ADVERSARY PROCEEDINGS IN BANKRUPTCY:

§ 523 AND § 727 OBJECTIONS

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AN OVERVIEW OF DISCHARGE DENIALS UNDER 11 U.S.C. § 727

I. INTRODUCTION – THE FUNDAMENTALS OF ADVERSARY BANKRUPTCY PROCEEDINGS

The provisions of 11 U.S.C. § 727 are narrowly construed in furtherance of the Bankruptcy Code's policy favoring a fresh start to the "honest, but unfortunate debtor."[1]

Before examining those elements, however, it is useful to review several general principles. An action to deny or revoke discharge is prosecuted as an adversary proceeding and is governed by Fed. R. Bankr. P. 4004(d), 7001(4), 7001 et. seq. An adversary proceeding is commenced by filing a complaint, not a motion.[2]

The complaint objecting to discharge must be filed within 60 days of the first date set for the § 341(a) meeting of creditors.[3] A request for extension must be filed before the expiration of the 60-day period.[4]

The chapter 7 trustee, a creditor, or the United States Trustee may object to the granting of a discharge.[5] A chapter 7 trustee is charged with the affirmative duty of opposing the discharge of the debtor if, after investigation, such opposition is advisable.[6] Therefore, whenever appropriate, the chapter 7 trustee should examine the acts and conduct of the debtor to determine whether grounds exist for denial of discharge. On the request of a party in interest, the court may order the chapter 7 trustee to examine

[1] Huckfeldt v. Huckfeldt (In re Huckfeldt), 39 F.3d 829, 832-33 (8th Cir.1994); Razabonni v. Schifano (In re Schifano), 378 F.3d 60, 66 (1st Cir. 2004); Boroff v. Tully (In re Tully), 818 F.2d 106 (1st Cir. 1987) (the statutory elements of § 727 causes of action are construed liberally in favor of the debtor).
[2] Fed. R. Bank. P. 7003.
[3] Fed. R. Bankr. P. 4004(a).
[4] Fed. R. Bankr. P. 4004(b).
[5] 11 U.S.C. § 727(c)(1).
[6] *See* 11 U.S.C. § 704(6).

whether grounds exist for denial of a discharge.[7] Notwithstanding the chapter 7 trustee's general affirmative duty to oppose the discharge, there are some occasions where it may be advisable for the U.S. Trustee to undertake the primary responsibility of opposing the discharge.

While there are no statutory presumptions at work, one view is that the debtor is entitled to a "starting presumption" that most debtors are honest and do not ordinarily engage in fraudulent activities.[8]

Nevertheless, the purpose of the statute is "to make sure that those who seek the shelter of the Bankruptcy Code do not play fast and loose with their assets or with the reality of their affairs."[9] The Tully Court elaborated on the meaning of § 727 when it stated:

> The statutes are designed to insure that complete, truthful, and reliable information is put forward at the outset of the proceedings, so that decisions can be made by the parties in interest based on fact rather than fiction. As we have stated, "[t]he successful functioning of the bankruptcy act hinges both upon the bankrupt's veracity and his willingness to make full disclosure."[10]

In other words, debtors approach the bankruptcy court with the benefit of the doubt, but are expected, upon arrival, to make an honest and complete account of their financial affairs.[11]

The Creditor, Trustee, or United States Trustee carries the burden of proving their case, which must be established by a preponderance of the evidence.[12] Even under

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[7] 11 U.S.C. § 727(c)(2).
[8] *See* Francis v. Riso (In re Riso), 74 B.R. 750, 756 (Bankr. D. N.H. 1987).
[9] Palmucci v. Umpierrez 121 F.3d 781, 786 (1st Cir. 1997) (quoting In re Tully, 818 F.2d at 110).
[10] Id. (quoting Matter of Mascolo, 505 F.2d 274, 276 (1st Cir. 1974)).
[11] Mayer v. Spanel Int'l Ltd., 51 F.3d 670, 674 (7th Cir. 1995) ("Congress concluded that preventing fraud is more important than letting defrauders start over with a clean slate, and we must respect that judgment."), cert. denied, 516 U.S. 1008, 116 S.Ct. 563, 133 L.Ed.2d 488 (1995).
[12] Fed. R. Bankr. P. 4005; *see also*, Gillickson v. Brown, (In re Brown), 108 F.3d 1290, 1293 (10th Cir. 1997); Landsdowne v. Cox (In re Cox), 41 F.3d 1294, 1297 (9th Cir. 1994); Grogan v. Garner, 498 U.S.

§727(a)(4), which denies a debtor the right to a discharge if the debtor has committed a fraud on the bankruptcy court, it is the Plaintiff's burden to prove his or her case by a preponderance of the evidence.[13]

Once the party objecting to entry of a discharge order has presented a prima facie case, the burden shifts to the debtor to offer a credible justification in defense.[14] Under §727(a)(3), once a prima facie case is shown, the burden shifts to the debtor who must establish either that the debtor maintained adequate books and records from which his financial condition could be ascertained, or that the failure to keep adequate books and records was justified under the circumstances.[15] Furthermore, "[w]here the nature of the debtor's business operations indicates that others in like circumstances would ordinarily keep financial records, the debtor cannot justify his failure to maintain records merely by stating that he did not comprehend the need for them."[16]

Similarly, under §727(a)(4), once it reasonably appears that the oath is false, "the burden falls upon the bankrupt to come forward with evidence that he has not committed the offense charged."[17] Under §727(a)(5), "once it is shown that the debtor had a cognizable ownership interest in a specific identifiable property at a time not too far removed from the date of filing the petition, the burden is on the debtor to satisfactorily explain the loss of that particular asset, if at the time the petition is filed the debtor claims

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279 (1991) (holding that the standard of proof in debt dischargeability litigation under § 523(a) is a preponderance and suggesting that the same is true under § 727).

