UNITED STATES BANKRUPTCY COURT
DISTRICT OF NEW HAMPSHIRE

In re: Bk. No. 99-12517-JMD
Chapter 7

Charles Kalantzis,
Debtor

J. Christopher Marshall, U.S. Trustee,
Katherine Porter, and
Kristen Bowman,
(Substituted) Plaintiffs

v. Adv. No. 99-1173-JMD

Charles Kalantzis,
Defendant

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MEMORANDUM OPINION AND ORDER

I. INTRODUCTION

On June 8, 2000, the Court commenced the trial in this adversary proceeding brought by Absolute Financial Services, Inc. (the "Original Plaintiff") seeking to deny Charles Kalantzis (the "Debtor") a discharge pursuant to 11 U.S.C. §§ 727(a)(2), (a)(3), (a)(4)(A), and (a)(5). After the close of the Original Plaintiff's case, the trial was recessed for lunch. When the trial resumed after lunch, the parties informed the Court that they had reached a settlement agreement during the lunch recess. Accordingly, the Court suspended the trial to permit the parties to reduce their agreement to writing and seek approval of the settlement. The United States Trustee and creditors Kristen Bowman and Katherine

Porter objected to the settlement. On August 21, 2000, after notice and a hearing, the Court found that the settlement was not fair and equitable or in the best interests of the estate and denied approval. See Memorandum Opinion dated August 21, 2000 (Doc. No. 25). On August 30, 2000, the Debtor filed a motion to approve an amended settlement agreement between the Original Plaintiff and the Debtor. See Doc. No. 27. The same parties objected to approval of the amended settlement and moved to be substituted as plaintiffs in this adversary proceeding. At the hearing on the amended settlement agreement, the Debtor withdrew the settlement offer, the Original Plaintiff indicated that it no longer wished to pursue its complaint, and the Court granted the motion of the United States Trustee, Kristen Bowman, and Katherine Porter (the "Substituted Plaintiffs") to be substituted as plaintiffs in place of the Original Plaintiff. See Order dated October 5, 2000 (Doc. No. 42). The trial resumed on January 16, 2001 and the Court heard closing arguments.[1] Any reference to "Plaintiffs" in this opinion refers collectively to the evidence presented and statements made by the Original Plaintiff and/or the Substituted Plaintiffs.

This Court has jurisdiction of the subject matter and the parties pursuant to 28 U.S.C. §§ 1334 and 157(a) and the "Standing Order of Referral of Title 11 Proceedings to the United States Bankruptcy Court for the District of New Hampshire," dated January 18, 1994 (DiClerico, C.J.). This is a core proceeding in accordance with 28 U.S.C. § 157(b).

II. FACTS

The Plaintiffs claim the Debtor's discharge should be denied pursuant to 11 U.S.C. §§ 727(a)(2), (a)(3), (a)(4)(A), and (a)(5). At trial, the Debtor testified that prior to February of 1998 he had operated a business called "Tan Lines" as a sole proprietorship. The Debtor testified that in February of 1998 he incorporated the business under the name of Ching Ching Corporation (the "Corporation"). The testimony

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[1] Other than documents admitted into evidence as exhibits by agreement of the parties, the Defendant waived his right to put on a case and, therefore, all testimonial evidence was presented during the Plaintiffs' case. Accordingly, any reference to direct examination refers to questioning by the Plaintiffs and any reference to cross-examination refers to questioning by the Debtor.

of Pamela Sue Fielder ("Fielder") and the Debtor was that in October of 1998 Fielder loaned the Debtor $33,000.00 for use in the Corporation. The loan called for repayment in the amount of $45,000.00 and contained a default clause requiring the parties to keep the loan confidential or be declared in default. See Exhibit 3. Both Fielder and the Debtor further testified that in December of 1998 the Debtor transferred all of his interest in the Corporation to Fielder,[2] as the Debtor feared he would be unable to repay Fielder. While no stock certificate was produced during the trial, and Fielder testified that none was ever received, a so called stock subscription agreement (the "Agreement") was entered into evidence. See Exhibit 102. The Agreement, drawn up without the aid of an attorney, was undated and showed the transfer of the Debtor's interest in the Corporation to Fielder. Both Fielder and the Debtor testified that the Agreement was signed in December of 1998. When asked on direct examination about the current status of the loan, Fielder testified that it was being paid back weekly and that approximately $11,000.00 to $12,000.00 had been repaid. However, on cross-examination, when asked if the $11,000.00 to $12,000.00 represented her share of profits rather than repayment of the loan, Fielder responded affirmatively, thereby changing her previous testimony.

