

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
 DOUGLAS T. PERCIVAL and)
 BONNIE V. PERCIVAL,) CASE NO. BK86-758
)
 DEBTORS) A86-188
)
 SECURITY STATE BANK,)
 OXFORD, NEBRASKA, A)
 Corporation,)
)
 Plaintiff)
)
 vs.)
)
 DOUGLAS T. PERCIVAL and)
 BONNIE V. PERCIVAL, Husband)
 and Wife,)
)
 Defendant)

MEMORANDUM OPINION

Evidentiary hearing was held on June 26, 1987, in North Platte, Nebraska. Final arguments and briefs were presented in writing on July 27, 1987. Appearing on behalf of the plaintiff, Security State Bank, Oxford, Nebraska, (Bank) was Charles Cuyper of the law firm of Sherwood & Cuyper, Oxford, Nebraska. Appearing on behalf of the debtors was David W. Pederson of Murphy, Pederson, Piccolo & Pederson, North Platte, Nebraska.

Finding of Fact

Debtors, husband and wife, filed a Chapter 7 bankruptcy petition on about March 19, 1986. The Bank filed a complaint for determination of dischargeability and objections to discharge as an adversary proceeding on July 21, 1986. After appropriate discovery, the matter was set for trial on June 26, 1987, and trial was held on that date.

The debtors have been involved in a ranching operation since the early 1970's. The debtors provided to the Bank an annual financial statement on a regular basis. In addition, the debtors

borrowed money on a regular basis from the Bank and provided the Bank with executed security agreements and financing statements through the years of their banking relationship.

At the time of the bankruptcy filing, the Bank held perfected security interests in basically all of the personal property owned by the debtors except the personal property which are considered titled vehicles under Nebraska law and which Nebraska law requires liens to be noted upon such titles in order to be perfected.

In each year from 1981 through January of 1984, the debtors signed financial statements and presented them to the Bank. On each of those financial statements they claimed ownership in more than 100 head of cattle, certain farm equipment, including a Versatile tractor, a number of trailers and a John Deere 2280 swather.

On the financial statement they further purported to list all of their liabilities, including the debt to the complaining bank.

From 1981 through the end of 1984, the Bank loaned money to the debtors for various purposes, including down payment on land parcels and the purchase of farm equipment and titled vehicles.

In February of 1985, at the request of the Bank, the debtors submitted a new financial statement which varied substantially from the immediately preceding financial statement presented to the Bank in January of 1984. Such variance included the absence of most of the cattle and the absence of most of the equipment.

Eventually the debtors filed a Chapter 7 bankruptcy petition and the creditor Bank filed this adversary proceeding alleging that the debt should be nondischargeable because the debt was incurred by active fraud on the part of the debtors, presentation of false financial statements as well as omissions of certain liabilities on such financial statements. The complaint also alleged that the debtors should be denied a discharge because they had intentionally failed to keep or preserve books or records relating to their farming operations and that they disposed of assets prior to the filing of the petition and further that they have failed to explain the disposition of the livestock, crops and farm machinery and equipment. Finally, the Bank claims that the debtors have transferred, concealed or permitted to be removed and concealed livestock, farm machinery and equipment which was collateral securing loans made by the plaintiff and that such actions were done with the intent to hinder, delay or defraud the plaintiff.

The Court observed and heard testimony from a number of witnesses, including two representatives of the Bank, a rancher to whom Mr. Percival was previously employed, and each of the debtors. In addition, the Court has reviewed more than sixty

exhibits which have been admitted into evidence and which include depositions of the debtors as well as depositions of a notary public who acknowledged the signatures of the debtors on certain deeds and the deposition of the father of Mrs. Percival.

For a number of years the debtors had a ranching operation on which they raised some cattle for themselves and also took care of cattle owned by Mr. Leuking, the father of Mrs. Percival. There was some arrangement between the debtors and Leuking by which the debtors were to care for the livestock and would receive as consideration for such care, 40% of the calves born each year. The arrangement was not a partnership. The debtors did not own the majority of the stock cows, but only had a right to a percentage of the calves born of such stock cows.

However, in addition to caring for livestock owned by Leuking, the debtors did have, at some point in time, between 1983 and 1985, more than 100 head of livestock which they did own. Mr. Percival admits such ownership in his deposition and the exhibit which summarizes sales of cattle made by the debtors during 1984 convinces this Court that he owned cattle at some time well in excess of the number 40, which he sometimes claims to have owned and which his wife claims that they owned.

On the financial statement for 1984, the debtors claim to own far in excess of 200 head of cattle.

From 1981 through 1984 the debtors, on financial statements provided to the Bank, claimed to own a Versatile tractor and a John Deere swather and they claimed that the value of those pieces of farm equipment were far in excess of \$20,000. However, on the 1985 financial statement and on the bankruptcy petition and schedules, the debtors either claim that they do not own such equipment or that the value of the equipment is only nominal.

