UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF	)	
	)	
LARRY DEWAYNE ROYSE and FRANCESS JANE ROYSE,	)	CASE NO. 06-31294 HCD CHAPTER 7
	)	
DEBTORS.	)	
	)	
DAVID T. HECKE,	)	
	)	
PLAINTIFF,	)	
vs.	)	PROC. NO. 07-3022
	)	
LARRY DEWAYNE ROYSE and FRANCESS JANE ROYSE,	)	
	)	
DEFENDANTS.	)	

Appearances:

Samuel L. Bolinger, Esq., counsel for plaintiff, 126 West Columbia Street, Suite 300, Fort Wayne, Indiana 46802; and

Donald H. Leslie, Esq., counsel for defendants, 208 West 4th Street, Marion, Indiana 46952-4093.

MEMORANDUM OF DECISION

At South Bend, Indiana, on September 26, 2007.

Before the court is the Plaintiff's Amended "Complaint for Objection to Discharge of Debtors and Request for Denial of Discharge," filed by David T. Hecke ("plaintiff"), creditor of the defendants Larry DeWayne Royse and Francess Jane Royse ("defendants" or "debtors"). The plaintiff sought denial of the debtors' discharge pursuant to 11 U.S.C. § 727(a)(4)(A) and the nondischargeability of the debt the debtors owe him pursuant to 11 U.S.C. § 523(a)(2). Trial in the matter was held on July 31, 2007, in South Bend, Indiana. For the reasons that follow, the court finds that the plaintiff's Complaint is denied and that the defendants' debt to the plaintiff is discharged.

Jurisdiction

Pursuant to 28 U.S.C. § 157(a) and Northern District of Indiana Local Rule 200.1, the United States District Court for the Northern District of Indiana has referred this case to this court for hearing and determination. After reviewing the record, the court determines that the matter before it is a core proceeding within the meaning of § 157(b)(2)(I) and (J) over which the court has jurisdiction pursuant to 28 U.S.C. §§ 157(b)(1) and 1334. This entry shall serve as findings of fact and conclusions of law as required by Federal Rule of Civil Procedure 52, made applicable in this proceeding by Federal Rules of Bankruptcy Procedure 7052 and 9014. Any conclusion of law more properly classified as a factual finding shall be deemed a fact, and any finding of fact more properly classified as a legal conclusion shall be deemed a conclusion of law.

Background

The background facts in this case are undisputed. On September 4, 2002, the defendants entered into an "Agreement to Purchase & Promissory Note" with the plaintiff. *See* Pl. Ex. 2. With a down payment of $4,000, they purchased a liquor license for $30,000, to be used at their bar Pop-a-Top Tavern ("the Tavern") in Marion, Indiana. The parties also executed a "Consent to Transfer." *See* Pl. Ex. 3. The defendants timely paid $392.41 each month, as required under the Agreement, from October 2002 until December 2006. They were supposed to make a final balloon payment on December 1, 2005, in the amount of $16,090.29. However, on September 30, 2005, the defendants wrote the plaintiff a letter, asking to be able to extend the length of their contract. *See* Pl. Ex. 4. Hecke testified that he agreed to their terms and let them continue with the same payments of $392.41 until they could pay off the debt.

On December 4, 2006, the plaintiff received no check. On January 4, 2007, when again he received no check, Hecke telephoned the Tavern and learned that the Royses did not own the bar any more. Mr. Lovelady said that he had purchased the bar, with the liquor license, almost a year earlier. The debtors had filed a voluntary petition for relief under chapter 7 of the Bankruptcy Code on September 15, 2006.[1] However, the debtors did not tell Hecke about the bankruptcy until January 2007, when they sent him a letter telling him of the sale of the business and the liquor license.

The plaintiff's Complaint alleged that the defendants failed to list the sale of the liquor license on their Statement of Financial Affairs and failed to give notice of their bankruptcy filing to the plaintiff. It contended that the debt owed to him is nondischargeable pursuant to 11 U.S.C. § 523(a)(2). In addition, it alleged that the defendants knowingly or fraudulently made a false oath or account of the debt by failing to list it. Because they sought to hide the debt, the Complaint asserted, the defendants' discharge should be denied pursuant to 11 U.S.C. § 727(a)(4)(A).

