

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF WISCONSIN

In Re:

Case Numbers:

RAYMOND J. SCHMITZ, s/d/b/a
WOODBORO WHOLESALEERS,

76-150 Vol.

Bankrupt.

R & S DISCOUNT STORES, INC.

76-151 Vol.

Bankrupt.

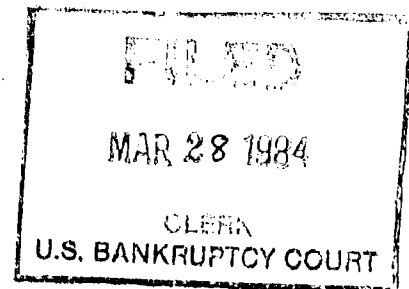
CITIZENS STATE BANK & TRUST
COMPANY OF WAUSAU, a Wisconsin
Banking Corporation,

Plaintiff,

vs.

RAYMOND J. SCHMITZ, s/d/b/a
WOODBORO WHOLESALEERS and
R & S DISCOUNT STORES, INC.,

Defendants.



FINDINGS OF FACT,
CONCLUSIONS OF LAW
AND
JUDGMENT GRANTING DISCHARGE

Citizens State Bank & Trust Company of Wausau, having filed
a Complaint and Objections to Discharge in each of the above

entitled matters; and an Answer having been duly filed; and a trial having been held, and witnesses sworn; and the Court having considered the arguments of counsel, and all the filings and proceedings herein, and being fully advised in the premises,

FINDS:

1. That the defendants, Ray J. Schmitz (Schmitz) and R & S Discount Stores, Inc. (R & S), duly filed voluntary petitions in bankruptcy under the Bankruptcy Act of 1898 on February 11, 1976.

2. Procedural Background. That the plaintiff, Citizens State Bank & Trust Company of Wausau (the Bank), filed an identical Complaint and Objection to Discharge in each of the said matters.

3. That pre-trial hearings were held from time to time; that motions to strike objections to discharge and other preliminary motions have been considered by the Court; that identical Answers have been duly filed by the defendants in each of said matters; that further pre-trials have been held; and that, after numerous unnecessary delays in the proceedings, a consolidated trial was held.

4. That said trial was held August 16 and 17, 1978, and was resumed and concluded on September 26, 1978.

5. That both parties were allowed to file briefs within 10 days after the transcript of said trial was filed.

6. That the transcript was filed on February 15, 1979, and that no briefs or applications to extend time to file were received by this Court.

7. That this Court issued original Findings of Fact, Conclusions of Law and Judgment dismissing the Complaint in both of the above captioned matters on March 6, 1979.

8. That the United States District Court, Western District of Wisconsin, vacated this Court's original Findings of Fact, Conclusions of Law and Judgment in both of the above captioned matters and remanded for further proceedings in conformity with its opinion. Citizen's State Bank & Trust Company of Wausau v. Schmitz (In re Schmitz), 79-C-257 (W.D.Wis. Dec. 30, 1981) (hereinafter Bank v. Schmitz).

9. That the plaintiff and defendants had each submitted consolidated Proposed Findings of Fact on or before April 19, 1982; that, according to an amended time schedule, the Bank agreed to submit a Reply Proposed Findings of Fact on or before June 18, 1982; and that, according to said amended time schedule, all parties agreed to submit additional¹ written arguments, if any, on or before July 2, 1982.

¹ The parties' District Court briefs are available to this Court.

10. That it is now over a year and a half since the aforementioned, agreed upon deadlines; that the Bank has not submitted a Reply Proposed Findings of Fact; that neither party has filed additional written argument; that the parties have had a full, fair and indulgent opportunity to be heard; and that these matters are now ready for determination.

11. That the District Court opinion permits this Court to support its dismissal of the Complaints "on strictly legal grounds," Bank v. Schmitz, supra Finding 8, slip op. at 5, but directs this Court to enter "a fresh and separate set of Findings of Fact" specifically addressed to subparagraphs of the Complaints and "to explain its view of the law applicable to [those] facts," id at 7-8.

12. That, in the interest of justice, this Court should now set forth each of the alternative legal and factual grounds for the dismissal of the Complaints: the Bank is without standing to object to discharge, the Bank has not met its burden of proof regarding its objection to discharge and the violations the Bank sought to prove at trial, even if proven, are de minimus and do not prevent discharge.

13. Procedural Facts. That the Bank has a general and inventory security interest in all assets and property of R & S;

said security interest growing out of loans made to R & S and personally guaranteed by Schmitz and his wife. However, the Bank has not filed a claim in either the Schmitz or R & S proceedings.

14. That, prior to the filing of defendants' bankruptcy petitions, the Bank began state foreclosure actions against the defendants; and that, although trial of the matter at bar was postponed to permit completion of the foreclosure actions, there is no evidence in the record that the Bank completed or took deficiency judgments in said actions within a reasonable time.

15. That, in one of the state foreclosure proceedings, the defendants voluntarily surrendered property to the Bank.

16. That the defendants have alleged that they received no accounting relative to the sale of surrendered property by the Bank; and that, in effect, said sale was not commercially reasonable.

17. That, although the Bank has promised to provide this Court with an accounting, no accounting has been filed before this Court.

18. That the Bank's Complaint does not request money damages or judgment in the alternative.

19. That the Bank, in its "Appellants Brief," states that it "is not appealing this case because it is optimistic that it will benefit financially. The reason for this appeal is that

[the Bank] is outraged by the conduct of the bankrupt. . ."

Appellants Brief 42.

General Findings

20. That this case, in brief, involves a familiar but tragic scenario: a successful small business which expands too rapidly and ends in ruin.

21. That, prior to the events which led to bankruptcy, R & S operated a successful retail operation in Woodruff, Wisconsin (a small town approximately 70 miles north of Wausau, Wisconsin). Trial Transcript of Resumed Trial [hereinafter T.2d] at 69-70.

22. That, in the early 1970's, with financing provided by the plaintiff-Bank, R & S expanded: opening a warehouse/cabinet factory and a retail outlet in Wausau, Wisconsin. T.2d at 70-74.^{1A}

23. That the decision to embark on said expansion was based, in part, upon assurances of adequate financing by the Bank. Id.

