

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF WISCONSIN

In re:

MAX KEVIN CHULEW,

Debtor.

Case No. 95-23801

Chapter 7

SIERRA CENTER 24, INC.,

Plaintiff,

vs.

Adversary No. 95-2406

MAX KEVIN CHULEW,

Defendant.

MEMORANDUM DECISION

I. INTRODUCTION

This is an action to deny the discharge of the debtor, Max Kevin Chulew, under several subsections of 11 U.S.C. § 727. The grounds stated in the complaint relate primarily to the debtor's nondisclosure of his personal assets and financial affairs and those of the corporation under his control. This court has jurisdiction under 28 U.S.C. § 1334(b); this is a core proceeding under 28 U.S.C. § 157(b)(2)(J).

For the reasons stated herein, the relief requested by the plaintiff is granted, and the debtor's discharge will be denied.

II. FACTS

The debtor's case was commenced by the filing of an involuntary petition on June 16, 1995. The petition was not contested, and an order for relief was entered on July 12, 1995. The debtor/defendant, Max Chulew, is a fifty percent owner and an officer of Midwest Carpet Distributors, Inc., d/b/a Midwest Bedroom ("Midwest"). An involuntary petition was also filed against Midwest on June 16, 1995. An order for relief was entered on July 12, 1995, and that case is currently pending in this court.

The business of Midwest was the retail sale of bedroom furniture and carpeting. Midwest first had a store in Kenosha, Wisconsin, and in the fall of 1994 it opened an additional store in Milwaukee, Wisconsin. The Milwaukee store was located at Woodland Court shopping center. The plaintiff in this action was Midwest's landlord at Woodland Court. The plaintiff is a creditor of the defendant by virtue of a personal guarantee of Midwest's lease with Woodland Court.

Before opening the stores in Kenosha and Milwaukee, the debtor operated similar stores in Phoenix, Arizona and Austin, Texas. He also worked in his father's furniture and carpet businesses at various times. All told, the debtor has been in the furniture and carpet business for about eighteen years.

In early 1994, Mark Dechant joined the business with a \$10,000 investment. The debtor is the cousin of Mr. Dechant's wife. Since Mr. Chulew's forte is sales, Mr. Dechant was to handle the financial side of the business. However, when Mr. Chulew decided to open the Milwaukee store, there were two separate bank accounts, and Mr. Dechant only kept records for the Kenosha store. The two kept no sales ledgers; only invoices and bank deposits and checks were used for financial reporting. Eventually, sales declined, and both stores went out of business.

For a significant period before the debtor's and the corporation's bankruptcies, the debtor lived with Brenda Haley. At trial, she stated she moved in with him in December of 1994, and he recalled it was December of 1992. He testified she then moved with him to Milwaukee in October 1994. Since she stated they lived together for a year and a half, and they agreed she moved out in November of 1995, his sense of timing is probably more accurate.

Additional facts will be developed in the discussion section of this decision.

III. DISCUSSION

The plaintiff has filed alternative counts for denial of discharge under § 727. Sierra Center 24, Inc., must prove its objections to discharge by a preponderance of the evidence. *See In re DeBruin*, 144 B.R. 90, 92 (Bankr. E.D. Wis. 1992) (citing *Grogan v. Garner*, 498 U.S. 279 (1991)). If any of the § 727 provisions were violated, the debtor cannot be granted discharge of his debts. Nevertheless, the court is mindful that § 727 must be liberally construed in favor of the debtor and against the creditor in order to effectuate the fresh start goal of bankruptcy relief. *Matter of Juzwiak*, 89 F.3d 424, 427 (7th Cir. 1996).

All allegations revolve around whether Mr. Chulew's and Midwest's bankruptcy statements and schedules fairly and accurately depict each debtor's finances, and whether those statements and schedules reflect all compensation Mr. Chulew received from Midwest and elsewhere. The plaintiff contends Mr. Chulew took cash from Midwest without reporting such revenue to the appropriate taxing and bankruptcy authorities. It also contends that the debtor failed to disclose income and assets, at least until he was caught in the concealment, and intentionally filed false schedules, all with the intent to defraud creditors. The defendant claims

his statements regarding sources of income were correct, but that he managed to meet his living expenses with cash he retained from several sources, including financial assistance from his former live-in girlfriend and the proceeds from rummage sales of furniture and appliances. He also states he received extra income from furniture and carpet deliveries for which he was paid personally.