At the trial, the plaintiff David T. Hecke testified that the Royses' bankruptcy petition did not indicate that the liquor license was sold or that the defendants had owned inventory or received business income from the bar before they filed bankruptcy. Hecke admitted that he was listed as an unsecured creditor on Schedule F and that the payment of $392.14 was listed on Schedule J, but stated that he was not notified of his status as a creditor or of the defendants' bankruptcy. He testified that approximately $13,000 was outstanding on the liquor license debt; he later stated that about $24,000 had been paid. Moreover, he acknowledged that, once the petition and matrix were amended, he did receive notice of the chapter 7 petition.

After Hecke spoke with Mr. Lovelady, who said he was in the process of buying the building from the Royses, the plaintiff put a lien on the building to stop the sale. He went to an office supply store, purchased a "Claim of Lien" form, and took it to the County Recorder's Office. With some help from a lady in that office, he filled out the form, paid his $15.00 fee, and filed the claim against the Royses. Hecke acknowledged that the economy in Marion, Indiana, was not good: The factory closed and now other businesses were closing. However, he still believed that the debtors' building (housing the Tavern) was worth more than they had surmised and that

[1] The Trustee filed his no-asset report on November 27, 2006. The debtors were discharged on January 3, 2007, and the case was closed on January 24, 2007. However, it was reopened on March 8, 2007, to add Hecke to the matrix.

their karaoke equipment was worth a lot of money. Hecke accused the debtors of taking advantage of him, of never advising him of the bankruptcy, and of not presenting an accurate, truthful representation on their bankruptcy schedules. He asked to be made whole by being paid $30,000, since the liquor license cannot be returned to him.

Francess Jane Royse, one of the debtors, testified that she and her husband purchased the liquor license from Hecke about a year after they opened the Tavern. They sold the business, all the inventory, and the liquor license together, and got about $60,000 gross for it all. They had paid $40,000 for the building and had put $40,000 into it to fix it up before they opened the Tavern. Once they paid off the bank notes and taxes, they were left with only $3,000-$4,000, she said. They had intended to pay Hecke off, she testified. Mrs. Royse said they filed bankruptcy in June or July of 2006.[2] However, they had been in difficulty for at least six months before that. Hecke had given them permission to extend the time for their payments to him, and they continued to pay him as long as they could, until December 2006. The debtors notified Hecke of the bankruptcy in January 2007, once they knew they could not keep up their payments.

Francess Royse testified that the bankruptcy petition was accurate and complete. The debtors disclosed to the Trustee that they wanted to continue paying Hecke, and the Trustee said that was fine.

Carroll Wayne Lovelady, the present owner of the Tavern (now called the Bar and Grille), testified that he bought everything in the building for $60,000 in January 2006. A woman at the state license bureau helped him to purchase the liquor license from the Royses. When Hecke called and told him that the Royses owed $12,000 on the license, Lovelady told him that he had purchased the license. Then Hecke called the excise office, the state license bureau, and was told that the license had been sold to Lovelady and that there was no lien on it. Lovelady could not remember when those calls occurred.

Lovelady knew that there were termites in the building. He said that he was afraid to put money into the building, because of the termites. Nevertheless, when their two-year lease ends in January 2008 he would like

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[2] The Royses actually filed bankruptcy on September 15, 2006.

to buy the building, if it is free of liens and termites. He testified that he pays $563 a month to the bank, which holds the mortgage on the building, and sends $93 a month to the Royses. He did not know the estimated value of the property, but guessed that it was worth only $20,000 without the equipment.

After the plaintiff rested, the defense called Mrs. Royse to the stand again. She testified that she and her husband had continued to make regular monthly payments on the liquor license purchase from Hecke. She stated that they did not notify him of the bankruptcy because they were going to pay him off. Mrs. Royse insisted that they fully disclosed their assets and debts in the bankruptcy. The schedules reflected that they received $93 each month from Mr. Lovelady. Moreover, she insisted that her testimony at the 341 meeting was accurate and complete. She said that she disclosed everything to the Trustee. Debtors' Exhibit C, a partial transcript of the 341 meeting, was admitted in evidence without objection. It revealed that Mrs. Royse, responding to the Trustee's questions, testified that (a) their restaurant was being leased to Mr. Lovelady, the potential purchaser of the business, (b) the party was paying the debtors $92.68 a month, which amount went to pay taxes and insurance, (c) the debtors still owned the real estate until the lien is removed, (d) the debtors reaffirmed the mortgage, (e) the liquor license was purchased by Mr. Lovelady, along with the business, (f) the debtors still pay $392.41 per month to Hecke for the license.