Mrs. Percival testified at the deposition and on the witness stand that she kept no records of the farming or ranching operation and that she didn't know anything about the type of equipment that they owned, when they owned it, what it was used for or what its value was. In addition, she didn't know where any of it was. However, she signed each of the financial statements presented to the Bank.

At the deposition and on the witness stand, the debtor, Mr. Percival, testified that he had no idea how the equipment got listed on the financial statements, didn't know what their value was, even if he did own them, and claimed that he left this Versatile tractor, worth far in excess of \$20,000, on some land in Colorado ten years before the bankruptcy was filed. He claimed he had no idea where it was or what it was worth and had not seen it in ten years. He further claimed that the swather which had been listed on all of the financial statements did not exist. That is,

that it has been damaged or destroyed or was traded for another swather. Further, he testified that a Hesston bailer had been left on some land in Furnas County and apparently had been stolen. He also claimed that another piece of farm equipment, a "sweep", had been left in Colorado and he did not know what happened to it.

Both Mr. and Mrs. Percival claimed that they had exchanged most of their titled vehicles which had been listed on the financial statements for a reduction in debt that they owed Mr. Leuking. They claimed that he now owned all of the titled vehicles, even though the titled vehicles may still be in their names.

On the bankruptcy schedules the debtors listed a debt to Mr. Leuking of approximately \$400,000. No debt to Mr. Leuking was listed on any of the financial statements which had been provided to the Bank. Mr. Leuking testified that he may or may not own some of the equipment that the debtors claim to have transferred to him. Whether he owns it or not, the debtors have full use of the equipment.

Mr. Leuking also testified in his deposition that he was the actual owner of the Versatile tractor because, although Mr. Percival signed the purchase contract, Mr. Leuking made all of the payments. He, therefore, claimed he had the right to, and did, sell the Versatile tractor to a purchaser in Kansas for \$12,000.

The Versatile tractor is not a titled vehicle under Nebraska law.

The bankers testified that they frequently went past the livestock operation of Mr. and Mrs. Percival and noted that the numbers of head of livestock that they saw on the premises coincided with the numbers listed on the financial statements. They testified that they did rely upon the financial statements for support in their loan evaluation process and that had they known the debtors did not own the numbers of cattle alleged on the financial statements or did not own the Versatile tractor and other equipment listed on the financial statements or that the debtors owed \$400,000 to Mr. Leuking, no loans would have been made.

The bankers did what was necessary to obtain the appropriate financial information from the debtors and to verify it. They requested financial information each year, they reviewed the financial statements with one or both debtors prior to such statements being signed and they physically viewed the livestock.

In addition, the Bank provided loans to the debtors which the debtors used as a down payment on real estate purchases. The banker believed until the bankruptcy petition was filed that the

debtors still owned the real estate for which the money was loaned and that the Bank had a security interest in the debtor's interest in the appropriate real estate contract.

The debtors did provide false financial statements to the Bank with the intent to deceive the Bank and with the intent to obtain either new money or renewals of loans. The debtors alleged each year on their financial statements that they owned certain farm equipment which, even if they did own, they knew was not available to the creditor because it either had been given away, stolen, lost or misplaced. They signed financial statements on which they claimed to have hundreds of tons of milo and they admit in their deposition and on the stand that they never had any such amount. All through the years of their banking relationship they owed Mr. Leuking thousands and even hundreds of thousands of dollars and yet they never once mentioned that to the Bank, nor did they list it on their financial statements.

The financing and refinancing by the Bank was obtained by the debtors through fraud as well as through providing false written financial statements.

Within the year prior to bankruptcy, the debtors conveyed away their interest in real estate which may or may not have had some value. They conveyed that real estate to Mr. Leuking who allegedly gave them credit against the amount they owed him, at least to the extent of their equity. The debtors' interest in the land which could have been available to the Bank and other creditors was transferred to Mr. Leuking who then gave it up to the contract sellers. The land apparently sold recently for less than the debt, but that is not conclusive evidence of the value of the land at the time of the transfer, which was within one year prior to bankruptcy.

Between January 4, 1984, and March 19, 1986, the debtors transferred to Mr. Leuking, or at least attempted to transfer to Mr. Leuking, an ownership interest in a variety of titled vehicles. Even if those transfers are valid under Nebraska law, it appears to this Court that such transfers were made with an intent to defraud this Bank.

The debtors, although testifying both in the deposition and at trial that they had not seen certain equipment for ten years, conveniently listed such equipment on their federal tax returns and took depreciation and probably investment credit in such equipment up through 1984.

