

IN THE UNITED STATES DISTRICT COURT  
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE	)	
	)	
ELMER K. BAILEY,	)	
	)	
Debtor.	)	
	)	
RONALD K. BAILEY and	)	CAUSE NO. 98-CV-190-WDS
HERSHEL KASTEN,	)	
	)	BK. No. 97-60112
Plaintiffs-Appellants,	)	
	)	Adv. No. 97-6016
VS.	)	
	)	
ELMER BAILEY,	)	
	)	
Defendant-Appellee.	)	

**MEMORANDUM & ORDER**

STIEHL, District Judge:

This matter is before the Court on appeal from the United States Bankruptcy Court for the Southern District of Illinois. For the reasons stated below, this Court affirms the ruling of the bankruptcy court.

**BACKGROUND**

As the Bankruptcy Court stated, this case stems from an intense family feud whose principal parties are brothers. Throughout the case, the parties have filed a plethora of other motions on various issues and bickered over matters not germane to this case.

The plaintiff-appellant, Ronald Bailey, and defendant-appellee, Elmer Bailey, were engaged in the timber business together on and off for over thirty-five years. According to appellants, the most recent partnership between the Bailey brothers to engage in the timber business existed from 1990 until sometime in 1993. After the brothers' working arrangement ended, Ronald Bailey sued appellee in state court. The state court case proceeded until the eve of trial, when appellee filed for bankruptcy pursuant to Chapter 7 of the Bankruptcy Code.

Shortly after appellee filed for bankruptcy, appellants conducted an examination of appellee pursuant to **Bankr. Rule 104** and filed a two-count complaint. The complaint was subsequently amended by adding a third count. Count I alleges that appellee failed to maintain adequate records pursuant to **11 U.S.C. §727(a)(3)**; Count II alleges that appellee breached his fiduciary duty owed to appellants pursuant to 11 U.S.C. § 523(a)(4); and Count III alleges that appellee fraudulently filed his bankruptcy schedules pursuant to **11 U.S.C. §727(a)(4)(A)**. The Bankruptcy Court initially held that Count III was timely filed.

The Bankruptcy Court granted appellee's motion for summary judgment. The Bankruptcy Court further held that appellants did not timely file Count III, reversing its original decision that

it was timely filed. One day after summary judgment was granted, appellants moved to amend Count III to set forth a new claim to revoke appellee's discharge pursuant to **11 U.S.C. §727(d)**. The Bankruptcy Court ruled against appellants on their **§727(d)** count. Appellants appealed the Bankruptcy Court's decisions to this Court pursuant to **28 U.S.C. §158(a)(1)**.

### **ANALYSIS**

#### **A. STANDARD OF REVIEW**

In an appeal from a decision of the bankruptcy court, the district court will uphold the bankruptcy court's findings of fact unless they are clearly erroneous. **Fed. R. Bankr. P. 8013**. The District Court reviews the bankruptcy court's legal conclusions *de novo*. *In re Marrs-Winn Co.*, **103 F.3d 584,589 (7th Cir. 1996)**. As it is a conclusion of law, the Court will review the Bankruptcy Court's decision to grant summary judgment *de novo*. *In re Lefkas General Partners*, **112 F. 896, 900 (7th Cir. 1997)**.

#### **B. SUMMARY JUDGMENT STANDARD**

**Bankruptcy Rule 7056** states that **Fed. R. Civ. P. 56** applies in adversary proceedings. **Fed. R. Civ. P. 56(c)** provides that a district court shall grant summary judgment "if the pleadings, depositions, answers to interrogatories, and admissions on file,