Mrs. Royse also explained that Hecke had prepared the transaction documents for the sale of the liquor license. The defendants made payments to him as long as they could and stopped payment only when they could not pay Hecke or the other creditors. She testified that, to the best of her knowledge, Hecke does not have a judgment lien, mechanic's lien, or any other kind of lien on the debtors' property. The "claim of lien" he filled out interferes with their opportunity to sell the real estate to Mr. Lovelady, she stated.

After counsel presented their final arguments, the court gave oral findings of fact and conclusions of law from the bench. It found that this was a straightforward chapter 7 case. The Trustee had examined the debtors thoroughly at the § 341 meeting, according to the partial transcript. There was no evidence that the debtors had lied in writing and that the plaintiff had relied on such a writing. In addition, there was no evidence that Hecke perfected a lien against the liquor license. However, the court commented, the plaintiff did file an improper claim to obtain a lien during the Royses' bankruptcy. The court concluded that there was no evidence of conduct by the debtors that would make the debt to the plaintiff nondischargeable and that denial of their discharge was not warranted. The court took the case under advisement, however, to present written conclusions.

Discussion

The issue before the court in this adversary proceeding is whether the plaintiff demonstrated by a preponderance of the evidence that the debt owed to him by the debtors should be excepted from the debtors' discharge pursuant to 11 U.S.C. § 523 or whether the debtors' discharge should be denied altogether pursuant to 11 U.S.C. § 727. To preserve and further the goal of the Bankruptcy Code to provide debtors with a fresh start, "exceptions to discharge are to be construed strictly against a creditor and liberally in favor of a debtor." *Goldberg Sec., Inc. v. Scarlata (In re Scarlata)*, 979 F.2d 521, 524 (7th Cir. 1992) (quoting *In re Zarzynski*, 771 F.2d 304, 306) (7th Cir. 1985)). At the end of the trial, the court found that the plaintiff had not proven the elements of either § 523(a)(2) or § 727(a)(4)(A). The court now makes written findings of fact and conclusions of law with respect to the court's oral determination in open court.

The plaintiff alleged that the debt owed to him by the defendants was nondischargeable under § 523(a)(2), without specifying which subsection was applicable. It was clear to the court that the facts in this case did not support an exception to discharge under § 523(a)(2)(B), which required a written financial statement, or § 523(a)(2)(C), which concerned consumer debts for luxury goods and services or cash advances. The only plausible basis for finding the plaintiff's debt nondischargeable was under the fraud exception of § 523(a)(2)(A).[3] To succeed under § 523(a)(2)(A), a creditor has the burden of proving by a preponderance of the evidence that the debt owed to it by the debtors was obtained by actual fraud, false pretenses, or misrepresentation. *See*

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[3] Section 523(a)(2)(A) provides that an individual debtor is not discharged from any debt "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." 11 U.S.C. § 523(a)(2)(A).

McClellan v. Cantrell, 217 F.3d 890, 893-94 (7th Cir. 2000) (stating that fraud is not limited to misrepresentations and misleading omissions); *In re Bero*, 110 F.3d 462, 465 (7th Cir.1997) (setting forth burden of proof).