As for the day-to-day running of the Corporation after the Agreement was signed, both the Debtor and Fielder testified that the Debtor was in charge of the day-to-day running of the Corporation, including the writing of checks. Further testimony revealed that Fielder stopped in weekly, or on an as needed basis, to sign checks the Debtor had written, as the Debtor had no authority to sign checks for the Corporation after the Agreement was signed. The checks were written on an account Fielder had opened up in the name of Pam Fielder d/b/a Tan Lines.

When questioned about the use of the $33,000.00 he had received from Fielder, the Debtor testified that he had used the money to pay bills. The Debtor claimed he kept the money at home and had used it primarily to pay expenses of the Corporation, including over $20,000.00 in rental payments to the

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[2] The Debtor testified that at the time of the transfer to Fielder he was the owner of 75% of the issued and outstanding shares of the Corporation.

Corporation's landlord. The Debtor testified that due to past credit problems he was often required to pay the Corporation's bills in cash. The Debtor's testimony was supported by a representative of the landlord, Kimberly Soucy ("Soucy'), who testified that the Debtor had been required to pay by cashier's check, money order, or in cash, sometimes on a weekly basis, due to previous bad checks received from the Debtor.[3]

The Debtor filed his Chapter 7 petition on August 9, 1999. In response to the section 727(a)(3) claim regarding the lack of business records, the Debtor's testimony was that in February of 2000 there had been a robbery at the Corporation's business premises during which the contents of the safe were stolen. The Debtor testified that the robbery had been reported to the police. According to the Debtor's testimony, all of the business records, including such items as the annual meeting minutes, daily receipts, and W-2 forms were kept in the safe. The Debtor further testified that an accountant had been hired to attempt a recreation of the records, but the task had not yet been completed.

When specifically questioned about the financial health of the Corporation, the Debtor testified that the business had not been doing well. The Court notes that this seemed to be an indirect explanation as to why the Debtor was personally paying the Corporation's rent. When later asked how Fielder could have been paying herself profits when the business was not doing well, the Debtor stated that he did not know what Fielder was doing with regards to profits as Fielder wrote those checks herself.

III. DISCUSSION

A. Section 727(a)(2) Claim.

Section 727(a)(2) provides that:

> The court shall grant the debtor a discharge, unless —

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[3] The testimony was not clear on whether the checks were the Debtor's checks, the Corporation's checks, or some combination thereof.

> . . . 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 –
>
> (A) property of the debtor, within one year before the date of the filing of the petition; or
>
> (B) property of the estate, after the date of the filing of the petition.

At trial, the Debtor readily admitted that he had transferred his shares in the Corporation to Fielder within one year of filing his bankruptcy petition. Therefore, the only disputed issue is whether the shares were transferred with the intent to hinder, delay, or defraud creditors.

The Plaintiffs argue that the transfer was done to protect the Debtor's ownership interest from creditors that were quickly closing in on the Debtor. The Plaintiffs point out that the Original Plaintiff was breathing down the Debtor's neck and the Debtor was facing a trial in the spring regarding debts owed to other creditors.[4] The Plaintiffs claim the transfer was really a sham in that Fielder was just a straw person who made no real business decisions and did not exercise any control or decision making authority over the company. The Plaintiffs contend that the evidence shows that although Fiedler kept the Corporation's funds in a bank account under her name, she simply signed whatever checks the Debtor made out for her signature. Further, the Plaintiffs point out that the evidence showed that the Debtor was personally paying the bills of the Corporation, such as the rent, in cash which apparently was not deposited in the account maintained by Fielder. The Plaintiffs argue that the evidence demonstrates that the Debtor was still in de facto control of the Corporation.