24. That part of said expansion, made with the approval of the Bank, was the purchase of a warehouse building which, it turned out, required extensive and expensive repairs. Id.

25. That, in 1974, R & S began to experience cash flow problems and Ray Schmitz's little financial empire began to crumble. T.2d at 73-74.

^{1A} Uncontested testimony of Schmitz. The Bank did not offer the testimony of the bank officers who serviced the R & S account at the time the original loans were made.

26. That, on May 31, 1975, with the R & S loan from the Bank in a delinquent status, an auction was held (with the Bank's acquiescence) to liquidate some R & S merchandise in order to reduce R & S debt with the Bank. Pl.Ex. 4, T.2d at 10 (auction May 31, 1975); T.2d at 10 (bank acquiescence); T.2d at 33 (reason for sale).

27. That said auction proved economically unsuccessful and was stopped. T.2d at 35-36.

28. That, following said auction, the Bank sued to recover the R & S loan. T.2d at 17-18.

29. That said suit resulted in a voluntary surrender to the Bank of R & S assets located at the Wausau store and warehouse. Said surrender occurring in June or July, 1975. See Trial Transcript [hereinafter T.] at 335-336, T.2d at 18.

30. That, at or about the same time, although the record is far from clear regarding the details, R & S lost possession of the Wausau store and warehouse. See T. at 132, 235 & 256-260.

31. That, in August 1975, R & S involuntarily surrendered assets located at the Woodruff Store to the Bank. See T. at 335-336.

32. That, at or about the same time, although the record is

far from clear regarding the details, R & S lost possession of the Woodruff store. See T. at 132, 235 & 256-260.

33. That, even after R & S had ceased retail, wholesale and manufacturing operations, Ray Schmitz attempted to meet corporate obligations. T. at 75-78, 244-245, 249-250; T.2d at 168-169.

34. That Mr. Schmitz is an unsophisticated small town businessman, unschooled in basic accounting principles. T. at 76-77, T.2d at 104-105, 174.

35. That, nevertheless, Mr. Schmitz arranged for the keeping of complete and accurate R & S affairs until the complete failure of the business resulted in the loss of bookkeeping employees. See T. at 236 & 239.

36. That, in short, the evidence supports the application of the "fresh start" doctrine to both R & S and Schmitz.

Specific Findings

37. Fraudulent Concealment. That paragraph 5 of the Complaint states a cause of action for knowing and fraudulent concealment of property belonging to the bankrupt estate. Bank v. Schmitz, supra Finding 8, slip op. at 4 (citing Bankruptcy Act of 1898 sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976)(repealed) (incorporating by reference 18 U.S.C. sec. 152, clause 1 (1976))).

38. That Plaintiff-Appellant's Proposed Findings of Fact paragraphs 11-14 are directed toward paragraph 4 of the Complaints.

39. That subparagraph 4(a) of the Complaints alleges concealment of unknown R & S inventory and assets stored in a locked building on lands owned by Edward Bembinster, doing business as Aero Auto Parts (Apparently also doing business as Aero Motors, Inc. Hereinafter, both are referred to as "Aero").

40. That subparagraph 4(b) of the Complaints alleges the concealment of R & S office equipment and fixed assets (including a copy machine, a safe, desks, filing cabinets, typewriters and electronic calculators) stored at the Aero property.

41. That, as both subparagraphs 4(a) and 4(b) allege concealment of R & S assets at the Aero property, Findings related to said subparagraphs are consolidated below.

42. That, in the Spring and Summer of 1975, Schmitz moved, or had moved, several items of office equipment from R & S locations to the Aero property. T. at 112 & 165-166. T.2d at 162.

43. That Schmitz believed that some of said office equipment was not the property of R & S. T.2d at 87-88; cf. T. at 115-116.

44. That some or all of said office equipment was carried on the R & S books as corporate assets. Plaintiff's Exhibit [hereinafter Pl.Ex.] 1 (items marked "Eddie"); see T. at 115-116.

45. That, in September of 1975, when Schmitz learned, or was reminded, that certain items of said office equipment were carried on the corporate books, he informed his accountant of the physical location and disposition (i.e., whether or not they had been sold to Edward Bembinster) of the items and the accountant charged the R & S account payable to Schmitz (expressed in corporate records as "Due Officer") and other corporate accounts accordingly. See

T. at 226-229, 231 & 236; Pl.Ex. 1 (items marked "Eddie" charged to accounts labeled "Ray" and "L & A"); cf. T.2d at 83.

46. That, on February 11, 1976, Schmitz filed a bankruptcy petition for R & S which indicated that no corporate property was in the hands of a third person. R & S Petition, Official Form 8 (Statement of Affairs), Question 11.

47. That Schmitz, in good faith, did not believe that there was corporate property in the hands of a "third person." T.2d at 163.

48. That, as of the date of the trial, some of said office equipment was stolen, some was sold to Edward Bembinster, some was removed by Schmitz and some remained at the Aero property. T. at 166-167, 169-170, T.2d at 88-89, 162.

49. That there is no direct evidence that the Trustee or any creditor made a request for physical possession of said office equipment or that such a request was refused. See T. at 21-27.

50. That subparagraph 4(c) of the Complaints alleges the concealment of personal property of Schmitz, including bank accounts, boats and motors, snowmobiles and accounts receivable (assigned to Schmitz by R & S).

51. That, on or before September 30, 1975, certain R & S accounts receivable were transferred to Schmitz and his personal

"Due Officer" account was charged for same. T. at 125-126, 239-242, 318.

52. That the purpose of said transfers was collection. T. at 122-123, 126.

53. That despite--or perhaps in ignorance of, T.2d at 141--the fact that the accounts receivable had been charged against his account, Schmitz applied funds collected on said accounts toward corporate debts. T. at 244-245, T.2d at 100, 141, 143-144; cf. T. at 169-170.

54. That all of the transferred accounts receivable were collected and applied toward corporate debts or were of no value. See T.2d at 97-102.

55. That there is no direct evidence that Schmitz concealed any bank accounts. See T. at 90-94.

56. That Schmitz owned hardware items which were stored on Schmitz's property and which were not a part of R & S inventory. T.2d at 76, 125-126, T. at 30.