The plaintiff in this case was required to establish that (1) the debtors promised to purchase the liquor license through representations that the debtors either knew to be false or made with such reckless disregard for the truth as to constitute willful misrepresentation; (2) the debtors acted with an intent to deceive the creditor; and (3) the creditor justifiably relied on the debtors' false representations to his detriment. *See In re Sheridan*, 57 F.3d 627, 635 (7th Cir. 1995); *Mayer v. Spanel Int'l, Ltd.*, 51 F.3d 670, 673 (7th Cir.), *cert. denied*, 516 U.S. 1008 (1995); *In re Maurice*, 21 F.3d 767, 774 (7th Cir. 1994); *see also Field v. Mans*, 516 U.S. 59, 74-75, 116 S. Ct. 437, 446, 133 L.Ed.2d 351 (1995) (holding that a creditor's reliance need only be justifiable, not reasonable). The intent to defraud or deceive is a factual question usually determined by circumstantial evidence and may be inferred if the totality of the circumstances "present[s] a picture of deceptive conduct by the debtor which indicates he intended to deceive or cheat the creditor." *Leeb v. Guy (In re Guy)*, 101 B.R. 961, 978 (Bankr. N.D. Ind. 1988); *see also WebMD Practice Services, Inc. v. Sedlacek (In re Sedlacek)*, 327 B.R. 872, 887-88 (Bankr. E.D. Tenn. 2005). "Proof of intent for purposes of Section 523(a)(2)(A) must be measured by a debtor's subjective intention at the time of the transaction in which the debtor obtained the money, property or services." *Nite Lite Signs and Balloons, Inc. v. Philopulos (In re Philopulos)*, 313 B.R. 271, 282 (Bankr. N.D. Ill. 2004).

Hecke accused the debtors of taking advantage of him, of never advising him of the bankruptcy, and of not presenting an accurate, truthful representation on their bankruptcy schedules. The court found that the plaintiff failed to prove by a preponderance of the evidence that the debtors intended to defraud him when they executed the liquor license documents in 2002, sold the license in 2005, or filed bankruptcy in 2006. The debtors first signed the written agreements provided by the plaintiff; although he testified that they made their business sound successful, Hecke did not allege any fraudulent representations in the initial purchase transaction. They then paid Hecke "like clockwork," he testified, even after they wrote him that they could not make the balloon payment and he permitted them to continue their monthly payments.[4] They made their regular payments to him before and during their bankruptcy until they couldn't pay any longer. They reopened the bankruptcy to add him to the matrix, as well. The court finds that the debtors had listed their debt to Hecke on Schedule F, their lease income from the business on Schedule I, and the $392.14 payment to Hecke on Schedule J. Furthermore, they had notified the Trustee of their intent to pay Hecke outside the bankruptcy. In fact, the court notes that the Agreement between the debtors and Hecke required that the payments not be included in the bankruptcy. *See* Pl. Ex. 2, ¶ 5. The debtors explained that they had sold the liquor license along with the entire business, and thus could not return the license to Hecke, but they were continuing to pay for the license.[5] The court finds that the debtors properly disclosed their assets and debts on their schedules.

Hecke argued, nevertheless, that his debt should be excepted from discharge because the debtors failed to notify him of their bankruptcy filing.[6] Mrs. Royse responded credibly that the debtors fully intended to pay off their debt to Hecke and had continued their payments to him during the bankruptcy, with the knowledge and assent of the chapter 13 Trustee, as long as they could. The court finds no evidence that the debtors intended to conceal their debt to the plaintiff. It determines that the plaintiff did not show that the failure to schedule the plaintiff on the matrix was the result of fraud or intentional design. *See In re Stark*, 717 F.2d 322, 324 (7th Cir. 1983). Moreover, in a chapter 7 no-asset case, there is no bar date for the timely filing of a proof of claim, and thus a failure to schedule a creditor does not result in harm to that creditor. *See id.* The plaintiff did not show

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[4] The Royses' letter of September 30, 2005, makes clear that they were struggling with expenses at that time. They mentioned that Mr. Royse was still involved in a lawsuit with GM and that Mrs. Royse had fallen down the stairs and had significant medical bills. There was no challenge to the credibility of their statements in the letter. *See* Pl. Ex. 4.

[5] The Agreement between the parties did not contemplate the sale or transfer of the liquor license. Under Indiana law, the transfer of a liquor license requires the approval of the state's Alcoholic Beverage Commission. *See* Ind. Code § 7.1-3-24-1. There is no challenge to the valid transfer of the license to Carroll Lovelady.