together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." In determining whether a district court properly granted summary judgment, "[a]ll factual inferences are to be taken against the moving party and in favor of the opposing party." **International Adm'rs, Inc. v. Life Ins. Co. of N. Am.**, 753 F.2d 1373, 1378 (7th Cir. 1985). In instances in which "inferences contrary to those drawn by the trial court might be permissible," a district court's grant of summary judgment must be reversed. **Munson v. Friske**, 754 F.2d 683, 690 (7th Cir. 1985). Once a motion for summary judgment has been made and properly supported, however, the nonmovant does have the burden of setting forth specific facts showing the existence of a genuine issue of a material fact for trial. **See Rule 56(e); Posey v. Skyline Corp.**, 702 F.2d 102, 105 (7th Cir.), **cert. denied**, 464 U.S. 960 (1983), (noting that "a bare contention that an issue of fact exists is insufficient to raise a factual issue"). Although a requisite, the existence of a factual dispute is not, standing alone, sufficient to bar summary judgment. It is well settled that a "factual dispute does not preclude summary judgment unless ... the disputed fact is outcome determinative under the governing law." **Egger V. Phillips**, 710 F.2d 292, 296 (7th Cir.), **cert. denied**, 464 U.S.

918 (1983), cited in *Shlay v. Montgomery*, 802 F.2d 918,920 (7th Cir. 1986).

C. COUNT I: DUTY TO MAINTAIN ADEQUATE RECORDS FOR REVIEW

Plaintiffs allege that the Bankruptcy Court should have denied appellee's discharge because he failed to maintain adequate records and financial statements from which his financial condition could be determined. **Section 727(a)(3)** states that a discharge should be granted unless

the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or to preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case.

**11 U.S.C. §727(a)(3)**. It is undisputed that appellee did not conceal, destroy, mutilate, or falsify any records. Therefore, the issue is whether a genuine issue of material facts exists as to whether appellee failed to maintain adequate records.

**Section 727** should be liberally construed in favor of debtors in order to effectuate the "fresh start" goal of bankruptcy relief. *In re Johnson*, 98 BR. 359, 364-65 (Bank. N.D. Ill. 1988). Under **§727(a)(3)**, however, a debtor may not be granted a discharge if the debtor's financial records do not enable the Court to evaluate the debtor's overall financial position and to reconstruct the debtor's business transactions

for a reasonable period of time,"with substantial completeness and accuracy." *In re Bailey*, 145 BR. 919, 924 (Bank. N.D. Ill. 1992). The completeness and accuracy of the records is determined on a case by case basis. *Id.* Relevant factors include the size and complexity of the debtor's business and the debtor's sophistication and business experience. *In re Martin*, 141 BR. 986, 995 (Bank. N.D. Ill. 1992). Intent to defraud is not a relevant issue. *Bailey*, 145 BR. at 924, *citing In re Potter*, 88 BR. 843, 848 (Bank. N.D. Ill. 1988). Thus, appellants only need to prove that the debtor has inadequate records pursuant to § 727(a)(3).

In *In re Juzwiak*, the Seventh Circuit held that the debtor's records were insufficient to adequately reconstruct his transactions and financial dealings. 89 F.3d 424, 428 (7th Cir. 1996). In *Juzwiak*, the Seventh Circuit focused on the inability to determine the source of the funds deposited into debtor's account and how those funds were spent. *Id.* at 428. Other factors used by the Seventh Circuit included the intermingling of personal and business funds, the steady stream of large transactions undertaken by the debtor's business, the business acumen possessed by the debtor, and the creditor's need to speculate as to the debtor's financial condition. *Id.* Moreover,

the Seventh Circuit noted that the debtor in *Juzwiak* had extensive bookkeeping and managerial experience before operating his business that went bankrupt. *Id.* at 426. Courts have consistently held that sophisticated business persons are expected to maintain better records than those without any experience. *In re Cox*, 41 F.3d 1294,1296 (9th Cir. 1994); *Meridian Bank v. Alten*, 958 F.2d 1226,1231-32 (3rd Cir. 1992).

In this case, appellee is not a sophisticated businessman- his business operations are very simple and his business dealings were confined to his local, rural community. Thus, the Court cannot expect appellee to provide complex summaries of reports. Appellee, however, has provided the Court with ample financial records that detail his financial condition and business transactions. The record demonstrates that appellee produced his canceled checks, income tax returns with summaries, and bank statements. Appellee noted the source of the funds or the explanation for the expenses on these records. In fact, appellee was audited by the Internal Revenue Service during the relevant time period and his records were sufficient for the IRS to conduct its audit. Therefore, no genuine issue of material fact exists as to whether appellee failed to maintain adequate business records.

