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signed 6-21-01

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In Re:

**TERRY LEE SMITH,
GENA DAWN SMITH,**

DEBTORS.

**CASE NO. 00-40987-7
CHAPTER 7**

PARALLEL FARMS, INC.,

PLAINTIFF,

v.

ADV. NO. 00-7072

**TERRY LEE SMITH,
GENA DAWN SMITH,**

DEFENDANTS.

MEMORANDUM OF DECISION

This proceeding is before the Court for decision following a bench trial. Plaintiff Parallel Farms, Inc., appeared by counsel Kyle J. Mead. The defendant-debtors appeared by counsel Michael A. Ireland. At the end of the trial, the parties were directed to submit briefs on certain issues, which they have done. Having considered the evidence and briefs, the Court is now ready to rule.

FACTS

Before 1999, debtor Terry Lee Smith ("Terry") and his father, Daryl Smith ("Daryl"), operated a farming partnership, raising cattle and crops. They had no written partnership agreement. While the partnership existed, it appears that Terry and Daryl each individually owned one-half of the machinery

and equipment that the partnership needed to operate. Plaintiff Parallel Farms, Inc. (“Parallel”), had business dealings with Terry and Daryl, but did not know what form Terry and Daryl’s business arrangement took. When either of them ordered farming-related product from Parallel, it billed each of them for one-half the cost of the product.

In late March or early April of 1999, after Terry discussed his financial situation with his and his wife’s main creditor, the State Bank of Whiting (“the Bank”), and with Daryl, he decided to stop farming. Terry’s debt to the Bank exceeded the value of the collateral securing it. He transferred cattle and equipment subject to the Bank’s lien to Daryl in exchange for Daryl’s agreement to assume his debt to the Bank. Terry’s note with the Bank did not come due until February 2000, though, and it was only then that the Bank rewrote the note to show that Daryl and his wife were the obligors. The Bank also prepared a formal document showing the transfer of the cattle and equipment from Terry and his wife to Daryl and his wife.

The debtors’ 1999 federal income tax return reports no income from raising either cattle or crops. During 1999, Terry worked full-time for the Kansas Department of Transportation and also worked part-time for Daryl on his farm. The tax return does show that the debtors received a government farm payment of \$3,839.45, which Terry got as partial payment for his farm work. The debtors also lived rent free in a house Daryl owned. In performing the farm work, Terry used some or all of the equipment he had transferred to Daryl early in the year.

Parallel delivered seed to the farming operation during 1999, and billed the seed as it had in prior years, one-half to Terry and one-half to Daryl. Neither Terry nor Daryl advised Parallel that the

partnership had been dissolved. At some unspecified time, though, Daryl did inform Parallel that he would be responsible for all charges for the seed delivered in 1999.

The debtors filed a chapter 7 bankruptcy petition in May 2000. Of course, they had discussed various matters with their attorney in preparing to file. They told him about Terry's transfer of cattle and equipment to Daryl in exchange for Daryl's assumption of their debt to the Bank. They told him that Daryl and his wife had later signed the note that released the debtors from their debt to the Bank. They also told him that in March 2000, they had given their daughter a 1993 Ford Taurus that she had been using while she was in high school.

Federal Rule of Bankruptcy Procedure 1007(b)(1) requires debtors to file, among other things, "a statement of financial affairs, prepared as prescribed by the appropriate Official Forms." Form 7 of the Official Bankruptcy Forms is the required statement of financial affairs ("Statement"). The portions of the Statement that are relevant in this case are question 10, where the transfer to Daryl would have been reported, and 7, where the gift to their daughter would have been reported. Question 10 requires debtors to "[l]ist all other property, other than property transferred in the ordinary course of the business or financial affairs of the debtor, transferred either absolutely or as security within one year immediately preceding the commencement of this case." Question 7 requires debtors to "[l]ist all gifts . . . made within one year immediately preceding the commencement of this case except ordinary and usual gifts to family members aggregating less than \$200 in value per individual family member."

The debtors' attorney advised them that the transfer to Daryl did not have to be reported on their Statement, because it had occurred more than one year before their intended bankruptcy filing. He did not give them such advice about the transfer of the car to their daughter. Neither of the transfers

was reported on the Statement filed with the debtors' bankruptcy petition. The debtors signed the Statement, declaring under penalty of perjury that the answers it contained were true and correct.

At the meeting of creditors held in connection with the debtors' bankruptcy filing, Parallel's representative questioned the debtors, and they readily admitted both transfers had occurred and disclosed their particulars. The debtors' attorney states that the transfer to Daryl was omitted from the Statement based on the attorney's advice that it did not have to be reported. However, the debtors and their attorney agree that the omission of the transfer of the car was inadvertent.

