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Spec # 309

THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF UTAH

DIVISION

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MARY YVONNE ("BONNIE") S. HAYMOND; CLARENCE R. SILVER; LARRY R. SILVER; ROY R. SILVER; MARJORIE S. SMITH; RICHARDS G. SMITH; C. LEWIS BUTEHORN; and MAMIE R. SILVER, MARJORIE S. SMITH, and CLARENCE R. SILVER as Co-Trustees of Testamentary Trusts created by the Estate of C.W. Silver,	Civil No. 90-C-969-S
Appellants/Plaintiffs,	MEMORANDUM DECISION AND ORDER
vs.	88PB-0972
BROOKE GRANT,	
Appellee/Defendant.	

* *

This matter is before the court on appeal from the bankruptcy courts's order discharging the debt owed by appellee/defendant Brooke Grant ("Grant") to the appellants/plaintiffs hereinafter referred to as (the "Shareholders" or "Plaintiffs").

FACTS

The Plaintiffs in this action are former Shareholders of C.W. Silver Inc. ("CWS"). In December 1984 they approached defendant

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Grant to discuss the sale of CWS to Hanover Western. Grant is the majority stockholder and chairman of the board of directors of Hanover Companies[1], a group of related entities engaged in a wide variety of enterprises, including asset acquisitions and land and energy development. He is a well educated entrepreneur, having received a B.A. in economics and a J.D. from Stanford University. He is also a CPA.

Negotiations over the sale of CWS to Hanover Western continued over several months. The Shareholders were concerned about security for payment by Hanover Western so it was agreed that Grant and his business partner, David Jerman ("Jerman"), would personally guarantee the purchase. The Shareholders became more concerned when they received information from an officer at Zions Bank that the Hanover Companies were highly leveraged and might be incapable of making substantial capital infusions into CWS.

After discussing several alternatives with CWS' general counsel, the Shareholders decided that, in addition to the personal guarantees previously agreed upon, they would require signed personal financial statements from both Grant and Jerman, certified

[1]Hanover Western, Hanover Energy, Inc., Hanover Energy Partnership, Hanover Lantrust and Hanover Financial, Inc., a group of related entities engaged in a wide variety of enterprises including asset acquisition and land and energy development.

by the signor as true and correct. This request was flatly rejected by Grant and, as a result, negotiations stalled.

The parties finally reached a compromise in which Grant and Jerman would allow the Shareholders to review copies of their financial statements prior to the closing. Grant provided a copy of his financial statement, but excluded from it contingent liabilities of between $6,000,000 and $10,000,000.

Upon closing the sale of the Shareholders' stock in CWS on February 15, 1985, Hanover Western paid 20% of the sales price to the Shareholders. The balance of the payments were to be made in seven equal yearly installments. On February 21, 1986, Hanover Western paid to the Shareholders $183,673.72. However, when the 1987 payment came due, Hanover Western requested that the Shareholders accept an interest only payment.

In response, the Shareholders demanded Grant's current financial statement. Grant supplied a financial statement dated January 31, 1987. Grant now disclosed contingent liabilities of $19,880,000. The Shareholders thereupon accelerated the remaining amounts due under the promissory notes.

On May 21, 1987, the Shareholders filed suit in this court. On August 12, 1988, one working day before the scheduled jury trial of this case, Grant filed a petition under Chapter 7 for bankruptcy. The Shareholders filed an adversary proceeding seeking to have the debt declared non-dischargeable under 11 U.S.C. § 523(a)(2)(B).

DISCUSSION

The Shareholders raise three principle arguments on appeal.

1) The bankruptcy court erred by requiring the Shareholders to prove that Grant did not intend to repay the loan and that the he prevented the Shareholders from receiving negative information concerning Grants' financial status.

2) The bankruptcy court erred by using the "clear and convincing evidence standard" rather than the "preponderance of the evidence" standard.

3) The bankruptcy court erred by denying a jury trial.

In reviewing these issues, this court is bound by the "clearly erroneous" standard for finding of facts and a "de novo" standard for findings of law. United States v. United States Gypsum Co., 333 U.S. 364, 395 (1948).

Intent to Deceive

11 U.S.C. § 523(a)(2)(B) provides that a discharge does not affect any debt incurred in obtaining money or property by use of a statement in writing:

(i) that is materially false;

(ii) respecting the debtor's or an insider's financial condition;

(iii) on which the creditor to whom the debtor is liable for obtaining such money, property, services, or credit reasonably relied; and

(iv) that the debtor caused to be made or published with intent to deceive;

Intent to deceive will be presumed when the plaintiff has proved all of the other elements of 11 U.S.C. § 523(a)(2)(B). Park Credit v. Harmer (In re Harmer), 61 B.R. 1, 4 (Bankr. D. Utah 1984). Once the prima facia case is established, the burden is then shifted to the defendant to refute that presumption. Id. The bankruptcy court found that the Shareholders, with the exception of Mary Yvonne ("Bonnie") S. Haymond and C. Lewis Butehorn, had established a prima facia case and the burden was on Grant to prove otherwise. Bankruptcy Court's Memorandum Decision and Order dated September 14, 1990 (hereinafter "Memorandum Decision and Order") pp. 19, 21, 35.