57. That some of said items were sold at auction in May of 1975 (see Finding 26) with the Bank's knowledge, T.2d at 124-126, and the remaining items had little or no value, T. at 30.

58. That, in the summer of 1975, some of said items were

moved to a small cabin owned by Edward Bembinster, T. at 185 & 187, because a garage on Schmitz's property was collapsing, T. at 30.

59. That, on February 11, 1976, Schmitz filed a personal bankruptcy petition which indicated that he had no property in the hands of a third person. Schmitz Petition, Official Form 7 (Statement of Affairs), Question 9.

60. That Schmitz, in good faith, did not believe that there was personal property in the hands of a "third person." See T.2d at 163.

61. That, in the Summer of 1976, T. at 185, after the Schmitz garage was reinforced, said items were returned to the Schmitz garage, T. at 76.

62. That subparagraph 4(d) of the Complaints alleges the concealment of R & S fixed assets held by Schmitz, including a floor sander, snowblower, mobile telephone, tape recorder and milk coolers.

63. That the items listed in subparagraph 4(d) of the Complaint were some of the items marked "Gone" on the R & S September 30, 1975, Asset Schedule. Pl.Ex. 1.

64. That, on September 30, 1975, Schmitz informed his

accountant that the "Gone" items were no longer available to R & S and the accountant charged Schmitz's "Due Officer" account for those items. T. 227-229, Pl.Ex. 1. And that a forklift (with the marking "Eddie" crossed out) and a 1973 Dodge Truck (with the marking "Aero") were similarly charged against Schmitz's personal account. Pl.Ex. 1, T. at 231.

65. That some of the "Gone" items were charged to Schmitz's account despite the fact that they had been, or were subsequently, transferred for the benefit of R & S. T. at 140-141, T.2d at 86 (milk coolers); T.2d at 85 (truck); T.2d at 84 (forklift).

66. That some of the "Gone" items were junked or inadvertently transferred without benefit to Schmitz or R & S. T.2d at 86-87, 103.

67. That, at the trial (held more than two years after the fact), Schmitz was understandably unable to testify regarding the disposition of other "Gone" items. T.2d at 84-88.

68. That items which were not marked "Eddie", "Aero", or "Gone" on the September 30, 1975, R & S Asset Schedule (Pl.Ex.1) were listed under "j." (Office equipment, furnishings and supplies) and "k." (Machinery, fixtures, equipment. . .) on the R & S Bankruptcy Petition Schedule B-2 (personal property).

69. That a forklift--an unmarked item on the Asset Schedule

which was charged against the Schmitz account, Finding 64--should have been marked "Gone" and was inadvertently placed on the Bankruptcy Petition. See Pl.Ex. 10 & 11 (forklift ledger sheet in "Sale of Fixed Assets 9/30/75" folder).

70. That there is no direct evidence in the record that Schmitz had possession of the Schedule B-2 items or that he knew the location of said items at the time the bankruptcy petition was filed. See T. at 14-15 (Schmitz told Trustee that the items were in Woodruff) and T. 132 (Woodruff store closed by third party on August 7, 1975).

71. Fraudulent Transfer. That paragraph 5 of the Complaints states a cause of action for knowing and fraudulent transfer of property of the bankrupt estate. Bank v. Schmitz, supra Finding 8, slip op. at 4 (citing Bankruptcy Act of 1898 sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976)(repealed)(incorporating by reference 18 U.S.C. sec. 152, clause 7 (1976)) and Bankruptcy Act of 1898 sec. 14c(4), 11 U.S.C. sec. 32(c)(4)(1976)(repealed)).

72. That Plaintiff-Appellant's Proposed Findings of Fact paragraphs 15 & 16 are directed toward paragraph 5 of the Complaints.

73. That paragraph 5 of the Complaints alleges the transfer of corporate property in contemplation of bankruptcy. And specifically

alleges a bulk transfer of 780 doors to Marathon Mining & Manufacturing (a corporation owned by Edward Bembinster) at a time when R & S was insolvent and not an operating business; and alleges further that the proceeds of said transfer were appropriated by Schmitz as personal income.

74. That, in early June of 1975, doors belonging to R & S were stored in Schmitz's garage. T.2d at 75-76, see generally Finding 26 (auction held on May 31, 1975).

75. That, on June 17, 1975, said doors were sold to Edward Bembinster for \$1,200. T. at 169-170, T.2d at 76, Pl.Ex. 8.

76. That the doors were sold at, or above, fair market value. T. 171-172, 174-175.

77. That payment for the doors was made in the form of a check to R & S, T. 181-182, and that said check was deposited in an R & S corporate account. T.2d at 127-129.

78. That, on or about the date of the R & S auction, see Finding 26, Schmitz sold moulding, downspouts, eave troughs and window grills to Robert Derlich of Michigan. T. 60-62.

79. That Schmitz believed that the items sold were his personal property (assets of the dissolved Ray J. Schmitz, Inc.). T. 61, 78.

80. That, on a poster published by Thorp Sales Corporation (the auctioneer), some or all of the items sold to Robert Derlich were listed as part of the inventory and assets of R & S offered for sale at the R & S auction. Pl.Ex. 4.

81. That the items were transferred to Derlich in return for two trucks, T. at 60 & 78, which were subsequently sold at Aero Motors, T. at 63.

82. That the proceeds of the sale of said trucks, intermingled with the proceeds of the sale of other motor vehicles, see Findings 97-99, were applied to, or on behalf of R & S. T. 68-70, 75-76, 78 & 354.

83. That there is evidence to suggest that R & S disposed of \$34-\$36,000 of fixed assets (excluding land and improvements) between December 31, 1974, and September 30, 1975, see T. at 308-310, compare Pl.Ex. 9 with Pl.Ex. 1 and the R & S Bankruptcy Petition; however, due to a lack of testimony regarding the source of the figures which appear on Pl.Ex. 9, see T. at 215, cf. Pl.Ex. 1 and T. at 224, the Court finds that \$21,781.54² was transferred. Compare T. at 309 (accountant, bank's expert, testifies that he

² The book value of the fixed assets on Pl.Ex. 1 (\$26,241.81) minus the assets properly reported, see Finding 69, on the Bankruptcy Petition (\$4,460.27).

can account for \$34,000³ in transferred fixed assets) with T. at 326-328 (same witness is unable to account for \$34,000 total).