D.           **COUNT II: BREACH OF FIDUCIARY DUTY**

Appellant Ronald Bailey alleges that appellee's debts are not dischargeable pursuant to **11 U.S.C. §523(a)(4)**. **Section 523(a)(4)** states that claims that are fraudulently filed by an individual debtor while acting in a fiduciary capacity are not dischargeable. *Id.* Specifically, Ronald Bailey alleges that he and appellee were doing business as a partnership and appellee violated the fiduciary duties owed to him. The Seventh Circuit requires appellant to prove that an appropriate fiduciary relationship must have existed at the time the breach occurred. *In re Marchiando*, **13 F.3d 1111, 1116 (7th Cir. 1994)**. In other words, the trust relationship may not be a purely nominal one when debtor breached his fiduciary duty. *In re Woldman*, **92 F.3d 546, 547 (7th Cir. 1996)**. The Seventh Circuit has also stated that **§ 523(a)(4)** only reaches fiduciary obligations where the debtor seeking discharge possessed a "substantial inequality in power or knowledge." *Id.* at **547**.

In this case, Ronald Bailey alleges that a partnership existed between appellee and himself. In the absence of a written or oral partnership agreement, Illinois law directs the Court to examine the circumstances surrounding the parties' relationship. *Seidmon v. Harris*, **526 N.E.2d 543, 546 (Ill. App. Ct. 1988)**. To determine whether a partnership existed, the

following factors are material: the manner in which the parties have dealt with each other; the mode in which each has, with knowledge of other, dealt with persons in partnership capacity; whether the alleged partnership has advertised using the alleged partnership's name; and whether the alleged partners shared profits. *Argianas v. Chestler*, 631 N.E.2d 1359, 1369 (Ill. App. Ct. 1994); *Rizzo v. Rizzo*, 120 N.E.2d 546, 551 (Ill. 1954).

The evidence demonstrates that the Bailey brothers were not partners. The Bailey brothers did not maintain a partnership bank account of any kind; instead, they kept their money in personal accounts in their respective names. The Bailey brothers did not deal with each other as partners; instead, they were paid as individuals and did not share their earnings. Moreover, there is no evidence that the Bailey brothers advertised or made any representations that they were a partnership. Even if the Court found that an oral partnership existed, there were no clearly defined duties or rights. Thus, the only possible trust relationship that appellee could have breached was a failure to share partnership profits with his brother. Under Illinois law, failure to share profits would create a constructive trust. *In re Marchiando*, 13 F.3d at 1116. The Seventh Circuit has held that a breach of a constructive trust, which arose solely as a result of the breach, does not trigger the application of

**§523(a)(4)**. *In re Woldman*, 92 F.3d at 547. In addition, appellee did not possess a substantial inequality in power or knowledge"; instead, the evidence demonstrates that the Bailey brothers operated on equal footing.

**E. COUNT III: FRAUDULENT FILING OF BANKRUPTCY SCHEDULES**

Appellants argue that the Court should deny appellee's discharge in bankruptcy in that he fraudulently filed for a discharge pursuant to **11 U.S.C. §727(a)(4)(A)**. Before the Court will address the merits of this issue, it must first determine whether appellants timely filed this count. Claims for relief pursuant to **§727(a)(4)(A)** must be filed not later than sixty days following the first date set for the meeting of creditors, pursuant to **Bank. Rule 4004(a)**. *In re Perez*, 173 BR. 284, 289 (**Bank. E.D.N.Y. 1994**). After the limitation period has expired, the Court is without jurisdiction if the amended complaint does not meet the statutory deadline for filing unless the amended count relates back to the original complaint. *In re Ham*, 174 BR. 104, 106-07 (**Bank. S.D. Ill. 1994**). Pursuant to **Fed. R. Civ. P. 15(c)(2)** an amendment of a pleading relates back to the date of the original pleading when the claim asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading. *Id.* In addition, the Court must determine that notice of the

allegation in the amended complaint was given to appellee by the general fact situation set forth in the original complaint. ***In re Perez*, 173 BR. at 291.** Such notice must have alerted appellee of the general wrong or conduct to which the second amended complaint pertains. ***Id.***