[13] *See* H. R. Rep. No. 95-595, p. 384 (1977), U.S. Code Cong. & Admin. News 1978, pp. 5787, 6340 ("the fourth ground for denial of discharge is the commission of a bankruptcy crime, though the standard of proof is preponderance of the evidence"); S. Rep. No. 95-989, p. 98 (1978), U.S. Code Cong. & Admin. News 1978, p. 5884.

[14] *See* In re Devers, 759 F.2d 751, 754 (9th Cir. 1985) and In re Chalik, 748 F.2d 616, 619 (11th Cir. 1984).

[15] Meriden Bank v. Alten, 958 F.2d 1226, 1233 (3rd Cir. 1992); Matter of Horton, 621 F.2d 968, 972 (9th Cir. 1980); In re Lawler, 141 B.R. 425, 428-29 (B.A.P. 9th Cir. 1992).

[16] In re Morando, 116 B.R. 14, 15-16 (Bankr. D. Mass. 1990) ("A substantially accurate and complete record of the financial affairs of a debtor is a prerequisite to his discharge in bankruptcy, unless there is justification for the lack of records.").

[17] In re Tully, 818 F.2d at 110.

he no longer has the particular property. To pass muster, the explanation must be sufficiently reasonable to satisfy the trier of fact."[18]

The evidence may be singular. One false oath is sufficient to warrant a denial of discharge under § 727.[19]

On the other hand, an isolated error or omission in a bankruptcy schedule, or mere inconsistent entries where one entry is correct and the other is in error, generally reflect the inadvertence which accompanies haste or stress, as opposed to fraudulent intent.[20]

At the same time, a pattern of misleading conduct can also sustain an objection to the debtor's discharge.[21] When determining what a debtor actually intended, the bankruptcy court is bound to make an assessment of the debtor's credibility when the debtor denies any intention to deceive, but instead claims that the debtor was confused, inadvertent, or mislead by his counsel. The Court is not bound by the debtor's testimony. Rather, "the court is permitted to test the debtor's testimony against the appropriate inferences to be drawn from all the surrounding objective factual circumstances."[22]

Moreover, a debtor's "reckless indifference to the truth . . . 'has consistently been treated as the functional equivalent of fraud.'"[23] This principle is essential to the success of objections founded upon the debtor's fraudulent intent under §§ 727 (a)(2) and (a)(4). Some examples of what constitutes "reckless indifference" include: (1) failing to list

[18] In re Beausoleil 142 B.R. 31, 37 (Bankr. D. R.I. 1992).
[19] Smith v. Grondin, (In re Grondin), 232 B.R. 274 (B.A.P. 1st Cir. 1999) (citing Torgenrud v. Schmitz (In re Schmitz), 224 B.R. 149, 152 (Bankr. D. Mont. 1998) (finding fraudulent intent when debtor failed to disclose her current, married name)); Minsky v. Silverstein (In re Silverstein), 151 B.R. 657, 662 (Bankr. E.D.N.Y. 1993) (finding fraudulent intent when debtor failed to disclose his equitable interest in the marital home); First National Bank of Mason City, Iowa v. Cook (In re Cook), 40 B.R. 903, 907 (Bankr. N.D. Iowa 1984) (finding fraudulent intent when the debtor failed to disclose his transfer of a parcel of real estate one month prior to filing bankruptcy petition).
[20] In re Jackson, Slip. op. No. 03-10717, 2004 WL 2595900 (Bankr. D. N.H. Apr. 26, 2004).
[21] In re Devers, 759 F.2d at 753-754 ("Because a debtor is unlikely to testify directly that his intent was fraudulent, the courts may deduce fraudulent intent from all the facts and circumstances of a case.").
[22] Commerce Bank & Trust Co. v. Burgess, (In re Burgess), 955 F.2d 134, 137 (1st Cir. 1992).
[23] In re Grondin, 232 B.R. at 277-78 (quoting In re Tully, 818 F.2d at 112).

assets in original schedules[24]; (2) failing to disclose the pre-petition sale of an interest in a corporation and later failing to mention it during creditors' meeting[25]; and (3) failing to disclose an ownership interest in real property on the debtor's schedules and testifying inconsistently regarding the amount of money in bank accounts.[26]

Finally, pursuant to Federal Rule of Civil Procedure 12(b)(6), which is applicable in adversary proceedings, a debtor may move to dismiss a cause of action if it fails "to state a claim upon which relief can be granted." In deciding such a motion, a court must "take all well-pleaded facts as true, but it need not credit a complaint's 'bald assertions' or 'legal conclusions.'"[27] The complaint should contain a recitation of facts which fit within the parameters of one or more § 727 causes of action. The U.S. Supreme Court recently altered the Rule 12(b)(6) standard by requiring that a complaint allege "a plausible entitlement to relief."[28]

With these fundamental principles in mind, this outline will proceed, with a review of the elements of an action under § 727. Those elements which have been interpreted extensively (e.g. "knowingly and fraudulently**"**) will be discussed in detail within the context of each element.

[24] In re Tully, 818 F.2d at 106.
[25] In re Grondin, 232 B.R. at 277-78.
[26] Sullivan v. Tracey (In re Sullivan), 76 B.R. 876, 881 (Bankr. D. Mass. 1987)).
[27] Shaw v. Digital Equip. Corp., 82 F.3d 1194, 1216 (1st Cir. 1996) (citations omitted).
[28] Bell Atl. Corp. v. Twombley, 550 U.S. 544, 127 S.Ct. 1955 (2007) ("a formulaic recitation of the elements of a cause of action will not do. Factual allegations must be enough to raise a right to relief above the speculative level.").

II. THE ELEMENTS – REACHING NON-DISCHARGEABILITY UNDER 727(a) and (d)

A. PRE-PETITION TRANSFERS OR CONCEALMENT OF PROPERTY – SECTION 727(a)(2)(A)

11 U.S.C. §727(a)(2)(A) states:

> (a) The court shall grant the debtor a discharge, unless-
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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 filing of the petition.