The plaintiff further alleges that the defendant was not truthful at the § 341 hearings in his personal and Midwest's bankruptcy cases. According to the plaintiff, the defendant falsified or failed to keep or preserve records of some of Midwest's sales. Additionally, the plaintiff claims that the defendant concealed property of Midwest with intent to hinder, delay, or defraud creditors within one year prior to the petition date. The defendant contends that both debtors' schedules were true and correct, to the best of his ability to complete them at the time they were filed, and that errors, if any, are the product of innocent mistake.

A. 11 U.S.C. § 727(a)(2)

The plaintiff has alleged that the debtor concealed assets from creditors in contravention to 11 U.S.C. § 727(a)(2). Section 727(a)(2) provides, in relevant part, that the court shall not grant the debtor a discharge if:

the debtor, with intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed--

(A) property of the debtor, within one year before the date of the filing of the petition;

11 U.S.C. § 727(a)(2). The operative word in this case is "concealed." Actual intent to defraud creditors is a prerequisite to denying discharge under § 727(a)(2); constructive intent is not sufficient. *In re Bailey*, 145 B.R. 919, 926 (Bankr. N.D. Ill. 1992). Nevertheless, since direct

evidence of a debtor's intent to defraud is rarely present, such intent may be established by circumstantial evidence or inferences drawn from a course of conduct. *Bailey*, 145 B.R. at 926-27; *DeBruin*, 144 B.R. at 93.

At trial, the debtor stated that he often kept thousands of dollars in cash under the carpet in his apartment. Brenda Haley testified that he also stashed cash in a secret compartment in his desk and continually moved it around within the apartment. When asked why, the debtor had "no particular reason." He speculated that he might need it, or his daughter might need something. The debtor did not maintain a personal checking account since 1993 and instead used credit cards and money orders to pay his obligations.

Evidence relating to the debtor's alleged concealment of his personal assets revolved around a comparison of his acknowledged income and his living expenses. The plaintiff maintained that other sources of income and other assets, such as cash, were concealed to avoid the reach of creditors. The debtor's schedules and tax returns show in 1994 he had taxable wages of \$6,335.00, and in 1993 he had taxable wages of \$8,775.00. His schedules also state that during 1995, until the order for relief in July 1995, he had made about \$1,600.00.

The debtor's schedules revealed that his monthly expenses at the time they were prepared were \$1,643.00. As he testified, however, the debtor began to whittle down his expenses until it cost him very little to live. He decided finally that his 1994 living expenses were about \$10,600.00, or about \$833.33 per month. Occasionally, however, evidence of other expenses not previously enumerated crept into his testimony. For example, he stated he often took cabs when Brenda did not give him a ride to work. He also claimed to have personally paid for expenses related to the truck used in the business, for which he was occasionally reimbursed, but no records

of these transactions were introduced. The debtor also paid the airfare for his daughter's visits from Arizona.

Approximately one half of 1994 is included in the year prior to filing the petition and is relevant to this inquiry. Since his gross wages during 1994 were only about \$528.00 per month, the debtor obviously was getting money somewhere. At the § 341 meeting, the debtor testified he was helped by his girlfriend. No mention was made at that time of the sale of any assets or any extra income, such as furniture delivery income or other withdrawals from the business. This outside income was also not disclosed on the debtor's tax returns or his statement of affairs. Sales of personal property were also not shown on the statement of affairs, nor were they revealed at the § 341 meeting, but he remembered these by the time of trial. These sales rendered over \$12,000.00 over the three years preceding the bankruptcy (Ex. 21G). It is not clear how much of the proceeds, if any, was due to sales that occurred during the year before filing the petition. There are no records of any of this extra income.

During the first part of 1995, the debtor had gross wages of only about \$200.00 to 230.00 per month (depending on whether seven or eight months is used in the calculation). Because he was not living with Ms. Haley during this time, the debtor attempted to explain where his cash was coming from. He first testified that he had about \$2,000.00 in cash at the end of 1994; he then changed this to \$3,500.00 (Ex. 21G). There is, of course, no means to verify this. He also estimated that he received \$2,500.00 in delivery income for seven months in 1995, at a time when Midwest's sales were dwindling. Delivery income from prior years was not disclosed, either on the schedules or Mr. Chulew's tax returns, but the court has no reason to believe this was a new source that began in 1995.

The plaintiff argues that the debtor's failure to keep proof of personal transactions is evidence of his intent to conceal assets. The debtor maintains that such evidence does not show intent on his part to conceal property from creditors. He further asserts that Ms. Haley's testimony is incredible.