84. That at least \$6,320.90 of the transferred fixed assets were charged against the Schmitz account at book value. Pl.Ex. 1; see T. at 325-326, 355; see generally Findings 45 & 64.

85. That R & S corporate records reflect payments to creditors in 1975. See T. at 255, but see T. at 299-300.

86. That Schmitz viewed charges against his "Due Officer" R & S account as a form of compensation in lieu of salary authorized by the Bank. T.2d at 138-139, cf. T. at 363.

87. That despite, in ignorance of, or prior to the charging of fixed assets against his "Due Officer" account, Schmitz and other R & S employees transferred some of the charged items for the benefit of R & S. Finding 65; see T. at 89, T.2d at 94.

88. False Oaths. That paragraph 6 of the Complaints states a cause of action for false oaths or accounts in bankruptcy proceedings. Bank v. Schmitz, supra Finding 8, slip op. at 4 (citing Bankruptcy Act of 1898 sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976) (repealed)(incorporating by reference 18 U.S.C. sec. 152, clause 2 (1976))).

³ The Bank's expert apparently did not notice the erroneous inclusion of the forklift (book value \$1,550.) in the R & S Bankruptcy Petition, Finding 69, in arriving at the \$34,000 figure.

89. That Plaintiff-Appellant's Proposed Findings of Fact paragraphs 18-21 are directed toward paragraph 6 of the Complaint.

90. That subparagraph 6(a) of the Complaints alleges that Schmitz was employed by, and receiving income from, Aero at the time his bankruptcy petition was filed but that Schmitz testified that he was unemployed at that time; that subparagraph 6(b) of the Complaints alleges that Schmitz understated the value of the real estate; and that subparagraph 6(d) of the Complaints alleges that Schmitz retained a bank account in his wife's name and a joint bank account with his wife but that he stated in his bankruptcy petition that he had maintained no such accounts.

91. That the Bank concedes that it did not meet its burden of proof as to the allegations in subparagraphs 6(a), (b) & (d) of the Complaints. Plaintiff-Appellant's Proposed Findings of Fact, paragraph 21.

92. That subparagraph 6(c) of the Complaints alleges that corporate and personal property was being held and concealed by third parties but that Schmitz stated in defendants' bankruptcy petitions that no property was in the hands of third parties.

93. That the Findings regarding paragraph 4 of the Complaints, Findings 37-70, are sufficient for this Court to determine the

dischargeability of the bankrupts under subparagraph 6(c) of the Complaints.

94. That, although not specifically alleged in any subparagraph of paragraph 6 of its Complaints, the Bank presented evidence to show that Schmitz received income in 1975 but failed to disclose same on his personal bankruptcy petition.

95. That, in May of 1975, Schmitz transferred personal property to Robert Derlich in exchange for two trucks. Findings 78-81.

96. That said transfer was an exchange of assets. See T.2d 110-111, Pl.Ex. 2 (1975 Tax Return showing no income).

97. That Schmitz received \$5,000 from Aero for automobiles sold at Aero in 1975. Pl.Ex. 8 (Aero Motor's ledger); T. at 43-46, 68; Pl.Ex. 3 (Schmitz's calculations).

98. That the net result of the sale of said automobiles was a loss. T.2d at 121. Cf. T.2d 110-111, Pl.Ex. 2.

99. That said automobiles belonged to Schmitz personally or to his sons, T. at 44, T.2d at 63-64, 114-115 & 120; and that Schmitz transferred the proceeds of said sales to, or for the benefit of, R & S or his sons accordingly. T. 44-47, 51, 68, 75-78 (to R & S), cf. 354-355 (to R & S); T.2d at 117 (to sons).

100. That Schmitz, in good faith, believed he had no income

from said sales reportable on his bankruptcy petition. T. 46, 51, 57 & 78; T.2d 117.

101. That Schmitz or his wife collected approximately \$2,500 in rents in 1975, that said rents resulted in taxable income of \$1,340.81, and that said income was reported on the Schmitz's 1975 joint income tax return as income of Ms. Schmitz. Pl.Ex. 2.

102. That Schmitz did not list his wife's rental income on his bankruptcy petition.

103. That Schmitz, in good faith, believed he had no income from his wife's rental property reportable on his bankruptcy petition. T.2d at 164-165.

104. That plaintiff's expert, reviewing R & S books, determined that almost \$17,000 in cash and checks had been charged against the Schmitz "Due Officer" account in 1975. T. at 316-317, see T.2d at 128-136.

105. That the proceeds of some of said cash and check charges were applied for the benefit of R & S. T.2d at 133-134.

106. That Findings regarding paragraph 4 of the Complaints, Findings 37-70, set forth this Court's Findings relating to R & S fixed assets and accounts receivable charged against the Schmitz "Due Officer" account (and constructively received by Schmitz).

107. That said cash, check, fixed asset and accounts receivable charges against the Schmitz account were viewed by Schmitz--⁴ to the extent that he was aware of them--as a form of compensation in lieu of salary authorized by the Bank. T.2d at 136-139, cf. T. at 363.

108. That, early in 1975, Schmitz sold a Blue Cadillac and received at least \$700 over his cost. Tr. 86-88, Pl.Ex. 6.

109. That the proceeds of the sale of said automobile were used to pay 1974 taxes. Id.

110. Document Manipulation. That paragraph 7 of the Complaints states a cause of action for concealing, destroying or making false entries in documents affecting bankruptcy. Bank v. Schmitz, slip op. at 4-5 (citing Bankruptcy Act of 1898 sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976)(repealed)(incorporating by reference 18 U.S.C. sec. 152, clauses 2 and 8 (1976)) and Bankruptcy Act of 1898 sec. 14c(2), 11 U.S.C. sec. 32(c)(2)(1976)(repealed)).

111. That Plaintiff/Appellant's Proposed Findings of Fact paragraph 22 is directed toward paragraph 7 of the Complaints.

112. That subparagraph 7(a) of the Complaints alleges that Schmitz removed pages from the R & S fixed assets audit book.

113. That the Bank concedes that it did not meet its burden

⁴ I.e., liquidation of a corporate account payable to him.

of proof as to the allegations in subparagraph 7(a) of the Complaints. Plaintiff-Appellant's Proposed Findings of Fact, paragraph 22(a).