DISCUSSION AND CONCLUSIONS

Because the debtors omitted the two transfers from their Statement, Parallel contends they should be denied a discharge pursuant to 11 U.S.C.A. §727(a)(4)(A). The statute provides that the Court should grant a discharge unless "the debtor knowingly and fraudulently, in or in connection with the case—(A) made a false oath or account." In order to establish this claim, Parallel had to prove by a preponderance of the evidence that the debtors knew the answers on their Statement were false, and that they willfully omitted the transfers with the intent to defraud their creditors. *Gullickson v. Brown (In re Brown)*, 108 F.3d 1290, 1294 (10th Cir. 1997). The false information also must be material to the bankruptcy case. *Kunce v. Kessler (In re Kessler)*, 51 B.R. 895, 899 (Bankr.D.Kan. 1985). An inadvertent or honest mistake is not grounds for the denial of a discharge. *Gullickson v. Brown*, 108 F.3d at 1294-95. Generally, a debtor's explanation that he or she acted on the advice of an attorney who was fully informed of all the relevant facts rebuts an inference of fraud. *In re Mascolo*, 505 F.2d 274, 277 (1st Cir. 1974); *see also* Maggs, "Consumer Bankruptcy Fraud and the 'Reliance on Advice of Counsel' Argument," 69 Amer. Bankr. L.J. 1, 7-19 (1995) (indicating courts outside bankruptcy

usually treat advice of counsel as negating intent element of fraud, but in bankruptcy, many treat it as affirmative defense and require proof of additional elements unrelated to debtor's state of mind).

However, such an explanation will fail if the debtor's claim to have relied on the attorney's advice is unbelievable, *e.g.*, *Dubrowsky v. Estate of Perlbinder (In re Dubrowsky)*, 244 B.R. 560, 573-76 (E.D.N.Y. 2000), or the debtor failed to disclose all the facts to the attorney, *A.V. Reilly Internat'l, Ltd., v. Rosenzweig (In re Rosenzweig)*, 237 B.R. 453, 457-58 (Bankr. N.D. Ill. 1999).

The evidence established that the debtors disclosed both the omitted transfers to their attorney before the materials necessary for their bankruptcy filing were prepared. Apparently, their attorney concluded, rightly or wrongly, that Terry's transfer of cattle and equipment to Daryl was complete and final when Terry orally and physically transferred them more than one year before the debtors filed for bankruptcy, rather than later, within the one year reporting period, when the transfer was formally documented for the Bank. When there are no facts that debtors might plausibly think mean that a transfer occurred outside the one-year reporting period, they cannot avoid a false oath charge by claiming their attorney told them the transfer need not be reported. Here, however, because of the actions the debtors took before the one-year period, the Court is convinced they could—and in fact did—believe that the transfer occurred early in 1999, long before they documented it for the Bank. Even if their attorney's advice was incorrect, or the better approach would have been to report the transfer because of the time when it was documented, the evidence showed that the debtors told their attorney all the underlying facts and then relied on his advice not to report the transfer. The Court concludes this establishes that the debtors did not intend to defraud anyone by omitting the transfer from their Statement.

The debtors' gift of the car to their daughter should, of course, have been reported. The transfer was made to a relative for no consideration well within the one-year reporting period. The debtors do not claim their attorney told them to omit this transfer, and he concedes they informed him of the transfer before he had their bankruptcy pleadings prepared. They did not try to hide or deny the transfer when they were asked about it at the meeting of creditors. They contend only that both they and their attorney overlooked the omission of the transfer from their Statement. Having considered the relevant evidence about the transfer, including the debtors' demeanor when they were testifying, the Court concludes the omission was an inadvertent and careless, but honest mistake that the debtors made with no intent to defraud anyone.

For these reasons, the Court finds that the debtors' failure to list the two transfers did not constitute a false oath in violation of §727(a)(4)(A). The debtors' discharge will not be denied because of Parallel's complaint.

The foregoing constitutes Findings of Fact and Conclusions of Law under Rule 7052 of the Federal Rules of Bankruptcy Procedure and Rule 52(a) of the Federal Rules of Civil Procedure. A judgment based on this ruling will be entered on a separate document as required by FRBP 9021 and FRCP 58.

Dated at Topeka, Kansas, this ____ day of June, 2001.

JAMES A. PUSATERI
CHIEF BANKRUPTCY JUDGE