Turning to the documents, the Plaintiffs point to the undated stock subscription, the lack of stock certificates evidencing the transfer, Fielder's inconsistent testimony regarding the payment of $11,000.00 to $12,000.00 to her by the Corporation, and the requirement that Fielder's ownership was to be kept secret, as evidence of the true nature of the transfer. The Plaintiffs claim these facts show that the Debtor did not intend to transfer his interest in the business, but instead intended to hinder, delay, and defraud his creditors

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[4] The Original Plaintiff had a judgment against the Debtor, and a writ of execution in the amount of $47,531.50 was issued by Hillsborough County Superior Court on April 22, 1999. <u>See</u> Exhibit 1.

by concealing his ownership of the company. According to the Plaintiffs, had the issue of corporate ownership not been pressed in the bankruptcy court, the Debtor would simply have paid off the loan to Fielder and gone on his way as the owner of the company.

The Plaintiffs claim that Fielder was not a sophisticated business person, did not realize what was going on, and was simply being used as a straw person until the debt to her was paid off by the Debtor. As further evidence of the use of Fielder, the Plaintiffs point to Fielder's testimony that the so called profits she received were not reported to the Internal Revenue Service ("IRS") on a form W-2 or form 1099. The Plaintiffs claim the failure to report such payments to the IRS indicates that the money was really repayment of a loan rather than income to Fielder. Finally, the Plaintiffs point to the secrecy clause contained in the Agreement as evidence of the Debtor's intent to use Fielder to defraud creditors.

While the Court finds the inferences drawn by the Plaintiffs to be persuasive, the Court finds that equally persuasive inferences can be drawn in favor of the Debtor. According to the Debtor, the Corporation was set up without the aid of an attorney and was done instead by following the directions in a do-it-yourself book purchased at an office supply store. Therefore, the lack of stock certificates would not necessarily be all that unusual where parties were attempting to construct agreements on their own. As to the inconsistent testimony of Fielder, the Plaintiffs admitted that she is not a sophisticated business person and the Court can therefore infer that she did not really know the difference between receiving money as repayment of the loan and receiving money in the form of profits. Further, while it would appear that the Debtor was running the Corporation, the Court does not find anything unusual about hiring a manager with experience in the industry to run a company when the owner has no experience in running a business in such an industry. Lastly, there is the testimony of Fielder that the $11,000.00 to $12,000.00 dollars she received in the form of profits was not reported to the IRS on a form W-2 or form 1099. While this factor may be an indication that the parties really viewed the transaction as a loan, it could also be evidence of confusion by Fielder as an unsophisticated business person or the fact that the Corporation lacked an accountant.

As for the requirement that the Agreement be kept a secret, the Court notes that the Plaintiffs appear to be confused about the evidence on the matter. According to the evidence at trial, it was only the loan from Fielder, signed in October of 1998, that had a confidentiality requirement. See Exhibit 3. The Agreement, relating to the transfer of the shares, contains no clause requiring that the stock subscription be kept confidential. See Exhibit 102. The Court finds nothing unusual about requiring a loan agreement to be kept confidential. There may be legitimate reasons for keeping such a loan confidential, including such things as keeping customers from knowing the distressed situation of the business.

In order to prevail under section 727(a)(2) the Plaintiffs must show by a preponderance of the evidence that all of the elements of the section have been met. See Rhode Island Depositors Econ. Prot. Corp. v. Hayes (In re Hayes), 229 B.R. 253, 259 (B.A.P. 1st Cir. 1999) (citations omitted). In this particular case, there are two *equally* plausible inferences that can be drawn from the evidence presented at trial. Therefore, the Court finds that the Plaintiffs have failed to meet their burden of proof with regards to their section 727(a)(2) claim.

B. Section 727(a)(3) Claim.

Pursuant to section 727(a)(3):

> The court shall grant the debtor a discharge, unless —
> . . . 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.

At trial, the only evidence presented with regards to this particular claim was the testimony of the Debtor. The Debtor testified that in February of 2000 there had been a robbery at the Corporation and all of the business records kept in the safe at that location had been stolen. No contrary evidence was presented by the Plaintiffs.