Denial of discharge need not rest on a finding of intent to defraud. Intent to hinder or delay is sufficient.[29] Furthermore, a debtor need not succeed in harming creditors to warrant denial of discharge under this section because "lack of injury to creditors is irrelevant for purposes of denying a discharge in bankruptcy."[30]

Concealment has been defined to include withholding knowledge of the existence, ownership, or location of property.[31] A debtor's failure to list valuable property on the schedule of assets and to disclose property transfers is fraudulent concealment.[32]

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[29] Matter of Smiley, 864 F.2d 562, 568 (7th Cir. 1989); In re Adeeb, 787 F.2d 1339, 1343 (9th Cir. 1986).
[30] In re Adeeb, 787 F.2d at 1339.
[31] In re Macdonald, 114 B.R. 326, 334 (D. Mass. 1990) (quoting In re McIsaac, 19 B.R. 391, 396 (Bankr. D. Mass. 1982)).
[32] In re Ingle, 70 B.R. 979, 983 (Bankr. E.D.N.C. 1987).

The definition of "transfer" enacted as part of the 1978 Code was intended to be as broad as possible.[33] Collier on Bankruptcy, referring to the Senate report accompanying the 1978 legislation, noted that "under this definition, any transfer of an interest in property is a transfer, including a transfer of possession, custody or control, even if there is no transfer of title, because possession, custody, and control are interests in property."[34] Nevertheless, pre-BAPCPA, the Ninth Circuit interpreted "transfer" to mean "transferred and remain transferred."[35] A debtor could undo a "transfer" when in good faith the debtor recovered, prior to the petition, substantially all transferred property.[36] The definition of "transfer" was reworded under BAPCPA and amended to include the creation of a lien.[37]

The continuing concealment doctrine also applies in §727(a)(2) to extend the "look back" period beyond one year preceding the petition.[38]

B. POST-PETITION TRANSFERS OR CONCEALMENT OF PROPERTY – SECTION 727(a)(2)(B)

11 U.S.C. § 727(a)(2)(B) states:

> (a) The court shall grant the debtor a discharge, unless-
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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

[33] In re Bajgar, 104 F.3d 495, 498 (1st Cir. 1997).
[34] 6 Lawrence P. King, Collier on Bankruptcy, 727.02[5] ("Collier").
[35] In re Adeeb, 787 F.2d at 1343.
[36] Id. at 1345; *but see* In re Bajgar, 104 F.3d 495 (denying discharge to debtor who acknowledged a pre-petition fraudulent conveyance and recovered the transferred property, post-petition, in light of the debtor's admission that he transferred the asset in order to hinder creditors).
[37] *See* 11 U.S.C. § 101(54).
[38] *See* In Re Lawson, 122 F.3d 1237, 1240-41 (9th Cir. 1997) ("[A] transfer made and recorded more than one year prior to filing may serve as evidence of the requisite act of concealment where the debtor retains a secret benefit of ownership in the transferred property within the year prior to filing."); In re O'Brien, 190 B.R. 1 (Bankr. D. Mass. 1995).

under this title, has transferred, removed, destroyed, mutilated, or **concealed** or has permitted to be transferred, removed, destroyed, mutilated, or conceale

(B) property of the estate, after the date of the filing of the petition.[39]

The same intent analysis is used for cases under 11 U.S.C. § 727(a)(2) and 11 U.S.C. § 727(a)(4).[40] The intent to hinder, delay or defraud can be proven through circumstantial evidence. Actual intent may be proven from circumstantial evidence or inferred by a court when the debtor fails to disclose assets in his Statement of Assets and Liabilities and/or has given false answers in his Statement of Financial Affairs.[41]

C. INADEQUATE RECORD KEEPING - SECTION 727(a)(3)

11 U.S.C. § 727(a)(3) states:

(a) The court shall grant the debtor a discharge, unless-

(3) the debtor has **concealed**, destroyed, mutilated or falsified, or failed to keep or preserve and recorded information …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.[42]

[39] *See generally* In re Lawson, 122 F.3d at 1240; In re Devers, 759 F.2d at 751; In re Aubrey, 111 B.R. 268, 273 (B.A.P. 9th Cir. 1990).
[40] In re Roberts, 331 B.R. 876, 885, n.5 (B.A.P. 9th Cir. 2005).
[41] In re Metz, 150 B.R. 821, 824 (Bankr. M.D. Fla. 1993) (citing In re Sklarin, 69 B.R. 949 (Bankr. S.D. Fla. 1987)).
[42] *See generally* In re Meriden Bank v. Alten, 958 F.2d 1226, 1232 (3rd Cir. 1992).

There is a significant difference in the proof necessary to sustain a § 727(a)(3) action. Intent to conceal financial condition is not an element.[43] The only showing required under § 727 (a)(3) is that the debtor has unjustifiably failed to keep records of his financial condition.[44] Adequacy of records is decided on a case-by-case basis, depending on the debtor's business operation and sophistication.[45] The Bankruptcy Code does not condone a complete default in maintaining and preserving records from which basic information regarding a debtor's business affairs can be obtained.[46]

The purpose of Bankruptcy Code §727(a)(3) "is to ensure that dependable information be supplied to the trustee and to creditors upon which they can rely in tracing the debtor's financial history; the trustee and the creditors are entitled to complete and accurate information showing what property has passed through the debtor's hands during the period prior to bankruptcy. The production of appropriate records is the *quid pro quo* for the debtor's relief from substantially all financial obligations through a discharge in bankruptcy."[47]

Few consumer debtors maintain anything more than a collection of bills, receipts, and canceled checks. Collier includes commentary to the affect that a discharge should not be denied in a typical consumer bankruptcy case due to a lack of books or records.[48] Presumably, a consumer debtor who cannot produce bank statements or some other evidence of receipts and expenditures is subject to an objection to discharge. However, proof that the debtor destroyed records is not, standing alone, sufficient to satisfy the