The Shareholders contend that the bankruptcy court erred by placing a greater burden of proof than that which is required under 11 U.S.C. § 523. Specifically, they allege that they were wrongly required by the bankruptcy court to prove the "intent to deceive" element by establishing that Grant did not intend to repay the loan, and that he prevented the Shareholders from obtaining negative financial information. Memorandum Decision and Order p. 37.

Intent to deceive is a subjective element inferred from the surrounding circumstances. North Park Credit v. Harmer (In re Harmer), 61 B.R. at 9. Because it is so difficult to prove, courts have presumed it to be true when all the other elements have been met. Intent to repay and failure to prevent the plaintiff from obtaining negative information can be part of the circumstances that the court looks at in determining if the defendant has refuted the plaintiff's presumption. Therefore, if the bankruptcy court evaluated Grant's intent to repay the debt merely as points of evidence in deciding that the presumption (that Grant intended to deceive) is defeated, then there is no error.

From reading the Memorandum Decision and Order, it appears to this Court that the bankruptcy court, contrary to the law, may have

hinged its decision on the Shareholders proving intent to repay. On page 36 of the Memorandum Decision, the bankruptcy court states that "[t]he Shareholders have failed to prove that Grant was intentionally deceptive and dishonest and that he knew at the time of the transaction he had no likelihood of repaying the debt." In concluding its discussion of "intent to deceive" the bankruptcy court found that "[t]he Shareholders have failed to carry their burden of proving Grant's intent to deceive by clear and convincing evidence." Memorandum Decision and Order p. 41. The Shareholders in this case did not have the burden to prove the "intent to deceive" element. Rather, the shifted burden was on the defendant Grant to show that he was not intentionally deceptive. See North Park Credit v Harmer (In re Harmer), 61 B.R. at 4 (after creditor has met burden of persuasion on other elements burden of proof of intent element shifts to debtor). The bankruptcy court appears to make the Shareholders' claim contingent on the fact that they prove Grant's intent to deceive by showing that Grant had no intent to repay the debt and that Grant prevented them from obtaining financial information. At page 37 of its Memorandum Decision and Order, the bankruptcy court stated: "To be intentionally deceptive Grant must have known or had reason to know at the time of the negotiations that there was a reasonable likelihood Hanover Western could not satisfy the obligation. He must further have taken

action to prevent the Shareholders from receiving any negative information."

Notwithstanding the foregoing, it also appears to this court that the bankruptcy court considered other circumstances by which it may have concluded that Grant had rebutted the presumption that he was intentionally deceptive. See North Park Credit v. Harmer (In re Harmer), 61 B.R. at 4. For example, the bankruptcy court also noted that this type of transaction was an arm's length negotiation with equal bargaining power on each side. Memorandum Decision and Order p. 38. The bankruptcy court also considered evidence that Grant paid the Shareholders substantial amounts of money, obtained credit for CWS from Zions Bank, and infused $200,000 into CWS. Id. at 40. Finally, the bankruptcy court noted that Grant was not hopelessly insolvent at the time of the transaction and that he did not intentionally or recklessly provide incorrect financial statements. Id. at 37-38.

Although the bankruptcy court discussed other evidence that Grant did not intend to deceive, it appears to this court that the bankruptcy court, nevertheless, may have placed the burden upon the Shareholders to prove Grant's lack of intent to repay the debt thereby establishing his "intent to deceive." That is not the law.

The burden of rebutting the presumption of intent to deceive is on Grant. Accordingly, this issue must be remanded to the bankruptcy court for a clarification or re-examination of its ruling consistent with this opinion.

Standard of Proof

The bankruptcy court, at the time of its Memorandum Decision and Order, correctly used the "clear and convincing" evidence standard in reaching its conclusions. Memorandum Decision at 21, 41. A few months after that decision, the Supreme Court held that the "standard of proof for the dischargeability exceptions in 11 USC § 523(a) is the ordinary preponderance-of-the-evidence standard." Grogan v. Garner, ___ U.S. ___, 111 S.Ct. 654, 661 (1991).

The plaintiffs contend that the "preponderance of the evidence" standard should have been used in this case and that the decision be vacated on that basis. This Court has the authority to vacate a decision on appeal when a publication of an intervening Supreme Court decision changes the law in question. Busey v. District of Columbia, 319 U.S. 579 (1943). This court may also

remand for reconsideration in light of intervening decisions by the United States Supreme Court. Guste v. Jackson, 429 U.S 400 (1977).