[6] The plaintiff did not allege an exception to discharge under § 523(a)(3) for the debtors' failure to list him as a creditor; he brought the claim under § 523(a)(2), which requires proof that the debt owed to him by the debtors was obtained by actual fraud, false pretenses, or misrepresentation.

that, but for the debtors' alleged fraud, the discharge would not have been granted. *See White v. Nielsen (In re Nielsen)*, 383 F.3d 922, 925-27 (9th Cir. 2004); *In re M.A.S. Realty Corp.*, 318 B.R. 234, 239 (Bankr. D. Mass. 2004). In any case, the debtors' failure to list the plaintiff on the matrix is not proof that the debtors had promised to purchase the liquor license through false representations, with an intent to deceive the plaintiff. The court determines, therefore, that the plaintiff failed in his burden of proving by a preponderance of the evidence that the debt owed to him by the debtors was obtained by actual fraud, false pretenses, or misrepresentation.

The plaintiff also contended that the debtor's discharge should be denied under 11 U.S.C. § 727(a). A court should construe the exceptions to discharge "strictly against the creditor and liberally in favor of the debtor." *In re Juzwiak*, 89 F.3d 424, 427 (7th Cir. 1996) (citations omitted). When reviewing § 727(a) claims, however, a court should consider "that a discharge in bankruptcy is a privilege, not a right, and should inure to the benefit of the honest debtor." *Id.* (citations omitted); *see also Disch v. Rasmussen*, 417 F.3d 769, 774 (7th Cir. 2005). Section 727 authorizes a denial of discharge if the debtor is shown to have engaged in improper conduct as described in one or more of its subsections. The creditor must establish grounds for denial of discharge under § 727(a) by a preponderance of the evidence. *Peterson v. Scott (In re Scott)*, 172 F.3d 959, 966-67 (7th Cir. 1999). If the creditor is successful, the burden shifts to the debtor to prove by competent evidence that he did not commit the offense charged. "The general rule is that the right to a discharge is left to the sound discretion of the bankruptcy court." *Prairie Prod. Credit Ass'n v. Suttles (In re Suttles)*, 819 F.2d 764, 766 (7th Cir. 1987).

The plaintiff specified that the debtors' discharge should be barred under § 727(a)(4)(A), which denies a debtor a discharge if he "knowingly and fraudulently, in or in connection with the case, made a false oath or account." 11 U.S.C. § 727(a)(4)(A). To preclude discharge under this subsection, the creditor was required to show, by a preponderance of the evidence, that (1) the debtors made a statement under oath; (2) the statement was false; (3) the debtors knew the statement was false; (4) the debtors made the statement with fraudulent intent; and (5) the statement related materially to the bankruptcy case. *See Lee Supply Corp. v. Agnew (In re Agnew)*, 818 F.2d 1284, 1289-90 (7th Cir. 1987)*; Krudy v Scott (In re Scott)*, 227 B.R. 834, 841 (Bankr. S.D. Ind. 1998).

A debtor's bankruptcy petition, schedules, and statement of financial affairs constitute a statement under oath for purposes of a discharge objection under § 727(a)(4). *See Stathopoulos v. Bostrom (In re Bostrom)*, 286 B.R. 352, 360 (Bankr. N.D. Ill. 2002), *aff'd*, 2003 WL 403138 (N.D. Ill. 2003). To establish fraudulent intent, a creditor must show that the debtor knowingly made a false and material statement. *See In re Chavin*, 150 F.3d 726, 728 (7th Cir. 1998). "To be material the testimony must relate to such things as the debtor's estate, assets, liabilities and financial affairs, the disposition of property, or debtor's entitlement to discharge." *In re Hall*, 258 B.R. 908, 913 (Bankr. N.D. Ind. 2001) (citing *In re Senese*, 245 B.R. 565, 574 (Bankr. N.D. Ill. 2000)). Once the plaintiff has proven the elements of § 727(a)(4), then the burden shifts to the debtor to justify his actions. *See Hillis v. Martin (In re Martin)*, 124 B.R. 542, 545 (Bankr. N.D. Ind. 1991).