As was stated by the Court while discussing the Defendant's motion for clarification on January 16, 2001, there appear to be two problems with the section 727(a)(3) claim. First, the books and records that

are the center of the Plaintiffs' complaint are not the books and records of the Debtor, but are the books and records of a corporation that is not a debtor before this Court. The statute requires the Debtor to keep books and records from which his financial condition can be determined. The Court fails to see how the books and records of a corporation, in which the Debtor was previously a shareholder, are essential to determining the Debtor's financial condition. Second, there was no evidence presented at trial contradicting the Debtor's claim that all of the business records had been stolen in February of 2000. Accordingly, the Court finds that the Plaintiffs have failed to establish that the Debtor failed to keep records pertaining to his financial condition.

C. Section 727(a)(4)(A) Claim.

Under section 727(a)(4)(A):

> The court shall grant the debtor a discharge, unless —
> . . . the debtor knowingly and fraudulently, in or in connection with the case —
> (A) made a false oath or account.

While the Debtor's schedules were never entered into evidence as an exhibit, during closing arguments the Plaintiffs requested that the Court take judicial notice of the Debtor's schedules filed in the main case. Under the Federal Rules of Evidence the Court may take judicial notice of adjudicative facts not subject to reasonable dispute because they are generally known within the territorial jurisdiction of the court or capable of accurate determination from sources whose accuracy cannot reasonably be questioned. See Fed. R. Bankr. P. 9017; Fed. R. Evid. 201; Calder v. Job (In re Calder), 907 F.2d 953, 955 n.2 (10th Cir. 1990). Accordingly, while the Court can not take judicial notice of the truthfulness of information in the Debtor's schedules, the Court can take notice of the contents of the schedules. See id.; Staten Island Sav. Bank v. Scarpinito (In re Scarpinito), 196 B.R. 257, 267 (Bankr. E.D.N.Y. 1996).

To meet their burden under section 727(a)(4)(A) of the Bankruptcy Code, the Plaintiffs must prove by a preponderance of the evidence that the Debtor knowingly and fraudulently, in or in connection with his case, made a false oath or account relating to a material fact. See, e.g., Grogan v. Garner, 498 B.R. 279,

289 (1991); Desmond v. Varrasso (In re Varrasso), 37 F.3d 760, 764 (1st Cir. 1994); Boroff v. Tully (In re Tully), 818 F.2d 106, 110 (1st Cir. 1987); Smith v. Grondin (In re Grondin), 232 B.R. 274, 276 (B.A.P. 1st Cir. 1999); Riggs v. Cross (In re Cross), 156 B.R. 884, 887 (Bankr. D. R.I. 1993). "Once it reasonably appears that the oath is false, the burden falls on the bankrupt to come forward with evidence that he has not committed the offense charged." Tully, 818 F.2d at 110 (quoting Matter of Mascolo, 505 F.2d 274, 276 (1st Cir. 1974)). A debtor's schedules and statement of financial affairs are unsworn declarations made under penalty of perjury and are the equivalent of a verification under oath. See Grondin, 232 B.R. at 276. A fact is material when it bears a relationship to the debtor's business transactions or concerns the discovery of assets, business dealings, or the existence and disposition of the debtor's property. See Tully, 818 F.2d at 110-11; Grondin, 232 B.R. at 276.

The Courts have held that a debtor's discharge should not be denied under section 727(a)(4)(A) if the false statement or omission is due to mistake or inadvertence or if the mistake is technical and not real. See Gordon v. Mukerjee (In re Mukerjee), 98 B.R. 627, 629 (Bankr. D.N.H. 1989). "A trivial matter which has but little effect upon the estate and the creditors is treated as immaterial." Id. at 629 (quoting Field v. Irving (In re Irving), 27 B.R. 943, 945 (Bankr. E.D.N.Y. 1983) (citations omitted)). A debtor's reckless indifference to the truth, however, has been consistently treated by the courts as the functional equivalent of fraud. See Grondin, 232 B.R. at 277-78 (citations omitted).