[43] In re Schifano, 378 F.3d at 70.
[44] Alten, 958 F.2d at 1234.
[45] *See* In re Hiengen, 112 B.R. 382, 385 (Bankr. D. Mont. 1989).
[46] *See, e.g.*, In re Hoblitzell, 223 B.R. 211, 216 (Bankr. E.D. Cal. 1998).
[47] In re Ridley, 115 B.R. 731, 734-735 (Bankr. D. Mass 1990).
[48] Collier, 727.03[3][g].

moving party's burden. To prevail, the moving party must show that the Debtor's act prevented the moving party from ascertaining the debtor's financial situation.[49]

Factors to consider whether debtor should have been keeping records include: (1) debtor's intelligence and educational background; (2) debtor's experience in business matters; (3) extent of the debtor's involvement in the business; (4) debtor's reliance, including her knowledge of whether records were being kept; (5) nature of the marital relationship; (6) any recordkeeping or inquiry duties imposed by state law; (7) debtor's fear of spouse; and (8) whether the spouse keeps the business a secret or may have misled the debtor on the status of the business.[50]

Sometimes a debtor facing an objection to discharge responds with the proverbial shoe box of receipts, an overstuffed shopping bag, or a laundry basket of records. There is little sympathy on the part of bankruptcy courts for the notion that parties objecting to discharge should be put to the task of reconstructing the poorly documented financial condition of one seeking a bankruptcy discharge. Neither trustee nor creditors should be required to engage in laborious tug-of-war to drag the simple truth in to the glare of daylight.[51] The debtor has the affirmative duty to surrender to the trustee all information relating to the property of the estate, and is also obligated to cooperate with the trustee by, among other things, providing the trustee with all relevant documents and papers.[52] The federal courts have consistently interpreted this duty to mean, in part, that a debtor

[49] Robertson v. Dennis (In re Dennis), 330 F.3d 696, 703 (5th Cir. 2003).
[50] In re Cox, 904 F.2d at 1404, n.5.
[51] In re Tully, 818 F.2d at 110.
[52] In re Ridley, 115 B.R. at 736 (citing Broad National Bank v. Kadison, 26 B.R. 1015 (D. N.J. 1983)).

will not be entitled to a discharge in bankruptcy if he intentionally withholds records, books, documents, or other papers relating to the debtor's property or financial affairs.[53]

D. FALSE OATHS, FALSE CLAIMS, OR WITHOLDING - SECTION 727(a)(4))

11 U.S.C §727(a)(4)(A) provides that a debtor is not entitled to a discharge where she **"knowingly and fraudulently** in, or in connection with the case made a false oath or account."

Statements under oath include statements in the schedules and testimony during the course of the proceedings.[54] A false oath may involve a false statement or omission in the debtor's schedules.[55] The undervaluation of assets on the schedules may be a false oath.[56] To deny a discharge under section 727(a)(4)(A), the statute necessitates no more than "an intentional untruth in matter material to an issue which is itself material."[57]

Knowingly means deliberately and consciously.[58] "Careless and reckless" is a lower standard.[59] The Roberts court specifically declined to decide whether or not "a reckless disregard of both the serious nature of the information sought and the necessary

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[53] Id.
[54] Collier § 727.04[1][c], (citing In re Chalik, 748 F.2d 616 (11th Cir. 1984)).
[55] Matter of Beaubouef, 966 F.2d at 174; *see also*, Smith v. Grondin (In re Grondin), 232 B.R. 274, 276 (B.A.P. 1st Cir. 1999), In re Wills, 243 B.R. 58, 62 (B.A.P. 9th Cir. 1999).
[56] In re Weiner, 208 B.R. 69, 72 (B.A.P. 9th Cir. 1997), *rev'd on other grounds*, 161 F.3d 1216 (9th Cir. 1998).
[57] In re Tully, 818 F.2d at 112 (citing Troeder v. Lorsch, 150 F. 710, 713 (1st Cir. 1906)); *see also* In re Sherman, 67 F.3d 1348, 1354 (8th Cir. 1995) (while direct proof of fraudulent intent is often difficult to establish, courts frequently infer it from the debtor's course of conduct. In particular, courts are generally drawn to 'badges of fraud,' i.e. instances of conduct that typically suggest fraud . . . The confluence of several ['badges of fraud'] can constitute conclusive evidence of an actual intent to defraud, absent 'significantly clear' evidence of a legitimate supervening purpose.").
[58] In re Roberts, 331 B.R. 876, 883 (B.A.P. 9th Cir. 2005).
[59] Id. at 884; *see, e.g.*, In re Mondore, 326 B.R. 214, 217 (Bankr. W.D. N.Y. 2005).

attention to detail and accuracy in answering may rise to the level of fraudulent intent necessary to bar a discharge . . . ."[60]

Intent may be established by circumstantial evidence or by inferences from the debtor's behavior.[61]

False oaths that rise to the level of "knowingly and fraudulently" include: "(1) a false statement or omission in the debtor's schedules or (2) a false statement by the debtor at an examination during the course of the proceedings."[62]

The subject of a false oath is material if it bears a relationship to a bankrupt's business transactions or estate, or concerns discovery of assets, business dealings, or the existence and disposition of property.[63]

False statements can be material even if they don't cause direct financial prejudice to creditors if they aid in an understanding of the debtor's financial affairs and transactions.[64]

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[60] In re Roberts, 331 B.R. at 884, n.4; *but see* In re Quinones Rivera 184 B.R. 178, 185 (D. P.R. 1995) (Behavior exhibiting a reckless indifference to the truth is equivalent to fraud for purposes of 727(a)(4)).

[61] In re Roco Corp., 701 F.2d 978, 984-85 (1st Cir. 1983) (circumstantial evidence may establish fraudulent intent); In re Devers, 759 F.2d at 753-54 ("Intent may be proven by circumstantial evidence.").