The court concludes that the judgment of the bankruptcy court should be vacated and the case remanded to enable the bankruptcy court to re-examine its ruling in light of the subsequent decision of the Supreme Court in Grogan v. Garner.

Jury Trial

The Shareholders urge that it was reversible error for the bankruptcy court to deny its request for a jury trial. They cite Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989) as the basis for entitlement to a jury trial of their legal claims. In response, Grant urges that the Shareholders cause of action under § 523(a)(2)(B) was not a legal claim for fraud but a claim for an exception to discharge for which there is no right to a jury trial. As an alternative argument, Grant contends that the Shareholders waived their right to a jury by not including a request for a jury trial on the amended complaint and by not requesting a transfer to the district court as required by Latimer v. Stainer, 918 F.2d 136 (10th Cir 1990), cert. denied, 60 U.S.L.W. 3262 (U.S. Oct. 8, 1991) (91-148).

This court concludes that the plaintiffs timely and properly demanded a jury trial and did not waive that right by failure to request a transfer to the District Court. As noted earlier, the Shareholders originally filed suit in this court. Just prior to trial, Grant filed a petition in bankruptcy. The Shareholders thereafter filed an adversary proceeding in bankruptcy court. The demand for jury trial was indicated on the civil cover sheet, stated on the heading of the complaint, and set forth again in the body of the complaint. At the time the shareholders requested a jury trial, the bankruptcy court had authority to hold jury trials which authority was valid until Kaiser Steel Corp. v. Frates (In re Kaiser Steel), 911 F.2d 380, 389 (10th Cir. 1990) (holding that bankruptcy courts cannot hold jury trials). Latimer, which requires a request for transfer when demanding a jury, was decided three weeks after the bankruptcy court's Memorandum Decision. Therefore, Latimer did not apply to the Shareholders' demand for a jury trial. Accordingly, the Shareholders were not required to request a transfer to the district court at the time they demanded a jury trial, and therefore, did not waive their right for one.

However, there remains the underlying issue of whether the Shareholders', by virtue of the claim they assert, are entitled to a jury trial. A party to a bankruptcy proceeding is entitled to a

jury trial even if the bankruptcy action is a core proceeding, provided, among other things, that the cause of action is a legal claim, as compared to an equitable claim. Granfinanciera, S.A v. Nordberg, 492 U.S. 33, 109 S. Ct. 2782 (1989).

The relevant focus here is whether the proceeding is legal or equitable in nature. Under the facts presented, this court concurs with the analysis in Schieber v. Hooper (In re Hooper), 112 B.R. 1009 (9th Cir. BAP 1990), that an action for a declaration of a debt as non-dischargeable is equitable. A non-dischargeable debt proceeding has historically been defined as equitable and was not afforded a jury trial in the courts of equity of England prior to the merger of courts of equity and law in this country. Id.

Discharge does not entitle one to money damages, but rather rewards one with injunctive relief by not allowing the defendant to be discharged of his debt. It is well settled that injunctive relief is indicative of an action in equity. Id. Certainly, some of the elements of a non-dischargeable claim are related to legal issues. However, the court finds the following passage, from Schieber v. Hooper, both applicable and persuasive.

> Because of the equitable nature of the remedy sought and the historically equitable roots of dischargeability issues, under the test of Granfinanciera, Schieber is not entitled to a jury trial on the issue of discharge-

> ability. Although there may be a right to a jury trial on the underlying issue of damages, the bankruptcy court found the debt dischargeable and did not reach the damages question. Accordingly, there was no right to a jury trial on the issues addressed in the court below. . . .

Schieber v. Hooper (In re Hooper), 112 B.R. at 1012-13.

The court is sensitive to the Supreme Court's ruling, in Lytle v. Household Mfg. Inc., 110 S. Ct. 1331 (1990), that a right to a jury trial of legal issues cannot be lost through prior determination of equitable claims. See also, Beacon Theaters, Inc. v. Westover, 359 U.S. 500, 79 S.Ct. 948 (1959); Dairy Queen, Inc. v. Wood, 369 U.S. 469, 82 S.Ct. 894. However, the instant case differs from those cited above. The bankruptcy court in this case did not have to decide or consider the legal issues once it determined that the debt was dischargeable. The Shareholders were not denied a right to a jury trial on the legal issues because the court was not required to considered or rule on the legal issues unless the debt was declared non-dischargeable. Hooper 1112 B.R. at 113. In other words, the Shareholders had no legal actions available to them until the debt was declared non-dischargeable. Consequently, the Shareholders are not entitled to a jury trial on the discharge issue.

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CONCLUSION

The judgment of the United States Bankruptcy Court is vacated and the matter is remanded for further proceedings consistent with this opinion.

DATED this 18th day of November, 1991.

BY THE COURT:

David Sam

DAVID SAM
U.S. DISTRICT JUDGE