114. That subparagraph 7(b) of the Complaints alleges that Schmitz had records of R & S inventories taken in 1973 and 1974 in his possession and control, but stated that the location of same was unknown to him.

115. That inventories of R & S assets were taken on September 30, 1973, and on December 31, 1974. R & S Bankruptcy Petition (Statement of Affairs for Bankrupt Engaged in Business, Item 4), T. at 98, 138, T.2d at 158-159.

116. That records of said inventories would assist creditors attempting to ascertain the true status of R & S affairs, i.e., to determine the contents and disposition of R & S assets. T.2d at 161, T. at 328; but cf. T. at 332-338.

117. That Schmitz testified in court and on his bankruptcy petition that the location of said records was unknown to him; and that said records were last known to him to be at the Wausau warehouse in June or July of 1975. R & S Bankruptcy Petition Statement of Affairs (Item 4), T. at 99-100, T.2d at 159-160. See generally Finding 30 (warehouse locked up by third party).

118. That the R & S bookkeeper for the Wausau operations,

Lorraine Leonard, testified that some corporate books were moved from the Wausau warehouse to the Wausau store before the warehouse was locked up. T. at 124.

119. That Marathon County Sheriff's Deputy Brad Hoffman, who was assigned a key to the Wausau warehouse after it was locked up, testified that he found no "inventory books" when he made his first inspection of the building. T. at 101-102.

120. That Deputy Hoffman did not testify whether he found any "little school notebooks" during said inspection. Compare T. at 220 (inventories in little school notebooks) with T. at 102 (Deputy Hoffman had experience selling formal, pre-printed inventory control supplies).

121. That subparagraph 7(c) of the Complaints alleges that records of cash withdrawals by Schmitz and other R & S daily cash flow reports were not produced.

122. That the Bank's accountant did not find a 1974 R & S general ledger or a 1974 R & S cash receipts disbursements record among the books and records delivered to his office for inspection. T. at 296.

123. That Schmitz turned over corporate records in his possession to the trustee and that any other records were last

known to him to be in the Wausau warehouse in June or July of 1975. R & S Bankruptcy Petition Statement of Affairs (Item 2), T. at 33-34, 99; see Finding 118 (some corporate records were moved from warehouse). See generally Finding 30 (warehouse locked up by third party).

124. Paragraph 8. That paragraph 8 of the Complaints does not state a cause of action. Bank v. Schmitz, supra Finding 8, slip op. at 5.

125. Failure to Keep Records. That paragraph 9 of the Complaints states a cause of action for failing to keep adequate records. Bank v. Schmitz, supra Finding 8, slip op. at 5 (citing Bankruptcy Act of 1898 sec. 14c(2), 11 U.S.C. sec. 32(c)(2)(1976) (repealed)).

126. That Plaintiff-Appellant's Proposed Findings of Fact paragraphs 6-10 are directed toward paragraph 9 of the Complaints.

127. That paragraph 9 alleges that Schmitz failed to keep personal financial records including records of R & S assets assigned to him and records of income sources other than R & S.

128. That there is no evidence that Schmitz kept any personal records regarding the disposition of R & S fixed assets and accounts receivable charged against his "Due Officer" account with R & S.

See generally Findings 45, 51, 64 & 84.

129. That there is no evidence that Schmitz kept any records regarding transfers for the benefit of R & S which occurred after September of 1975. See T. at 214, T.2d at 174. See generally Findings 53-54, 65 & 87.

130. That the only evidence that Schmitz kept personal records of the motor vehicle sales set forth in Findings 97-99 is Pl.Ex. 3 (a partial list of gross receipts). T. 43-48, 120-122.

131. That Schmitz's records of said auto sales are insufficient for creditors to independently determine whether there was a net gain or loss from said sales.

132. Paragraph 10. That paragraph 10 of the Complaints does not state a cause of action. Bank v. Schmitz, supra Finding 8, slip op. at 5.

133. Unexplained Losses. That paragraph 11 of the Complaints states a cause of action for unexplained losses of assets. Bank v. Schmitz, supra Finding 8, slip op. at 5 (citing Bankruptcy Act of 1898 sec. 14c(7), 11 U.S.C. sec. 32(c)(7)(1976)(repealed)).

134. That Plaintiff-Appellant's Proposed Findings of Fact paragraph 23 is directed toward paragraph 11 of the Complaints.

135. That paragraph 11 of the Complaints alleges that, in

1973, both Schmitz and R & S claimed assets exceeding \$200,000 each; and that, at the time of the bankruptcy petition, both claimed assets in the neighborhood of \$50,000 each; and that no satisfactory explanation for the differences has been forthcoming.

136. That Findings 42-48, 62-70 & 74-77 are sufficient for this Court to determine the merit of the unexplained losses claim regarding R & S fixed assets.

137. That the Bank's expert made the following calculation to determine "unexplained losses" of inventory assets:

\$198,936.99	-inventory on hand 12-31-74
132,731.85	-inventory purchased in 1975
(131,434.82)	-sales of inventory in 1975 (at retail)
<u>(113,521.06)</u>	-inventory on hand 9-30-75
\$ 86,712.96	-"unexplained losses"

T. at 329-336.

138. That the figure for "inventory on hand 9-30-75" was based on actual inventory and that actual inventory was determined after an accounting write-off of over \$82,000 (explained only as an "adjustment" to show actual inventory). T.2d at 182-183.

139. That said accounting adjustment may reflect actual inventory in the possession of the Bank and others on or before September 30, 1975. See T. at 332-335, 367; cf. T.2d at 173-174.

140. That, although the Bank has promised to provide this

Court with an accounting of R & S assets in its possession, no such accounting has been filed with this Court.

141. That the Bank presented no evidence at trial regarding the value of R & S assets which came into its hands prior to October 1, 1975. Cf. T. at 356-357, T.2d at 19.

142. That said accounting adjustment, which may reflect actual inventory repossessed by the Bank, is roughly equivalent to--and could explain--the "unexplained loss."

143. That the plaintiff has presented insufficient evidence for this Court to find facts regarding any "unexplained losses" by Schmitz personally.