Therefore, if a debtor falsely fills out the statement of financial affairs or the schedules, the debtor has made a false oath. In this particular case, in Schedule B, personal property owned by the Debtor, the Debtor listed the shares of stock in the Corporation as being owned by him and claimed an exemption for such shares in Schedule C. In addition, in his statement of financial affairs the Debtor failed to properly answer question 16 in that he did not disclose that within the two years preceding bankruptcy the Debtor had run Tan Lines as a sole proprietorship. Finally, the Debtor listed Fielder as an unsecured creditor in Schedule F with a claim of $40,000.00. Accordingly, the information contained in the Debtor's schedules and statement of financial affairs is not consistent with the testimony of the Debtor and Fielder. During the

trial, the Debtor and Fielder testified that the Debtor had transferred his shares to Fielder in December of 1998 in lieu of his repayment of a $33,000.00 loan to him by her in October of 1998. The Debtor also testified that prior to February of 1998 he had run Tan Lines as a sole proprietorship since 1994 or 1995.

The Plaintiffs contend the these errors and omissions were false, mislead the Trustee on the fact that the Debtor had transferred his seventy-five percent stock interest in the Corporation for $33,000.00 less than one year before the filing of his petition where he listed it as having no value, failed to disclose to the Trustee the duration of his interest in the business, and overstated his unsecured debt. The Plaintiffs argue that the Debtor's schedules reflect that he was trying to protect the Corporation from investigation by the Trustee by hiding his transaction with Fielder. The Debtor contends that these errors and omissions were due to mistake or inadvertence and, in any event, are not material to the Debtor's financial condition.

An isolated error or omission in a bankruptcy schedule, or mere inconsistent entries where one entry is correct and another entry or omission is erroneous, generally reflect inadvertent errors that occasionally occur in the haste of filing a bankruptcy petition. However, the Court can not overlook the fact that in this case the Debtor made a number of errors or omissions in different parts of the Debtor's schedules and statement of affairs which were all consistent with each other and inconsistent with the evidence at trial. The testimony presented at trial was that since December of 1998 (1) all receipts of the Corporation were deposited into a bank account in Fielder's name, (2) that she stopped in one or more times per week during the eight months preceding the filing of the Debtor's schedules and statement of affairs and subsequent to the petition date to sign checks for expenses, as the Debtor had no authority to sign checks for the Corporation, and (3) during this eight month period the Debtor was also paying significant expenses such as rent and electric bills from the proceeds of Fielder's loan which were held by the Debtor in cash at his residence.

The Court finds it hard to believe that the Debtor would have forgotten about the stock transfer when he was reminded on at least a weekly basis, through his inability to write checks, that he no longer owned the Corporation. This is not a case where a debtor made one mistake in completing his schedules.

Based upon the evidence presented at trial, the contents of Debtor's schedules and statement of affairs reflect numerous errors and omissions, all of which are inconsistent with such evidence. A consistent pattern of errors and omissions reflects either a knowing and fraudulent false oath or a reckless indifference to the truth. The Debtor's failure to make the necessary disclosures about his affairs and prepetition transfers impairs the administration of the estate and cannot be condoned. Tully, 818 F.2d at 112 ("The law, fairly read, does not countenance a petitioner's decision to play a recalcitrant game, one where the debtor hides and the trustee is forced to go seek."); Grondin, 232 B.R. at 279 ("A debtor's failure to make necessary disclosures impairs the '[t]rustee's ability to perform his statutorily imposed obligations . . . and . . . cannot be cannot be [condoned].'") (quoting Sullivan v. Tracey (In re Tracey), 76 B.R. 876, 881 (Bankr. D. Mass. 1987)). The Court concludes that the above facts clearly show that the Debtor was attempting to hide from the Trustee his transfer of his shares in the Corporation to Fielder. There were numerous chances for the Debtor to reveal the transfer in his schedules and statement of affairs. His failure to do so at every turn clearly shows the requisite deceit needed to prove fraud and the intent necessary to prove the element of knowingly making a false oath.

The remaining question is whether the false oath was related to a material fact. The Debtor claims his failure to disclose the transfer of the shares in his schedules is immaterial. According to the Debtor, the false oath resulted in more assets, not less, appearing to belong to the bankruptcy estate. The Debtor also argues that he could not have been hiding anything when the Corporation was listed in numerous places in his schedules. The Debtor claims that if he were attempting to hide his involvement in the Corporation he would not have included anything about the Corporation in his schedules. Finally, the Debtor argues that if anything he erred on the side of over-disclosure.

