), Adv. No. 95-4086XM (Bankr. N.D. Iowa Sept. 20, 1996), this court described the farmer-debtor's 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.

Id., slip op. at 12.

The court holds a similar view of the Pages' farming operation. Theirs was a small business that regularly lost money and took them deeper in debt. The Pages apparently did not need a better record keeping system to meet the Bank's standards for lending operating money. The Pages were concerned primarily with records needed for tax purposes. They threw papers away if they believed the papers had no tax significance. Considering the Pages' particular characteristics and those of their business, the court concludes that the inadequacy of their books and records is not a sufficient ground to deny their discharges.

At trial, the court raised the concern that the Trustee's objection, as to the bank records, is a claim for failure to keep records that are in existence. Account records may be obtained from financial institutions. Both the Pages and the Trustee stated that the difficulty and expense of doing so is prohibitive. The Trustee filed a post-petition brief on the issue of who bears the burden of obtaining copies of bank records. The brief emphasized that, once the Trustee has established the non-existence of records, the debtor has the burden of producing evidence of adequate justification of the lack of records. Trustee's Brief, unnumbered page 3 (citing Meridian Bank v. Alten, 958 F.2d 1226 (3d Cir. 1992)).

It seems that, if the trustee requests bank records and the debtor does not provide them, the debtor has failed to keep records for purposes of § 727(a)(3). The financial institution presumably provided the

records to the debtor at one time; the debtor disposed of them. A trustee should not have to incur extraordinary expenses to perform his duty to examine the debtor's financial history. Thus, if no one obtains copies of available bank records, it becomes critical that the debtor show sufficient justification for the lack of records.

A case cited in the Trustee's brief merits discussion here. In Matter of Juzwiak, 89 F.3d 424 (7th Cir. 1996), the debtor operated a grain hauling business. He owned three trucks and had two employees. For a recent year, his income tax return showed \$5 million in sales. Id. at 425. A creditor objected to the debtor's discharge under § 727(a)(3). The bankruptcy court granted the discharge, finding that the creditor could have hired an accountant to reconstruct the debtor's business transactions from the records produced by the debtor and from the debtor's oral identification of the sources of funds. The district court reversed; the Seventh Circuit affirmed. The debtor argued that the district court's decision would operate unfairly against the small business person who could not afford an accountant. The Seventh Circuit responded that

our decision today simply requires businesses to maintain adequate invoices of sales along with documentation substantiating business expenses. This does not require an accountant or a bookkeeper. The debtor must merely keep the primary documents disclosing his business transactions. [E]xpert accountants testified that even their small clients typically keep such records. . . .

Id. at 429, n.2. Moreover, the creditor was "entitled to written documentation" of the source of funds. The debtor "offered no justification" for the inadequacy of his records. Id. at 430.

A debtor may choose to defend a § 727(a)(3) objection by producing further documents to show that his records are adequate. The court's comment in Juzwiak suggests that debtors in certain businesses, regardless of the size of the business, would have to produce particular documents, and that a debtor who does not actually produce such records could not meet the burden of showing justification. See also Aid Auto Stores, Inc. v. Pimpinella (in re Pimpinella), 133 B.R. 694, 698 (Bankr. E.D. N.Y. 1991)(to justify lack of adequate records, debtor must do more than explain that "it was not his practice to keep additional records" and "must show that the circumstances were in fact so unusual that ordinary record keeping was not required.") This court declines to adopt a per se rule that the lack of records may never be justified if others in the same business would keep better records. The exceptions to discharge are to be construed narrowly in favor of the debtor. The Code permits the court to consider whether the lack of records was justified under "all of the circumstances of the case." 11 U.S.C. § 727(a)(3).

The Pages did not keep the basic records that competent small farmers would have. The court has had an opportunity to observe the demeanor of the Pages and is satisfied that their failure to keep records is explained by incompetence rather than a level of culpability sufficient to deny their discharges. The court concludes that their failure to obtain copies of records that exist at their financial institutions does not warrant the denial of their discharges. The Trustee's claim under § 727(a)(3) should be dismissed.

ORDER

IT IS ORDERED that the complaint in Farmers State Bank, Lake View, Iowa v. Page, Adv. No. 98-9011-S is dismissed;

IT IS FURTHER ORDERED that the complaint in Forker v. Page, Adv. No. 98-9013-S is dismissed.

SO ORDERED THIS 1st DAY OF JUNE 1999.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on I mailed by U.S. mail or FAXed a copy of this order and a judgment to Wil Forker, James McCarthy, A. Frank Baron, U.S. trustee.

1. Even if the court had found conversion, which it did not, the conversion of an undersecured creditor's collateral is not sufficient to deny the debtor's discharge under § 727(a)(2). First National Bank of Oelwein v. Holtz (In re Holtz), 62 B.R. 782, 787 (Bankr. N.D. Iowa 1986).