[62] In re Beaubouef, 966 F.2d at 178; *see also* In re Chalik, 748 F.2d at 618 n.3 ("A material omission from a debtor's sworn statement of affairs or schedules presents grounds for denying a discharge under 11 U.S.C § 727(a)(4)(A)"); In re Scimeca v. Umanoff, 169 B.R. 536, 543 (D. N.J. 1993) ("The debtor's failure to reveal the existence or recent existence of a business would prevent creditors from having the opportunity to investigate the debtor's financial condition. Accordingly, such a failure would be a material false oath justifying denial of discharge under section 727 (a)(4)(A)."); In re Coombs, 193 B.R. 557, 565 (Bankr. S.D. Cal. 1996) ("Multiple omissions of material assets or information may well support an inference of fraud if the nature of the assets or transactions suggests that the debtor was aware of them at the time of preparing the schedules and that there was something about the assets or transactions which, because of their size or nature, a debtor might want to conceal."); In re Ingle, 70 B.R. 979, 983 (Bankr. E.D.N.C. 1987) (failure to list assets on bankruptcy schedules is a fraudulent false oath).

[63] In re Bourgess, 955 F.2d 134, 137 (1st Cir. 1992) (quoting In re Chalik, 748 F.2d at 618 ("[t]he recalcitrant debtor may not escape a section 727(a)(4)(A) denial of a discharge by asserting that he admittedly omitted or falsely stated information concerned a worthless business relationship or holding; such a defense is specious. It makes no difference that he does not intend to injure creditors when he makes a false statement. Creditors are entitled to judge for themselves what will benefit, and what will prejudice, them. The veracity of the bankrupt's statements is essential to the successful administration of the Bankruptcy Act.")).

Use of a false social security number or omission of a valid social security number is material.[65]

Under § 727(a)(4)(D), all books and records which are material to the proper understanding of the debtor's financial condition and recent business transactions are within its scope. Thus, when the debtor fails to provide records which are necessary for the trustee to properly understand debtor's financial condition and recent business transactions, the discharge will be denied.[66]

E. FAILURE TO EXPLAIN LOSS OF ASSETS – SECTION 727(a)(5)

11 U.S.C. § 727(a)(5) states that a debtor should be denied a discharge where she "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." This section is broadly drawn and confers broad power to the court to deny discharge when the debtor does not adequately explain a shortage, loss, or disappearance of assets.[67]

"The debtor's explanation of the loss of assets must consist of more than a vague, indefinite, and uncorroborated hodge-podge of financial transactions."[68] The debtor will be required to produce some kind of direct, specific evidence in order to defeat an objection based upon a failure to explain loss of assets.[69] "Discharge will be denied where the debtor makes only vague evidentiary showing that the missing assets involved

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[64] In re Wills, 243 B.R. 58, 63 (B.A.P. 9th Cir. 1999); s*ee also* In re Weiner, 208 B.R. at 72; In re Chalik, 748 F.2d at 618; In re Guadarrama, 284 B.R. 463, 473 (C.D. Cal. 2002); In re Hoblitzell, 223 B.R. 211, 215-16 (Bankr. E.D. Cal. 1998); In re Ford, 159 B.R. 590, 593 (Bankr. D. Ore. 1993); In re Haverland, 150 B.R. 768, 771 (Bankr. S.D. Cal. 1993).

[65] In re Guadarrama, 284 B.R. at 463; United States v. Phillips, 606 F.2d 884, 887 (9th Cir. 1979); *see also* United States v. Gellene, 182 F.3d 578, 588 (7th Cir. 1999); In re Minetos, 248 B.R. 729, 731 (Bankr. S.D.N.Y. 2000).

[66] In re Ridley, 115 B.R. at 738.

[67] First Federated Life Insurance v. Martin (In re Martin), 698 F.2d 883, 886 (7th Cir. 1983).

[68] In re Gagnon, 40 B.R. 951, 952 (Bankr. D. Me. 1984); *see also* In re Ridley, 115 B.R. at 737 (citing Baum v. Earl Millikin, Inc., 359 F.2d 811 (7th Cir. 1996)).

[69] In re Ridley, 115 B.R. at 737 (citations omitted).

have been used to pay unspecified creditors, or where the debtor fails to provide corroborative documentary evidence to confirm his explanation."[70]

F. DISCHAGE REVOCATIONS – SECTIONS 727(d)(1) and (d)(2)

There are two alternate causes of action by which a party may seek revocation of a discharge previously granted.[71]

1. ELEMENTS OF SECTION §727 (d) (1)

There are three elements of a cause of action to revoke a discharge under 11 U.S.C. §727(d)(1).[72] The first element is that the debtor has committed a fraud. The intentional failure to schedule an estate asset is an example of "fraud." In Gillis, the bankruptcy court found that the debtor intentionally made false statements at the § 341 meeting, where she testified that she was unsure of the status of an insurance claim; when, at the same time, the debtor had retained her own adjuster and was in the process of collecting funds. The bankruptcy court construed the debtor's testimony as intentionally false, designed to mislead and hinder the Trustee from investigating the claim further.[73]

The second element of an action under section 727(d)(1) is that the creditor possessed no knowledge of the debtor's fraud prior to the granting of the discharge.

The third element is that the fraud, if known, would have resulted in denial of discharge under § 727(a). Again, in Gillis, the fraud, if known, would have resulted in the denial of a discharge under § 727(a)(4). Presumably fraud under § 727(a)(2) would also suffice. The bankruptcy appellate panel concluded in Gillis that the debtor's failure

[70] In re Ridley, 115 B.R. at 737-738.
[71] 11 U.S.C. §§ 727(d)(1) and (d)(2).
[72] Yules v. Gillis (In re Gillis), 403 B.R. 137 (B.A.P. 1st Cir. 2009).
[73] Id., at 145.

to accurately describe the nature and status of an insurance claim in her schedules and at her § 341 meeting amounted to a knowing and fraudulent false oath.

