

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH DAKOTA

ROOM 211

FEDERAL BUILDING AND U.S. POST OFFICE

225 SOUTH PIERRE STREET

PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

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October 27, 2004

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Subject: *Cen-Dak Leasing of North Dakota, Inc., v. Thomas J. Wipf (In re Wipf)*, Adv. Proceeding No. 04-1008; Chapter 7; Bankr. No. 03-10306

Dear Counsel:

The matters before the Court are the parties' cross-motions for summary judgment. This is a core proceeding under 28 U.S.C. § 157(b)(2). This letter decision and accompanying order shall constitute the Court's findings and conclusions under Fed.R.Bankr.P. 7052. As set forth below, Defendant-Debtor's motion will be granted.

Summary. Thomas J. Wipf ("Debtor") filed a Chapter 13 petition in bankruptcy on August 19, 2003. He converted his case to Chapter 7 on August 20, 2003. By notice served on August 22, 2003, creditors were advised that November 24, 2003, was the last date to file a complaint to determine the nondischargeability of a particular debt under 11 U.S.C. § 523(c) or to object to Debtor's general discharge under 11 U.S.C. § 727(a). Cen-Dak Leasing of North Dakota, Inc., ("Cen-Dak") was one of Debtor's creditors that was served with the notice.

On November 21, 2003, the Marlin Hutterian Brethren filed a nondischargeability complaint against Debtor, Adversary No. 03-1060. Debtor received his general discharge of debts on November 25, 2003. On December 22, 2003, Debtor answered the complaint and filed a third-party complaint against Cen-Dak. On January 21, 2004, Cen-Dak answered the third-party complaint and filed a counterclaim against Debtor for nondischargeability under 11 U.S.C. §§ 523(a)(2), (4), and (6). Therein, Cen-Dak alleged

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Debtor made several false representations in regard to numerous sale/leaseback transactions with Cen-Dak involving equipment and cattle. Cen-Dak also alleged that Debtor had fraudulently obtained some insurance money on equipment he had leased from Cen-Dak. Debtor replied to the counterclaim saying it was untimely. By order entered February 11, 2004, Cen-Dak's counterclaim against Debtor for nondischargeability was dismissed.

On March 12, 2004, Cen-Dak commenced a new adversary proceeding against Debtor, no. 04-1008. Therein, Cen-Dak again alleged that Debtor had engaged in several instances of fraud regarding the sale/leaseback transactions, and it asked that Debtor's general discharge be revoked under 11 U.S.C. § 727(d)(1) and that its claim be declared nondischargeable under § 523(a)(2) and (6). As to its revocation of discharge request, Cen-Dak stated it did not know the "nature and depth" of Debtor's fraudulent acts until after it deposed Debtor's brother, Johnny Wipf, on December 8, 2003, which was after Debtor's discharge was entered. The most notable difference in the facts alleged in this new complaint and those alleged in Cen-Dak's counterclaim in Adv. No. 03-1060 was that the new complaint included references to partnerships and related entities that Debtor and his brother Johnny operated.

In his answer, Debtor denied the allegations of fraud. He affirmatively alleged that Cen-Dak had

failed to investigate any potential fraud diligently prior to the entry of the discharge ... and as such the Complaint to revoke his discharge under 11 USC § 727(d)(1) by [Cen-Dak] is barred.

On August 11, 2004, Cen-Dak moved for summary judgment. In its supporting brief, Cen-Dak specifically alleged that much of the equipment that was subject to the sale/leaseback agreements or leaseback "re-writes" was unaccounted for; that Debtor and his brother had executed a sale/leaseback agreement for cattle they never owned and that Cen-Dak did not know this until after Debtor's discharge was entered; that Debtor had sold two trailers he had leased from Cen-Dak to another without Cen-Dak's knowledge, failed to account for the proceeds, fraudulently led Cen-Dak to believe that a trailer taken in trade was his, and had taken funds from Cen-Dak for selling this trailer to Cen-Dak; and had falsified or forged invoices that were integral to the sale/leaseback transactions.

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Cen-Dak acknowledged that one element for revocation of discharge under § 727(d)(1) is that it must show that it did not know of such fraud until after the discharge was entered and that it must not have known facts that would put it on notice of possible fraud. Cen-Dak argued that these instances of fraud were "elusive and calculated" because Debtor's use of partnerships with his brother "cloaked his misconduct." Cen-Dak also argued that it did not have pre-discharge notice of possible fraud because Debtor indicated in his bankruptcy schedules that he intended to reaffirm the various sale/leaseback agreements, and this intention "clouded the situation and indicated to Cen-Dak that they would have nothing to worry about." Cen-Dak also acknowledged that one of its principals had suspicions in mid-October 2003 that some of the leased equipment might be missing, but it argued these suspicions were not enough to lead Cen-Dak to believe that fraud had occurred, "especially when Debtor and his wife were cooperating with Cen-Dak and assuring Cen-Dak that the equipment would be located" and also when Johnny Wipf, Debtor's brother, was under greater suspicion than Debtor. Cen-Dak also argued that Debtor's discharge should be revoked on equitable grounds.

Debtor filed a cross-motion for summary judgment on August 12, 2004. He argued that Cen-Dak is now time-barred from bringing a nondischargeability action under § 523(a). Debtor further argued that Cen-Dak had sufficient concerns about missing equipment and cattle before his discharge was entered so as to preclude a revocation of his discharge for fraud. Debtor relied on the depositions of Jamie Stoudt and Dennis Paulsrud.

Cen-Dak replied that its pre-discharge suspicions regarding missing cattle and equipment were clouded by Debtor's placating statements.