Appellants do not dispute the fact that their claim under the foregoing section was pled after the sixty day period had expired, but assert that their claims are not untimely because they relate back to the date of its original complaint. Specifically, appellants argue that this count is closely related to Count I, the **§727(a)(3)** claim, in that appellee's failure to provide sufficient records undermined their efforts to find appellee's assets. To relate back, there must be a factual nexus connecting the amended count to a count pled within the relevant time period. **Fed. R. Civ. P. 15(c); *In re Biederman*, 165 BR. 783, 792 (Bank. D.N.J. 1994).** Contrary to appellants' contention, no factual nexus exists between the **§727(a)(4)** and **§727(a)(3)** counts. **Section 727(a)(3)** concerns the quantity and type of records maintained by appellee, whereas **§727(a)(4)(A)** concerns whether the information on the records was accurate. Moreover, appellants' allegation that appellee failed to maintain and to provide financial records did not put him on notice that appellants would later argue that he

fraudulently valued his assets. Because appellants' claim is jurisdictionally barred, the Court need not address the merits of this issue.

However, appellants' contention is without merit. After reviewing the evidence, the Court adopts the Bankruptcy Trustee's opinion that "the property is not worth the cost of hauling it away." As a result, the alleged misrepresentations by appellee were not "material" and, therefore, do not violate **§727(a)(4)(A)**. *In re Agnew*, 818 F.2d 1284 (7th Cir. 1987).

**F. MOTION TO AMEND THE PLEADINGS AFTER THE BANKRUPTCY COURT GRANTED SUMMARY JUDGMENT**

Shortly after the Bankruptcy Court granted appellee's motion for summary judgment, appellants filed a motion to amend their complaint. Specifically, appellants moved to replead Count III as a new count pursuant to **11 U.S.C. §727(d)(1)**<sup>1</sup>

by alleging that appellee fraudulently obtained his discharge. *Id.* Appellants further argue that the addition of the **§727(d)** count would not prejudice appellee in that it is neither a new legal theory nor reliant on facts not previously alleged.

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<sup>1</sup>In their motion to amend, appellants failed to specify which subsection of **§727** applied to this case. The Bankruptcy Court held that **§727(d)(1)** was the only subsection applicable to this case. The Court agrees with the Bankruptcy Court's decision. Moreover, in their appellate brief, appellants only address whether appellee violated **§727(d)(1)**.

Finally, appellants argue that a **§727(d)** claim would be their only opportunity to allege that appellee acted fraudulently because their **§727(a)(4)(A)** claim was procedurally barred.

**Section 727(d)(1)** states that discharge shall be revoked if "such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge." *Id.* Generally, courts have required creditors to establish three requirements to satisfy **§727(d)(1)**: 1) creditor must not have known of the fraud until after the granting of discharge; 2) debtor must have intentionally defrauded the court; and 3) the fraud at issue must be fraud in fact. *In re Kaliana*, 202 BR. 600, 604 (Bank. N.D. Ill. 1996); *In re Jones*, 71 BR. 692, 684 (Bank. S.D. Ill. 1987). Moreover, if the creditor suspected fraud before discharge, then the creditor cannot seek relief pursuant to **§727(d)(1)**. The Court agrees with the Bankruptcy Court's holding that the evidence demonstrates that appellants suspected appellee engaged in fraudulent conduct before objecting to appellee's discharge in bankruptcy. In fact, appellants have alleged that appellee has misrepresented facts throughout the entire course of the proceedings. In addition, appellants' post-discharge contention also violates the principle of laches. *In re Jones*, 71 BR. 684-85.

**CONCLUSION**

Accordingly, the Court **AFFIRMS** the decisions of the Bankruptcy Court and **DENIES** plaintiff's appeal.

**IT IS SO ORDERED.**

**DATED: September 3, 1998**

/s/ WILLIAM D. STIEHL  
DISTRICT COURT JUDGE