2. ELEMENTS OF §727(d)(2)

An action under subsection (d)(2) requires proof that: (a) the debtor acquired property of the estate; and (b) the debtor knowingly and fraudulently failed to report or deliver that property to the trustee.[74] In Gillis, the debtor did not dispute receipt, post-petition, of settlement proceeds, that the proceeds were property of the estate, and that she failed to inform the Trustee of the existence and receipt of the funds.[75] The debtor, instead, maintained that she was unaware of her obligation to notify the Trustee of the receipt of the funds. The bankruptcy appellate panel found that it was "entirely reasonable" to charge the debtor with knowledge of her misconduct, based upon the content of her schedules, her attempts to evade questions posed at the § 341 meeting and her false testimony at a deposition.[76]

[74] 11 U.S.C. § 727(d)(2).
[75] In re Gillis, 403 B.R. at 146.
[76] *Accord* Appeal of Daniel J. Yonikus, 974 F.2d 901 (7th Cir. 1992).

AN OVERVIEW OF DISCHARGE DENIALS UNDER 11 U.S.C § 523

I. INTRODUCTION

11 U.S.C. § 523(a) provides that at least 19 different kinds of liabilities are non-dischargeable in bankruptcy proceedings.[77] The kinds of non-dischargeable liabilities vary from the extremely general,[78] to the extremely specific.[79] One of the first steps for any bankruptcy practitioner considering an adversary proceeding will be to carefully review § 523 in its entirety, along with its historical background and statutory notes as needed.

"Normally, exceptions to discharge [are to] be narrowly construed against the creditor and liberally against the debtor, thus effectuating the fresh start policy of the Code."[80] "However, the Bankruptcy Code has long prohibited debtors from discharging liabilities incurred on account of their fraud, embodying a basic policy animating the Code of affording relief only to an 'honest but unfortunate debtor.'"[81]

[77] 11 U.S.C. § 523(a)(1)-(19).
[78] 11 U.S.C. § 523(a)(2)(A) (holding non-dischargeable "any debt . . . to the extent obtained by – false pretenses, a false representation, or actual fraud . . .").
[79] 11 U.S.C. § 523(a)(16) (holding non-dischargeable "any debt . . . for a fee or assessment that becomes due and payable after the order for relief to a membership association with respect to the debtor's interest in a unit that has condominium ownership, in a share of a cooperative corporation, or a lot in a homeowners association, for as long as the debtor or the trustee has a legal, equitable, or possessory ownership interest in such unit, such corporation, or such lot . . .").
[80] Merchants National Bank of Winona v. Moen (In re Moen), 238 B.R. 785, 790 (B.A.P. 8th Cir. 1999) (citation omitted).
[81] Cohen v. de la Cruz, 523 U.S. 213, 118 S.Ct. 1212, 1216, 140 L.Ed.2d 341 (1998).

II. A BIGGER TOOLBOX – THE MOST USEFUL ARGUMENTS FOR FRAUD NON-DISCHARGEABILITY UNDER § 523(a)

Because more general non-dischargeability provisions will be applicable to a larger group of practitioners in adversary bankruptcy proceedings, this section focuses on the broader portions of § 523(a).

A. DEBTS OBTAINED BY FALSE PRETENSES AND FALSE REPRESENTATIONS – SECTION 523(a)(2), Parts 1 and 2

11 U.S.C. § 523(a)(2) states that a discharge of a debtor does not affect a debt:

> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by—
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
> (B) use of a statement in writing— (i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and (iv) that the debtor caused to be made or published with intent to deceive . . . .[82]

To prevail under § 523(a)(2)(A) a creditor must prove a false pretense, misrepresentation, or actual fraud by a preponderance of the evidence.[83] A claim of false pretense or misrepresentation consists of the following elements:

> (1) That the debtor made a representation; (2) that at the time the debtor knew the representation was false; (3) that the debtor made the representation deliberately and intentionally with the intention and purpose of deceiving the creditor; (4) that the creditor justifiably relied on such representation; and (5) that the creditor sustained the alleged loss and damage as the proximate result of the representation having been made.[84]

"[W]hen the circumstances imply a particular set of facts, and one party knows the facts to be otherwise, that party may have a duty to correct what would otherwise be a

[82] 11 U.S.C. § 523(a)(2)(A)-(B).
[83] Grogan v. Garner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 75 (1991).
[84] Merchants, 238 B.R. at 790; In re Ophaug, 827 F.2d 340 (8th Cir. 1987), as supplemented by Field v. Mans, 516 U.S. 59, 116 S.Ct. 437, 133 L.Ed.2d 351 (1995).

false impression."[85] "A debtor's silence regarding a material fact may constitute a false representation actionable under section 523(a)(2)(A)."[86] "A 'misrepresentation' denotes not only words spoken or written but also any other conduct that amounts to an assertion not in accordance with the truth."[87] "While it is certainly not practicable to require the debtor to 'bare his soul' before the creditor, the creditor has the right to know those facts touching upon the essence of the transaction."[88]

"In assessing a debtor's knowledge of the falsity of the representation . . . the Court must consider the knowledge and experience of the debtor."[89] "A false representation made under circumstances where a debtor should have known of the falsity is one made with reckless disregard for the truth, and this satisfies the knowledge requirement."[90] "The intent element of § 523(a)(2)(A) does not require a finding of malevolence or personal ill-will; all it requires is a showing of an intent to induce the creditor to rely and act on the misrepresentations in question."[91] "Because direct proof of intent (i.e., the debtor's state of mind) is nearly impossible to obtain, the creditor may present evidence of the surrounding circumstances from which intent may be inferred."[92] "Intent to deceive will be inferred where a debtor makes a false representation and the debtor knows or should know that the statement will induce another to act."[93]

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[85] Merchants, 238 B.R. at 791; In re Malcolm, 145 B.R. 259, 263 (Bankr. N.D. Ill. 1992).
[86] Id. at 791; In re Van Horne, 823 F.2d 1285, 1287-88 (8th Cir. 1987).
[87] Id.; In re Melancon, 223 B.R. 300, 308-09 (Bankr. M.D. La. 1998).
[88] Id.; Van Horne, 823 F.2d at 1288.
[89] Id.; In re Duggan, 169 B.R. 318, 324 (Bankr. E.D.N.Y. 1994)
[90] Id.
[91] Id.; In re Swan, 156 B.R. 618, 623 n.6 (Bankr. D. Minn. 1993) (citing In re Hunter, 771 F.2d 1126, 1129 (8th Cir.1985)).
[92] Id.; Van Horne, 823 F.2d at 1287.
[93] Id.; Duggan, 169 B.R. at 324.