144. Credit by False Statement. That paragraph 12 of the Complaints states a cause of action for obtaining credit by a materially false statement. Bank v. Schmitz, supra Finding 8, slip op. at 5 (citing Bankruptcy Act of 1898 sec. 14c(3), 11 U.S.C. sec. 32(c)(3)(1976)(repealed)).

145. That Plaintiff-Appellant's Proposed Findings of Fact paragraph 24 is directed toward paragraph 12 of the Complaints.

146. That subparagraph 12(a) of the Complaints alleges that Schmitz failed to state personal and corporate liabilities and overvalued real estate in a financial statement given to the Bank

in 1973; and that subparagraph 12(b) of the Complaints alleges that Schmitz failed to state personal and corporate liabilities, overvalued real estate and misstated personal income in a financial statement given to the Bank in 1974.

147. That the Bank concedes that it did not meet its burden of proof that the defendants obtained credit on the basis of the 1973 & 1974 financial statements.

148. That paragraph 12(c) of the Complaints alleges that Schmitz made false and misleading statements to the Bank regarding his net worth, R & S assets and R & S inventory from 1970 to 1974.

149. That the Bank has presented insufficient evidence for this Court to find facts regarding the materiality of false and misleading statements, if any.

150. Paragraph 13. That paragraph 13 of the Complaints merely repeats the allegations of paragraph 5 of the Complaints, Findings 71-73. Bank v. Schmitz, supra Finding 8, slip op. at 5.

Discussion

151. Applicable Law. That the Bankruptcy Reform Act of 1978 has no effect on the case at bar. Pub.L. 95-598, secs. 403(a) & 404(a), 92 Stat. 2683 & 2684; In re Parr, 3 B.R. 692, 696-697 (Bankr. E.D.N.Y. 1980).

Standing

152. That Bankruptcy Act of 1898 [hereinafter Act] sec. 14b(2), 11 U.S.C. sec. 32(b)(2)(1976)(repealed), provides, in pertinent part: "the court shall hear such proofs and pleas as may be made in opposition to the discharge, by the trustee, creditors, the United States attorney, or such other attorney as the Attorney General may designate. . ."

153. Volunteer. That, accordingly, ~~strangers~~ to the proceeding--no matter how outraged, see Finding 19--can not be heard to object. In re Walsh, 256 F. 653, 654 (7th Cir. 1919).

154. Creditor. That a "creditor" is one who has a provable claim. Act sec. 1(11), 11 U.S.C. sec. 1(11)(1976)(repealed). That a provable claim is one which may be proved and allowed against the bankrupt estate. Act sec. 63a, 11 U.S.C. sec. 103(a)(1976)(repealed).

155. That, while a party need not file a provable and allowable claim to be a "creditor", In re Dockins, 107 F.2d 33 (7th Cir. 1939), once that party's claim becomes one not provable or not allowable the party has insufficient interest in the bankrupt estate to object to discharge.

156. That it appears that the Bank does not have a provable claim. Finding 14 (no deficiency judgment taken), Finding 16 (cf.

Wis. Stats. 409.504 Secured party's right to dispose of collateral after default and Wis. Stats. 409.507 Secured party's liability for failure to comply with default provisions); see Finding 18 (Bank does not request money damages or judgment); cf. Finding 19 (Bank is not optimistic that it will benefit financially).

157. That it appears that the bank does not have an allowable claim. Compare Finding 13 (no claim filed) with Act sec. 57n, 11 U.S.C. sec. 93(n)(1976)(repealed)(claims must be filed within six months of the first meeting of creditors). See 1 D. Cowans, Bankruptcy Law and Practice sec. 179 (2d ed. 1978)(proof of claim must be filed within time required by law to be allowable).

158. Unclean Hands. That, whether viewed as a bar to the Bank proving its claim against the bankruptcy estate or as a bar to the Bank objecting to discharge, the failure of the Bank to do equity, e.g. Finding 17, deprives it of standing in this proceeding. See Bolling v. Bowen, 118 F.2d 59, 62 (4th Cir. 1941)("A court of bankruptcy is a court of equity; and he who comes into equity must come with clean hands.").

Merits

159. That the "objecting creditor must prove the commission of acts warranting a denial of the discharge by a fair preponderance

of the evidence and under some circumstances, by clear and convincing proof." In re Weiler, 1 B.C.D. 1521, 1523 (Bankr. S.D.N.Y. 1975)(citation omitted)(discussing Act sec. 14c, 11 U.S.C. sec. 32(c) (1976)(repealed) and Former Bankruptcy Rule 407). See also In re Martin, 554 F.2d 55, 58n1 (2d Cir. 1977). See generally 28 U.S.C. sec. 2075(1976)(repealed in pertinent part)(rules supersede prior law).

160. Fraudulent Concealment. That Act sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976)(repealed), by reference to 18 U.S.C. sec. 152, clause 1 (1976), prevents the discharge of a bankrupt who knowingly and fraudulently conceals property of the bankruptcy estate from a court officer or creditor. See generally Finding 37.

161. That there "must be proof of actual intent to defraud" to prevent a discharge under sec. 14c. Minnick v. LaFayette Loan & Trust Co., 392 F.2d 973, 977 (7th Cir. 1968), cert. denied sub nom. Lusk v. Strickland, 393 U.S. 875 (1968). Thus, evidence from which scienter (knowledge) alone may be inferred is insufficient to prove fraudulent intent. U. S. v. Lynch, 180 F.2d 696, 700 (7th Cir. 1950).

162. That, assuming Schmitz acted knowingly, but see Findings 47 & 60, the Bank has not shown that Schmitz acted with an intent to defraud creditors. See Findings 45, 51, 53, 54, 64-66.

163. That the definition of conceal includes secrete, falsify and mutilate, Act. sec. 1(7), 11 U.S.C. sec. 1(7)(1976)(repealed), i.e., something more than mere storage. Cf. Continental Bank & Trust Co. v. Winter, 153 F.2d 397, 399 (2d Cir. 1946)(Under Act sec. 3, 11 U.S.C. sec. 21(1976)(repealed): "something more than a mere failure to volunteer information to creditors").