The plaintiff's allegations – that the debtors failed to include the liquor license in their schedules and failed to list the plaintiff on the matrix – gave no evidence that the debtors made false statements, even statements by omission, with fraudulent intent. The court found Mrs. Royse to be a credible witness. She testified that she signed her bankruptcy petition and schedules knowing that she was under oath and promising that they were accurate and truthful. She recognized, as well, that she testified at the § 341 meeting under oath. The plaintiff did not point to any statement that the debtors knew were false or that were made with intent to deceive the plaintiff. The court finds not a scintilla of evidence that the debtors intended to conceal the debt to the plaintiff. The plaintiff presented no statements materially related to the bankruptcy case that were false. The court determines, therefore, that the plaintiff has failed in his burden of proving that the debtors' discharge should be denied.

Having found that denial of the debtors' discharge is not appropriate and that the debtors' debt to the plaintiff is dischargeable, the court turns to the last issue, the Claim of Lien filed on January 18, 2007, by the plaintiff against real estate owned by the debtors. The debtors asserted that the claim is an attempt to collect a debt. The plaintiff stated that he was trying to stop the sale of the building and business between the debtors and Mr. Lovelady from going forward.

The court finds that the plaintiff's recording of a "Claim of Lien" in the Grant County Recorder's Office on January 18, 2007, was an attempt to interfere with the debtors' bankruptcy. First, the document is completely inappropriate: It states that the person claiming the lien, namely David Hecke, provided labor and/or material on the debtors' property, that his work was valued at $30,000, and that $13,000 remains unpaid. This declaration is simply untrue. Moreover, because the document was filed on January 18, 2007, before the debtors' case was closed, it violated the automatic stay, which was effective when the debtors' bankruptcy petition was filed and continued throughout the bankruptcy, barring any unauthorized interference with property of the debtors' estate.

Section 362(a)(4) stays "any act to create, perfect, or enforce any lien against property of the estate." 11 U.S.C. § 362(a)(4). The plaintiff's recording of a "Claim of Lien" post-petition is just such an act. The debtors' building became part of the bankruptcy estate, when they filed their chapter 7 petition, and thus was protected by the automatic stay. The plaintiff's recording of a lien against the building constitutes a violation of the automatic stay and, as such, is void. *See In re Miglia*, 345 B.R. 919, 924 (Bankr. N.D. Iowa 2006) (finding that attempted perfection of lien post-petition was barred by automatic stay); *Nazar v. Allstate Ins. Co. (In re Veazey)*, 272 B.R. 486, 491 (Bankr. D. Kan. 2002) (finding that notice of lien was void and ineffective); *Davenport v. S.I. Securities (In re Davenport)*, 268 B.R. 159, 165-66 (Bankr. N.D. Ill. 2001) (finding that creditor was forbidden from attempting to obtain tax deed on debtor's property without first seeking modification of stay).

Section 362(k) (previously § 362(h)) provides damages if the stay violation is found to be "willful." The court finds that the plaintiff's filing of the Claim of Lien does not "fit within the narrow ministerial act exception to the automatic stay." *In re Miglia*, 345 B.R. at 924. The filing was deliberate and intended to stop the sale of the debtors' property to a potential buyer. The court concludes, therefore, that the debtors are entitled to actual damages, including costs and attorney fees.[7] It approves the debtors' itemization and affidavit of compensation requested by their attorney, in the amount of $3,347.50, as reasonable in these circumstances. *See* Defendants' Ex. B. The plaintiff presented no argument on this issue. The court therefore finds that the plaintiff's conduct, in filing the "Claim of Lien," was a willful violation of § 362(a)(4) of the automatic stay. It also grants the relief sought by the debtors, in the amount of $3,347.50.

Conclusion

For the reasons set forth in this Memorandum of Decision, the court denies the Amended Complaint for Objection to Discharge of Debtors and Request for Denial of Discharge, filed by the plaintiff David T. Hecke. The court grants the request of the debtors Larry DeWayne Royse and Francess Jane Royse for relief under 11 U.S.C. § 362(a)(4) and § 362(k).

SO ORDERED.

/s/ Harry C. Dees, Jr.
HARRY C. DEES, JR., CHIEF JUDGE
UNITED STATES BANKRUPTCY COURT

[7] Punitive damages have not been sought by the debtors and, in the view of the court, are not warranted.