B. DEBTS OBTAINED BY ACTUAL FRAUD – SECTION 523(a)(2)(A), PART 3 AND HUSKY INTERNATIONAL V. RITZ

Actual fraud under 11 U.S.C. §523(a)(2) is construed somewhat differently than false pretenses or misrepresentation:

> Actual fraud, by definition, consists of any deceit, artifice, trick or design involving direct and active operation of the mind, used to circumvent and cheat another--something said, done or omitted with the design of perpetrating what is known to be a cheat or deception.[94]

Though the prior definition and usage of "actual fraud" was somewhat vague, it was significantly clarified and expanded in 2016 by the U.S. Supreme Court.[95] The Supreme Court started from the presumption "that Congress did not intend 'actual fraud' to mean the same thing as 'a false representation,'" when it amended § 523 to account for actual fraud in 1978.[96] Looking to the Statute of 13 Elizabeth, the Supreme Court noted that actual fraud has widely been held to include fraudulent conveyances or transfers intended to hinder, delay, and defraud creditors.[97]

"Equally important, the common law also indicates that fraudulent conveyances, although a 'fraud,' do not require a misrepresentation from a debtor to a creditor. As a basic point, fraudulent conveyances are not an inducement-based fraud."[98] "Fraudulent conveyances typically involve a transfer to a close relative, a secret transfer, a transfer of title without transfer of possession, or grossly inadequate consideration."[99] "The fraudulent conduct is not in dishonestly inducing a creditor to extend a debt. It is in the

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[94] Id. at 790 (citing RecoverEdge L.P. v. Pentecost, 44 F.3d 1284, 1293 (5th Cir. 1995) and Collier § 523.08[5]); *see also* In re Stentz, 197 B.R. 966, 981 (Bankr. D. Neb. 1996).
[95] Husky International Electronics, Inc. v. Ritz, 578 U.S. ___ (2016), No. 15-145, *available at* https://www.oyez.org/cases/2015/15-145.
[96] Husky, 578 U.S. ___, slip op. at 3-4.
[97] Id. at slip op. at 5.
[98] Id. at slip op. at 5-6.
[99] Id. at slip op. at 6.

acts of concealment and hindrance. In the fraudulent conveyance context, therefore, the opportunities for a false representation from the debtor to the creditor are limited."[100] In making its observations, the Court rejected the debtor's argument that the clarified definition of "actual fraud" made other portions of § 523(a) duplicative and noted that some amount of overlap was inevitable.[101]

C. RECOVERING ATTORNEY'S FEES IN ADVERSARY ACTIONS – UNCHARTED WATERS FOR NEBRASKA COURTS

The Nebraska Supreme Court has, for many years, maintained that recovery of attorney's fees is governed by the "American rule":

> The "American rule" stands generally for the proposition that "a prevailing party may not also recover an attorney fee from his opponent." *Holt County Co-op.Assn. v. Corkle's, Inc.*, 214 Neb. 762, 767, 336 N.W.2d 312, 315 (1983). The justification for this general rule is that "a defendant should not be unduly influenced from vigorously contesting claims made against him." *Id.* See, also, 20 Am.Jur.2d *Costs* § 55 (2005) (purpose of American rule requiring each party to bear own costs in litigation is to avoid stifling legitimate litigation by threat of specter of burdensome expenses being imposed on unsuccessful party).
>
> There are exceptions to the American rule, and these exceptions vary from state to state. All states create **an exception to the general rule in cases where the legislature has expressly allocated those fees to the winning party**. Most jurisdictions, including Nebraska, also have **an exception to the American rule where attorney fees are granted pursuant to the court's inherent authority to do all things necessary for the proper administration of justice and *equity* within the scope of their jurisdiction**. See, *Holt County Co-op Assn., supra; Mangiante v. Niemiec*, 98 Conn.App. 567, 910 A.2d 235 (2006). (Emphasis added.)
>
> **Many jurisdictions have also created an exception where the attorney fees are provided for through contractual agreement. This court, however, has repeatedly held that in the absence of a uniform course of procedure or authorization by statute, contractual agreements for attorney fees are against public policy and will not be judicially enforced.** See, *Parkert v. Lindquist*, 269 Neb. 394, 693 N.W.2d

[100] Id.
[101] Id. at slip op. at 7-8.

> 529 (2005); *Nebraska Nutrients v. Shepherd*,261 Neb. 723, 626 N.W.2d 472 (2001); *GFH Financial Serv. Corp. v. Kirk*, 231 Neb. 557, 437 N.W.2d 453 (1989); *First Nat. Bank v. Schroeder*,218 Neb. 397, 355 N.W.2d 780 (1984); *Quinn v. Godfather's Investments*, 217 Neb. 441, 348 N.W.2d 893 (1984); *City of Gering v. Smith Co.*,215 Neb. 174, 337 N.W.2d 747 (1983).[102]

Said another way, Nebraska courts generally will not award attorney's fees unless authorized to do so by custom or statute, regardless of a contractual provision to the contrary.[103]

The Eighth Circuit Court of Appeals has ruled that attorney's fees provided by contract, and otherwise allowed by state law, can become part of the non-dischargeable debt under section 523(a)(2)(A).[104] Without such a rule, a debtor in certain situations would be permitted "to discharge any liability for losses caused by his fraud in excess of the amount he initially received, leaving the creditor[s] far short of being made whole."[105] This means that, in certain circumstances, where otherwise allowed, a creditor may be permitted to recover its attorney's fees in seeking a judgment of non-dischargeability.[106]

It remains unclear whether or under what circumstances Nebraska creditors are entitled to recover attorney's fees given the hard line position on such recovery taken in Nebraska. Though the Eight Circuit permits recovery of attorney's fees in an adversary bankruptcy proceeding if lawfully provided for by contract, it is doubtful that Nebraska courts would enforce a contractual provision allowing for recovery of attorney's fees