The use of forgery, partnerships, lies, and other acts of deception clouded the picture and made it difficult for Cen-Dak to properly assess the situation. That the Wipfs were long-standing customers and were assuring Cen-Dak that equipment and cattle would be returned further complicated the situation.

In the end, these convoluted facts significantly distinguish this case from the facts and circumstances of *Swendra* and associated cases such that revocation is warranted. This is especially true when considered in

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the overall context of the bankruptcy court system and its aim to benefit the honest debtor. The level of dishonesty exhibited by the Wipfs demonstrates their disrespect for creditors as well as the bankruptcy system in general and should not be rewarded.

Applicable law. On certain grounds provided by 11 U.S.C. § 727(d), a debtor's general discharge of debts may be revoked. It is an extraordinary remedy applicable in limited circumstances. *Miller v. Kasden (In re Kasden)*, 209 B.R. 239, 241 (B.A.P. 8th Cir. 1997).

Cen-Dak has asked the Court to revoke Debtor's discharge pursuant to 11 U.S.C. § 727(d)1). Under this Bankruptcy Code section, Cen-Dak must show (1) it had no knowledge of the fraud until after Debtor's discharge was entered, and (2) the discharge was obtained through fraud. Cen-Dak must establish both elements by a preponderance of the evidence. *Kaler v. Olmstead (In re Olmstead)*, 220 B.R. 986, 993-94 (Bankr. D.N.D. 1998) (cites therein). The Code section is construed strictly against Cen-Dak and liberally in favor of Debtor retaining his discharge. *Id.* at 993.

Under the first element, Cen-Dak must show that Debtor acted with a knowing intent to defraud and that the act of fraud would have barred Debtor's discharge had it been known before the discharge was entered. *Id.* at 994. Under the second element, Cen-Dak must establish that it was unaware of facts that would have put it on notice of the possible commission of fraud by Debtor prior to his discharge. *Mid-Tech Consulting, Inc. v. Swendra*, 938 F.2d 885, 888 (8th Cir. 1991). The creditor thus has the burden to investigate diligently any possible fraudulent conduct before the discharge is entered. *Id.*

Discussion. Cen-Dak is unable to establish the second element of § 727(d) (1). Three pre-discharge circumstances put Cen-Dak on notice that it needed to investigate Debtor's pre-petition actions further for possible fraud and file an appropriate nondischargeability complaint or a complaint for denial of discharge or seek an extension of the deadline to file such a complaint.

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First, before Debtor's discharge was entered, Cen-Dak, through its contract legal affairs manager, Jamie Stoudt,¹ was aware that Debtor had not scheduled any of the cattle and some of the equipment that he was supposedly leasing from Cen-Dak. The knowledge of these omissions prompted Cen-Dak in the later part of October 2003 to try to get additional information from Debtor. By mid-November 2003, Stoudt discussed with Cen-Dak's legal counsel his (Stoudt's) concerns about the property that was not on Debtor's schedules.

Second, Cen-Dak's efforts beginning in early November 2003, to try to recover its leased personalty from Debtor were not completely successful. While Stoudt's late October 2003 meetings with the Wipfs initially led him to believe that all the leased equipment existed somewhere and would eventually be accounted for, Stoudt grew more concerned about where the leased property was and whether it all even existed within the next few weeks. By the end of October 2003, Cen-Dak made the decision to try to recover the personalty. During its recovery effort, which began in early November 2003, it became more apparent to Cen-Dak and its principals that some leased items were indeed missing.

Third, Stoudt "definitely had suspicions" by late October 2003 that some of the cattle, which were leased from Cen-Dak by Debtor or by a partnership between Debtor and his brother, were missing. In his deposition testimony, Stoudt acknowledged that his investigations lead to initial concerns and then his brother, who then owned Cen-Dak, traveled to North Dakota and tried, unsuccessfully, to locate all the cattle.

These circumstances were sufficient to put Cen-Dak on notice -- before Debtor's discharge was entered -- that Debtor had possibly committed fraud. Cen-Dak then had a duty to investigate that potential fraud before the discharge was entered or to seek an extension of the deadline to file a nondischargeability or denial of discharge complaint. That Cen-Dak did not do. Consequently, it

¹ The Court did not rely herein on the June 23, 2004, deposition of Dennis Paulsrud, Cen-Dak's former manager. His deposition testimony indicates he did not readily discuss with Cen-Dak any concerns he had about Debtor and possible missing cattle and equipment before he was let go by Cen-Dak in late September 2003.

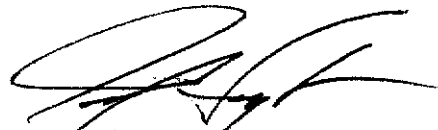
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now cannot seek a revocation of Debtor's discharge under § 727(d)(1).

The result reached here is certainly disconcerting for the Court. It is clear that Debtor's grave misdeeds will cost Cen-Dak a very large sum of money. And it is extremely unfortunate that Cen-Dak did not timely file a nondischargeability or a denial of discharge complaint. That said, however, the circumstances presented here and the applicable law under § 727(d)(1) does not permit another conclusion, especially where the law is to be construed in Debtor's favor. *Olmstead*, 220 B.R. at 993.

An order granting Debtor's motion for summary judgment will be entered.

Sincerely,



Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: adversary file (docket original; serve parties in interest)

NOTICE OF ENTRY
Under F.R. Bankr.P. 9022(a)
Entered

OCT 27 2004

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

OCT 27 2004

Charles L. Nail, Jr., Clerk
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By:

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