The debtors each appeared at their depositions and at the trial with no records of their business transactions. They claimed that they kept no calving records and the only thing they might have some place were records of sales. However, they did not bring such records to trial. The banker testified that he

asked the debtor at one point in time about the existence of records and the debtor, Mr. Percival, claimed that he threw them away because he didn't think he needed them. The testimony of the debtor, Mr. Percival, and the debtor, Mrs. Percival, on this subject and on most of the other subjects upon which they testified is simply unbelievable. They operated for several years as ranchers. They raised cattle, they sold cattle, they paid various creditors, they borrowed money, they purchased equipment and they sold equipment. They ask this Court to believe that either they kept no records of any transactions ever, or that the records have been mislaid. This Court simply doesn't believe it. Somehow, they had sufficient information in written form to provide to their tax preparer on an annual basis. Their tax returns are relatively thick and very detailed concerning purchases and sales and ownership of assets, which are subject to depreciation or investment credit. Furthermore, they had sufficient information from sources to prepare annual financial statements which varied each year, both in amount and value of assets and amount and value of obligations. This Court finds that they intentionally destroyed or concealed from the Bank and from this Court the records which would substantiate their ownership of assets, the disposition of such assets, the amount of debt they owed and to whom it was owed.

Both at the depositions and at trial both debtors claimed to have no knowledge or no recollection of the location of assets or the disposition of such assets. Specifically, Mrs. Percival says she knows nothing of pieces of farm equipment which were listed on the financial statements each year and which her father had possession just prior to her bankruptcy and which her father sold. Mr. Percival claims that he left all of the farm equipment in Colorado or that it got stolen or that it was traded and he doesn't know who he traded it to.

This Court finds as a fact that the debtors have not adequately explained the location of or disposition of assets that they claim ownership in, both on their financial statements and on their tax returns, but which did not exist at the time they filed their bankruptcy petition.

Conclusions of Law

Section 727 of the Bankruptcy Code provides that a discharge shall be granted to a debtor unless the debtor with intent to hinder, delay or defraud a creditor has transferred, removed, destroyed, mutilated or concealed property of the debtor within one year before the date of the filing of the petition; has concealed, destroyed or failed to preserve recorded information from which financial condition or business transactions might be ascertained; failed to explain satisfactorily any loss of assets or deficiency of assets to meet the debtors' liabilities.

Section 523 of the Bankruptcy Code provides that a discharge under Section 727 shall not discharge a debtor from any debt for money or renewal or refinancing of credit to the extent obtained by false pretenses, a false representation or actual fraud or by the use of a statement in writing, that is materially false respecting the debtor's financial condition on which the creditor reasonably relied and that the debtor caused to be made or published with intent to deceive.

Recently, the Eighth Circuit Court of Appeals decided In the Matter of Michael Van Horn, 823 F.2d 1285 (8th Cir. 1986) that a debtor's silence regarding material fact can constitute a false representation actionable under Section 523(a)(2)(A). The Court, at page 1288, stated that "a borrower has the duty to divulge all material facts to the lender". These borrowers did not bother to tell the lender that they owed Mr. Leuking \$400,000. They also did not bother to tell the lender that most of the assets that they listed on their financial statements from 1981 through 1984 either did not exist or had been conveyed to some other party. See also In re Ophaug, 827 F.2d 340 (8th Cir. 1987) concerning fraudulent representations.

In addition to obtaining financing by making fraudulent representations or omissions to the Bank, the debtors each provided written financial statements to the Bank that are materially false. They did not list all of the debt and they incorrectly listed the existence of assets and the value of those assets. The financial statements reflected the debtors' financial condition. The creditor did everything necessary to verify the existence of the assets and had no reason to attempt to verify the existence of a liability which was not even listed on the financial statement. Therefore, the Bank reasonably relied upon the financial statement. Finally, the debtors intended to deceive the Bank. There is no other conclusion this Court can reach. There is no reason for the debtors to provide such false financial statements unless they wanted to fool the Bank into believing that they were in financially good condition and to keep the Bank from finding out the true facts.

With regard to the Section 727 discharge provisions, the Court has found as a fact that the debtors did, with intent to hinder, delay or defraud, convey property to Mr. Leuking. That property specifically consisted of interests in real estate contracts and vehicles and farm equipment.

The debtors also destroyed their records. These records should have consisted of sales receipts, farming records indicating births, deaths and sales of cattle, or, at a minimum, some record indicating the number of calves that were born each year under the contractual arrangement with Mr. Leuking.

Finally, under Section 727(a)(5) the debtors' explanation of what happened to the Versatile tractor and what happened to the swather and what happened to the Hesston bailer is simply unbelievable. These explanations do not satisfactorily explain the loss of the assets upon which the creditor relied. They do not explain satisfactorily why the equipment was listed on the financial statements and on the tax returns, and yet the debtors now claim that the property had not been seen for years.

In conclusion, the debtors are denied a discharge under Section 727(a)(2)(3)(5). In addition, the creditor has met its burden to deny the specific discharge of its obligation under Sections 523(a)(2)(A) and (B).

Separate journal entry shall be entered.

DATED: October 26, 1987.

BY THE COURT:



U.S. Bankruptcy Judge

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