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[102] Stewart v. Bennet, 273 Neb. 17, 21-2, 727 N.W.2d 424, 429 (2006) (emphasis added).
[103] *See* Parkert v. Lindquist, 269 Neb. 394 (2005).
[104] In re Alport, 144 F.3d 1163, 1168 (8th Cir. 1998); In re Hunter, 771 F.2d 1126, 1131 (8th Cir. 1985); *see also* Cohen, 523 U.S. 213, 118 S.Ct. 1212, 140 L.Ed.2d 341 (1998) (affirming lower court's ruling that non-dischargeability judgment included non-dischargeability of punitive damages, attorney's fees, costs, and other relief that may exceed the value obtained by a debtor).
[105] Merchants, 238 B.R. at 795; Cohen, 118 S.Ct. at 1216, 1218.
[106] *See also* In re Kirk, 525 B.R. 325 (Bankr. W.D.Tex. 2015) ("Since the Bankruptcy Code does not address whether creditors can recover attorney's fees in non-dischargeability cases, they can do so only if allowed by another statute or by contract.").

without more. On the other hand, because Nebraska courts may reserve the right to award attorney's fees "pursuant to the court's inherent authority to do all things necessary for the proper administration of justice and equity within the scope of their jurisdiction," it may still be possible for a creditor to recover attorney's fees in limited circumstances.[107] One example may be a court's award of sanctions against an uncooperative debtor who continually disrupts the bankruptcy proceedings and conceals information or assets.

When it comes to a debtor's recovery of attorney's fees, 11 U.S.C. § 523(d) provides:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court **shall** grant judgment in favor of the debtor **for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified**, except that the court shall not award such costs and fees if special circumstances would make the award unjust.[108]

The U.S. Supreme Court has defined "substantially justified" as "justified in substance or in the main-that is, justified to a degree that could satisfy a reasonable person."[109] Based on this language, substantial justification is an objective test based on an analysis of reasonableness.

If a creditor is to be taxed with the debtor's defense costs and attorney's fees in a § 523(a)(2) case, five elements must exist:

> (1) The creditor filed a non-dischargeability action under § 523(a)(2);
> (2) The obligation must concern a consumer debt;
> (3) The obligation must be found to be dischargeable;
> (4) The complaint must not have been substantially justified; and

[107] Stewart, 273 Neb. at 21-2, 727 N.W.2d at 429.
[108] 11 U.S.C. § 523(d) (emphasis added).
[109] Pierce v. Underwood, 487 U.S. 552, 565, 108 S.Ct. 2541, 101 L.Ed.2d 490 (1988).

> (5) The bankruptcy court must be satisfied that there are no special or unique circumstances, which would make the imposition of costs and attorneys' fees unjust.[110]

"The purpose of §523(d) is to discourage creditors from initiating meritless § 523(a)(2) actions in the hope of obtaining a settlement from an honest debtor anxious to save attorney's fees."[111] "The debtor has the burden of proving the first three elements. The creditor must then demonstrate that the action was 'substantially justified' or that the 'special circumstances' exception applies."[112] "The substantially justified requirement applies both to the filing of the § 523(a)(2) complaint and to its prosecution."[113] "If at any point in the prosecution of a plaintiff's case, that case fails to be substantially justified, the plaintiff is subject to Section 523(d) sanctions."[114]

Courts have awarded sanctions, including attorney's fees, to a debtor under § 523(d) where a creditor failed to attend the debtor's § 341 meeting, failed to conduct a Rule 2004 examination, and failed to investigate its allegations of fraud after filing its adversary action.[115] The Flowers court indicated that the creditor might have avoided sanctions by conducting "some kind of pre-filing investigation to determine whether there was evidence to support fraud . . . ."[116] Other cases have reached similar outcomes regarding sanctions, indicating that creditors are encouraged to attend a § 341 meeting, conduct a Rule 2004 examination, or utilize other discovery methods to gather sufficient

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[110] In re Pusteri, 432 B.R. 181, 197 (Bankr. W.D.N.C. 2010); First Deposit Nat'l Bank v. Stahl (In re Stahl), 222 B.R. 497, 504 (Bankr. W.D.N.C. 1998); *see also* FCC Nat. Bank v. Dobbins, 151 B.R. 509, 511 (Bankr. W.D. Mo. 2001).
[111] Pusteri, 432 B.R. at 197 (citing H.R.Rep. No. 595, 95th Cong., 1st Sess. 365 (1977); S.Rep. No. 989, 95th Cong., 2d Sess. 80 (1978) U.S. Code Cong. & Admin. News 1978, pp. 5787, 5865, 5963, 6320).
[112] Id.
[113] Id.
[114] Id.
[115] FIA Card Services, N.A. v. Flowers, (In re Flowers), 391 B.R. 178, 180 (M.D.Ala. 2008).
[116] Flowers, 391 B.R. at 18.

facts to support allegations in adversary proceedings.[117] Thus, creditors should be wary of filing adversary bankruptcy proceedings without planning to conduct significant and meaningful factual investigations.

A VIEW FROM THE BENCH: HOW TO LOSE YOUR CASE WITHOUT REALLY TRYING

Comments from Judge Thomas Saladino, bankruptcy Judge for the U.S. Bankruptcy Court for the District of Nebraska.

[117] S*ee* Bridgewater Credit Union v. McCarthy (In re McCarthy), 243 B.R. 203, 209 (B.A.P. 1st Cir. 2000) ("The plaintiff must show that it reviewed its legal position before filing suit to determine if it is substantially justified."); *see also* In re Poirier, 214 B.R. 53 (Bankr. D. Conn. 1997) (awarding sanctions against a creditor under § 523(d) where the creditor alleging non-dischargeability failed to conduct a Rule 2004 examination or depositions of debtors who used balance transfer checks to pay certain creditors).

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