164. That Schmitz did not conceal assets. See Findings 45, 48, 49, 51, 55, 58 & 61, 64, 70.

165. That, under sec. 14c(1), the concealment must occur during a bankruptcy proceeding. 1A J. Moore, L. King, Collier on Bankruptcy para. 1419 (14th ed. 1978).

166. That, with the exception of the items properly listed on R & S schedules, Findings 68 & 69, hardware items of de minimus value, Finding 57, and some items of office equipment, the Bank's proof was directed toward assets which were transferred prior to Bankruptcy. See, e.g., Finding 57.

167. Fraudulent Transfer (14c(1)). That Act sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976)(repealed), by reference to 18 U.S.C. sec. 152, clause 7 (1976), prevents the discharge of a bankrupt who, in contemplation of bankruptcy or with intent to defeat the bankruptcy law, knowingly and fraudulently transfers or conceals

property. See generally Finding 71.

168. That, outside of the petition itself, there is no evidence that any actions were taken either in contemplation of bankruptcy or with intent to defeat bankruptcy law (e.g., no evidence regarding the date Schmitz first discussed bankruptcy with his attorney). See generally 2A J. Moore, L. King, Collier on Bankruptcy para 29.10 note 14 (14th ed. 1978).

169. That, assuming Schmitz acted knowingly, but see, e.g., Finding 87, the Bank has not shown that Schmitz acted with an intent to defraud creditors, Finding 161. See Findings 76 & 77, 82, 86 & 87.

170. That assets of the bankrupts were transferred prior to bankruptcy, e.g., Finding 81, but no assets of the bankrupts were concealed, Finding 163. See Findings 83 (transfers recorded).

171. Fraudulent Transfer 14c(4). That Act sec. 14c(4), 11 U.S.C. sec. 32(c)(4)(1976)(repealed), prevents the discharge of a bankrupt who, with intent to hinder, delay or defraud creditors, actually or constructively transferred, removed, destroyed or concealed property within 12 months before the bankruptcy petition was filed. See generally Finding 71.

172. That the intent, Finding 161, to hinder, delay or defraud creditors is something more than an intent to prefer a creditor.

In re Richter, 57 F.2d 159, 160 (2d Cir. 1932)(A. Hand, J.). Thus, it must be shown that the bankrupt sought to prevent collection of his debts. Kaganowitz v. Manufacturers Trust Co., 145 F.2d 754, 755 (2d Cir. 1944).

173. That the Bank has not shown that Schmitz acted with an intent to hinder, delay or defraud creditors. See Findings 76 & 77, 82, 86 & 87.

174. That assets of the bankrupts were removed and transferred within 12 months before the bankruptcy petitions were filed, Finding 170, but no assets were concealed, id., or destroyed during that period.

175. False Oaths. That Act sec. 14c(1), 11 U.S.C. sec. 32(c)(1) (1976)(repealed), by reference to 18 U.S.C. sec. 152, clause 2 (1976), prevents the discharge of a bankrupt who knowingly and fraudulently makes a false oath or account in or in relation to a bankruptcy proceeding. See generally Finding 88.

176. That, when bankruptcy schedules require a bankrupt to make a legal judgment, the bankrupt is required only to make an honest effort to understand and answer the question. Morris Plan Industrial Bank v. Finn, 149 F.2d 591, 592-593 (2d Cir. 1945) (so much of the opinion as discusses burden of proof has been superseded, see Finding 159).

177. That whether property stored on the land of a third person--as opposed, for example, to property lent to a third person--is "in the hands of" a third person, whether gross receipts--as opposed, for example, to net receipts or total taxable income--is "income", and whether liquidation of a personal account receivable (corporate account payable)--as opposed, for example, to a salary--is "income", are questions which call for the exercise of legal judgment.

178. That Schmitz made an honest effort to understand and answer questions on his bankruptcy schedules. See Findings 47, 60, 100, 103 & 107. Cf. Finding 70.

179. Document Manipulation (14c(1)). That Act sec. 14c(1), 11 U.S.C. sec. 32(c)(1)(1976)(repealed), by reference to 18 U.S.C. sec. 152, clause 8 (1976), prevents the discharge of a bankrupt who, while in bankruptcy or in contemplation thereof, knowingly and fraudulently conceals, destroys, mutilates, falsifies, or makes a false entry in any document affecting or relating to the property or affairs of a bankrupt. See generally Finding 110.⁵

180. That the records in question were last in the possession

⁵ The applicability of 18 U.S.C. sec. 152 clause 2 (false oath), see Finding 175, need not be considered independently here. See Finding 182.

or control of Schmitz in the Summer of 1975 (i.e., before bankruptcy), see Finding 117, and there is no evidence that he contemplated bankruptcy at that time, Finding 168.

181. That the records that Schmitz was able to produce, e.g. Findings 83 & 84 (records showing corporate transfers, including transfers to Schmitz), negate any finding that he withheld records with fraudulent intent, Finding 161.

182. That, other than the mere failure to produce, there is no evidence that Schmitz concealed--by false oath or otherwise--destroyed, mutilated, falsified or made a false entry in any document relating to the property or affairs of a bankrupt. See Findings 117 & 118 (some records not removed from Wausau warehouse before it was locked up by a third party). See also Finding 120 (Bank's post-seizure eyewitness did not look for records in the form kept by R & S).

183. Document Manipulation (14c(2)). That Act sec. 14c(2), 11 U.S.C. sec. 32(c)(2)(1976)(repealed), prevents the discharge of a bankrupt who destroyed, mutilated, falsified or concealed books from which his financial condition and business transactions might be ascertained unless such acts are justified. See generally Finding 110.

184. That, while sec. 14c(2) does not require a showing of bankrupt bad faith, it does require a showing of bankrupt fault.

In re Martin, supra Finding 159 at 57-58.

185. That,

[a]fter all, the law recognizes emergencies. We take judicial notice of the disorganization which follows when a man conducting a . . . business finds his business place under attachment, . . . and his books out of his possession. It is not reasonable to expect him under the circumstances, to sit down and set up a new set of books or records, especially when all he attempted to do is to keep his good faith with. . . [creditors]. . . and complete certain work-in-progress.

In re McNay, 58 F.Supp. 960, 964 (S.D.Cal. 1945).