The Court finds that whether or not the Debtor is the owner of the controlling shares of the Corporation is a material fact. Although the Debtor claims the Corporation was not doing well, Fielder took between $11,000.00 and $12,000.00 out of the Corporation as profits between December of 1998 and August of 1999. If the Corporation was in fact profitable, then the Trustee may very well have wanted to

investigate the transfer to Fielder. The Debtor consistently hid from the Trustee a transfer that the Trustee may have wanted to investigate. It is immaterial that the Trustee may have chosen to not pursue the matter. Debtors are required to give full disclosure in their schedules and thus allow the trustees to properly fulfill their duties. The Debtor's failure to disclose the stock transfer was not merely a technical oversight, but was one of a series of omissions which create a pattern demonstrating, at best, the Debtor's reckless disregard for the truth. From such a "pattern of behavior, fraudulent intent may be presumed." Phillips v. Phillips (In re Phillips), 187 B.R. 363, 370 (Bankr. M.D. Fla. 1995). "Neither the trustee nor the creditors should be required to engage in a laborious tug-of-war to drag the simple truth into the glare of daylight." Tully, 818 F.2d at 110. For the above stated reasons, the Court finds that the Plaintiffs have met their burden of proof on the claim under section 727(a)(4) and that the Debtor has failed to come forward with evidence rebutting such proof.

D. Section 727(a)(5) Claim.

Section 727(a)(5) provides that:

> The court shall grant the debtor a discharge, unless —
> . . . the debtor has failed to explain satisfactorily, before determination of denial of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities.

Under section 727(a)(5) the Plaintiffs must show that there has been a loss of assets and a failure by the Debtor to explain the loss. It is not enough for the Plaintiffs to show that the Debtor's expenditures were unwise. See Schreiber v. Emerson, 244 B.R. 1, 29 (Bankr. D.N.H. 1999) (citations omitted).

In the case before the Court, the Debtor received $33,000.00 from Fielder in October of 1998. According to the Debtor, all of the money was used to pay expenses. At trial, evidence was presented showing that the Debtor had paid over $20,000.00 in cash rental payments to the Corporation's landlord. The Debtor claims that the rest of the money was used to pay bills owed to other creditors, such as Public Service. The Plaintiffs presented no contradicting evidence on this matter.

What the Court finds troubling about the Debtor's explanation for the loss of the money is that the Debtor also testified that in December of 1998 he transferred all of his shares in the Corporation to Fielder because he could not repay the loan. If the Debtor did not have the money to repay Fielder in December of 1998, then presumably the $33,000.00 had been used up by the Debtor by December of 1998. Yet the Debtor claims, and the exhibits clearly show, that he paid over $20,000.00 in cash rental payments for the Corporation after the transfer of the shares to Fielder. If the Debtor still had over $20,000.00 in cash, then why did he not use at least some of the money to repay a substantial portion of the money he owed to Fielder? The Court finds it difficult to believe that the Debtor transferred his shares of the Corporation to Fielder because he could not repay her, yet at the same time retained over $20,000.00 in cash. The Court notes, however, that there was no evidence presented by the Plaintiffs to show that the Debtor did not transfer the shares as repayment to Fielder while at the same time retaining the cash for use in paying future bills.

As noted earlier, a showing that the Debtor made unwise financial decisions is not enough to deny the Debtor's discharge under section 727(a)(5). While it may have been an unwise decision for the Debtor to keep the cash instead of repaying Fielder, making unwise financial decisions is not justification for denying the Debtor's discharge under section 727(a)(5). The Court, therefore, finds that the Plaintiffs failed to meet their burden of proof under section 727(a)(5).

IV. ORDER

In accordance with the above discussion the Court finds that the Plaintiffs have failed to meet their burden of proof for the claims under section 727(a)(2), (a)(3), and (a)(5). However, the Court finds that the Plaintiffs have meet the burden of proof on the claim under section 727(a)(4). Accordingly, the Debtor's discharge is denied pursuant to section 727(a)(4).

This opinion and order constitutes the Court's findings of fact and conclusions of law in accordance with Federal Rule of Bankruptcy Procedure 7052.

DATED this 27th day of February, 2001, at Manchester, New Hampshire.

J. Michael Deasy
Bankruptcy Judge