The Dishonored Discharge

BY LAWRENCE SAVELL

America is, among other things, the land of the "second chance." We believe in the ability of people to turn their lives around, regardless of the trouble and adversity they may encounter. We cheer the loudest for those sports champions that reach the top after being at the very bottom. And we recognize that often the strongest personal relationships are those that have weathered, and overcome, moments when it seemed that it was all over.

The law similarly provides for such renewal and resurrection in a variety of contexts. One example is the concept of bankruptcy, where an individual or entity (the "debtor") may, when faced with insurmountable debts, in appropriate circumstances be given the chance to start largely afresh and anew.

The situation where people or companies find themselves in need of bankruptcy relief is an unfortunate and inordinately-commonly-occurring one. In such cases, the debtor may be forced to give up or at the very least disclose fully the existence of valuable property, which not infrequently includes collector cars.

Complying with the disclosure (in addition to other) requirements of the bankruptcy laws is critical. This was recently illustrated by the case of *In re Brown,* decided on March 29, 1996 by the United States District Court for the District of Kansas.

According to the Court, the debtor, who owned several collector cars, filed for bankruptcy, listing his assets as being far exceeded by his liabilities. Unfortunately, in his bankruptcy schedules (i.e., report of assets), he reportedly failed to list his 1962 Chevrolet. In addition, he reportedly listed a 1957 Ford and a 1958 Ford as being jointly owned with his wife, although as of less than two months before the cars were titled solely in his name, and no transfer of the ownership had been disclosed.

A creditor of the debtor filed a lawsuit seeking to deny the debtor's request to have his debts discharged. The Bankruptcy Court ruled in favor of that creditor and against the debtor. Among other reasons, it based its denial of the debtor's request on a provision of the federal Bankruptcy Law which allows the Bankruptcy Court to grant a debtor a discharge unless the debtor knowingly and fraudulently makes a false oath or account. The Bankruptcy Court found that the debtor had violated this provision by, among other things, omitting listing the Chevrolet and the recent transfer to joint ownership of the Fords. It concluded that these misrepresentations were material (i.e., very significant) to the discovery of the debtor's assets and transactions. It further concluded that, in light of its finding of a pattern of nondisclosure and failure to amend his schedules, the misrepresentations and omissions were not merely inadvertent, but rather had been knowingly and fraudulently made.

The debtor appealed this adverse determination. He argued, among other things, that his errors or omissions had been inadvertent, that he had admitted at trial that the cars were titled only in his name, and that while he had overlooked the omission of the 1962 Chevrolet from the schedule of property, he had mentioned it in a bankruptcy hearing. Unfortunately for him, the District Court affirmed the Bankruptcy Court's denial of his discharge.

The District Court noted that a creditor bears the burden of proving by a preponderance of the evidence that a debtor is not entitled to a discharge. It pointed out that, under the provisions involved here, two elements had to be proven to deny a discharge: (1) the debtor knowingly and fraudulently made an oath; and (2) the debtor's oath related to a material fact.

The District Court concluded: "We believe the alleged false oaths were material to the discovery of past assets and transactions.... [T]he alleged absence of material harm to creditors is not dispositive of a denial of discharge claim...Therefore, the bankruptcy court's judgment of fraudulent intent is critical on appeal. We will not reverse that determination unless it is clearly erroneous.... Particularly given the pattern of conduct and statements regarding debtor's antique car collection, the court cannot find the bankruptcy court's decision to be clearly erroneous. Moreover, debtor's failure to amend and correct the schedules is evidence of reckless indifference to the truth which has been considered proof of fraudulent intent.... For the above-stated reasons, the bankruptcy court's order denying discharge shall be affirmed."

The decision of a person or business to declare bankruptcy is obviously one that should not be lightly made, but one which, if appropriate, should be contemplated only with a full understanding of the potential downsides and effects (including any potential personal and/or professional stigma). It should be considered with the counsel of an attorney experienced and knowledgeable in this specific area of the law, who can offer advice tailored to the specific individual or entity, and to the specific facts involved. Finally, as this case illustrates, if this option is pursued, the disclosure and other requirements of the bankruptcy laws should be fully complied with.

Lawrence Savell is Counsel at the law firm Chadbourne & Parke LLP in New York City. This column provides general information and cannot substitute for consultation with an attorney. Additional background on this and prior "Old Cars in Law" articles can be found on-line at http://www.carcollector.com