186. That Schmitz did not destroy, mutilate, falsify or conceal books from which the bankrupts' financial condition and business transactions might be ascertained. See Findings 117, 123.

187. Failure to Keep Records. That Act sec. 14c(2), 11 U.S.C. 32(c)(2)(1976)(repealed), prevents the discharge of a bankrupt who failed to keep or preserve books from which his financial condition and business transactions might be ascertained unless such failure is justified. See generally Finding 125.

188. That " '[t]he test in applying this section of the bankruptcy act is a loose test, concerned with the practical problems of what can be expected of the type of person and the type of

business involved.' " In re Lepley, 227 F.Supp. 983, 988 (W.D.Wis. 1964)(citations omitted). Cf. In re Bendix, 127 F.2d 759, 761 (7th Cir. 1942) (adequacy a question for the trial court).

189. That the practical ability of the bankrupt is a factor under section 14c(2). International Shoe v. Lewine, 68 F.2d 517, 518 (5th Cir. 1934) (bankrupt "incapable of keeping books"); Hedges v. Bushnell, 106 F.2d 979, 982 (10th Cir. 1939) (bankrupt had a "limited education"); In re Newman, 126 F.2d 336 (6th Cir. 1942) ("inexperienced" bankrupt).

190. That there is no universal duty to keep records of books, In re Weismann, 1 F.Supp. 723 (S.D.N.Y. 132), especially when records are kept by others, see In re Martin, supra Finding 159 at 58 (corporate records to be used to show personal transactions). And, where there is such a duty, books are sufficient if they permit inquiry into the affairs of the bankrupt. Lewine, supra Finding 189; Hedges, supra Finding 189.

191. That Schmitz had corporate records kept of transfers from R & S to himself, see, e.g., Findings 45, 51 & 64, and had no duty to keep personal records of said transfers.

192. That Schmitz, by reason of his own ignorance and his inability to compensate a bookkeeper, Findings 34 & 35, was

justifiably incapable of keeping records of corporate transactions after September, 1975.

193. That the nature of Schmitz's automobile dealings were not of the sort that require independent record keeping. That, nevertheless, the records kept by Schmitz, in conjunction with the records kept by Aero Motors, were sufficient to permit inquiry into his affairs.

194. Unexplained Losses. That Act sec. 14c(7), 11 U.S.C. sec. 32(c)(7)(1976)(repealed), prevents the discharge of a bankrupt who has failed to explain satisfactorily any losses of assets or deficiency of assets to meet his liabilities. See generally Finding 133.

195. That sec. 14c(7) requires the objector to show more than bankruptcy itself. In re Horowitz, 92 F.2d 632, 633 (7th Cir. 1937) (proof insufficient when there is no direct evidence of concealment or of deficiency caused by illegal acts). Thus, a sudden depletion of assets prior to bankruptcy may establish a prima facie objection to discharge, In re McNay, supra Finding 185 at 967, while a failure of memory at trial--years after the fact--may not, In re Groth, 36 F.2d 41, 43 (7th Cir. 1929).

196. That corporate records, combined with the unfortunate

history of R & S, satisfactorily explains losses of R & S fixed assets.

197. That the requirement of satisfactory explanation is based upon the assumption that "nobody is in a better position to explain his losses than the bankrupt. . ." Federal Provision Co. v. Ershowsky, 94 F.2d 574, 575 (2d Cir. 1938).

198. That the Bank is in a better position to explain R & S inventory losses than is Schmitz. See Finding 139.

De Minimus

199. That the "reasons for denying a discharge must be real and substantial, not merely technical and conjectural." Dilworth v. Boothe, 69 F.2d 621, 624 (5th Cir. 1934).

200. That, in the context of the failure of a multi-city retail and manufacturing concern, the evidence adduced at trial was in the nature of pedantry and will not support a denial of discharge.

201. That, accordingly, this decision ends with reference to "the well accepted principle that the Bankruptcy Act was intended to permit the honest debtor to get a new start in life free from debt, and that section 14 of the Act must be construed strictly in favor of the bankrupt. In re Kokoszka, 479 F.2d 990, 997 (2d Cir. 1973), aff'd sub nom. Kokoszka v. Belford, 417 U.S. 642, 94

S.Ct. 2431, 41 L.Ed.2d 374 (1974). . . Minnick v. Lafayette Loan & Trust Co., 392 F.2d 973, 977 (7th Cir. 1968)." In re Adlman, 541 F.2d 999, 1003(2d Cir. 1976).

CONCLUSIONS OF LAW

1. That the Citizens State Bank & Trust Company of Wausau has no standing to object to the discharge of the bankrupts.

2. That the Citizens State Bank & Trust Company of Wausau has not met its burden of proof to prevent the discharge of the bankrupts.

3. That violations of Bankruptcy Act of 1898 sec. 14c, 11 U.S.C. sec. 32(c)(1976)(repealed), by the bankrupts--if any--were inadvertent, technical and de minimus.

4. That Raymond J. Schmitz and R & S Discount Stores, Inc. should be granted discharges and that the appropriate injunction orders relative to said discharges should be issued.

J U D G M E N T

NOW, THEREFORE, IT IS ORDERED AND ADJUDGED:

1. That plaintiff's Complaints be, and the same are, hereby dismissed on their merits and without costs.

2. That any indebtedness claimed by said plaintiff be and

the same is hereby subject to discharge and release in accordance with the provisions of the Bankruptcy Act.

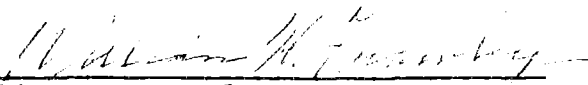
3. That the aforesaid indebtedness, if any, so claimed of the bankrupts to the plaintiff be and the same is hereby discharged and released.

4. Any judgment heretofore or hereafter obtained in any Court other than this Court in respect of the aforesaid indebtedness is null and void as a determination of the personal liability of the bankrupts in connection with the said indebtedness.

5. Citizens State Bank & Trust Company of Wausau be and the same is hereby enjoined from instituting or commencing any action or employing any process to collect the aforesaid indebtedness as a personal liability of the above named bankrupts.

Dated: March 28, 1984.

BY THE COURT:



William H. Frawley
Bankruptcy Judge