The court is convinced that Mr. Chulew's explanations relating to his financial affairs during the year prior to filing are not credible. He seemed to be making it up as he went. During the year preceding filing of the petition, he concealed income and assets, including the source of the \$3,500.00 he supposedly had under his carpet in December 1994 (a remarkable amount given his disclosed income), the side income he was earning from furniture deliveries, and the cash he received from the sale of his assets. There was no plausible explanation for this concealment, except to avoid the claims of his creditors, including his tax creditors. Such concealment warrants denial of his discharge.

B. 11 U.S.C. § 727(a)(3)

The plaintiff further alleges that the debtor violated § 727(a)(3) by destroying and failing to keep personal financial records. Section 727(a)(3) provides that the debtor shall be granted a discharge unless:

the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or 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). Under § 727(a)(3), a debtor will be denied a discharge if the debtor's financial records do not enable the court to evaluate the debtor's current financial condition and reconstruct the debtor's business transactions for a reasonable period of time "with substantial

completeness and accuracy." *Juzwiak*, 89 F.3d at 427 (citing *In re Martin*, 141 B.R. 986, 995 (Bankr. N.D. Ill. 1992)). The completeness and accuracy of a debtor's records are determined on a case-by-case basis, taking into account the size and complexity of his financial affairs or business. *Bailey*, 145 B.R. at 924.

As noted above, the plaintiff has the burden of proving the inadequacy of Mr. Chulew's records by a preponderance of the evidence. *Bailey*, 145 B.R. at 923 (citing *Grogan v. Garner*, 498 U.S. 279 (1991)). Mr. Chulew has produced virtually no records of his personal finances. He admitted at trial that he had side income from delivering furniture, for which he has no records and which he did not disclose on tax returns. The plaintiff has met its initial burden. The burden then shifts to Mr. Chulew to prove that his failure to keep adequate records was justified under the circumstances. *Bailey*, 145 B.R. at 924.

The sophistication and business experience of the debtor is another relevant factor in this consideration. *In re Minesal*, 81 B.R. 477, 481 (Bankr. E.D. Wis. 1988); *In re Calisoff*, 92 B.R. 346, 356 (Bankr. N.D. Ill. 1988). Mr. Chulew testified at trial that he operated successful carpet businesses for twelve years in Arizona ("Carpet Seconds" and "Mad Man Max Carpet") and also worked in his father's businesses. However, he stated that his business skill was in advertising, marketing, and buying, and he always had trouble with paper work. Basically, Mr. Chulew claims that he was a bad record keeper and his failure to keep adequate records was inadvertent. He further asserted that he had no duty to maintain a checking account.

This court is not convinced that a person who operated and worked in similar businesses for many years "inadvertently" failed to keep records of his extra income, or that he did not realize he should keep such records, or that he did not have the requisite intelligence to do so. Intent to

defraud is irrelevant in a § 727(a)(3) objection to discharge. *Juzwiak*, 89 F.3d at 430; *In re Potter*, 88 B.R. 843, 848 (Bankr. N.D. Ill. 1988) ("The question is not why doesn't the debtor have adequate books and records but rather simply does the debtor have adequate books and records.").

Lack of records is excusable when documents have been lost as the result of an outside force like robbery, fire, or flood. *In re Bucci*, 97 B.R. 954, 955 (Bankr. N.D. Ill. 1989), *aff'd*, 905 F.2d 1111 (7th Cir. 1990) (flood). Lack of records is not excusable in this instance. Mr. Chulew's inability to produce documentation regarding his financial situation is unjustified. *See Calisoff*, 92 B.R. at 357 ("The Debtor is a well educated, sophisticated business person."). Again, denial of the debtor's discharge is warranted under the circumstances.

C. 11 U.S.C. § 727(a)(4)(A)

The plaintiff claims that the debtor made a false oath or account on his schedules and in testimony. Denial of discharge under § 727(a)(4)(A) requires the following: (1) the debtor made a statement under oath; (2) the statement was false; (3) the debtor knew the statement was false; (4) the statement was made with a fraudulent intent; and (5) the statement related materially to the bankruptcy case. *See In re Chaplin*, 179 B.R. 123, 127 (Bankr. E.D. Wis. 1995). As noted above, direct evidence of fraudulent intent is generally unattainable. Consequently, fraudulent intent may be inferred in light of specific facts and circumstances of the case. *See Bailey*, 145 B.R. at 928. In fact, "[t]he cumulative effect of a number of false oaths by the debtor with respect to a variety of matters establishes a pattern of reckless and cavalier disregard for the truth by the debtor." *Id.*

The plaintiff points out various circumstances in which the debtor made alleged false oaths: On his schedules, the debtor listed a \$4,000.00 scuba equipment package (which, at one point in trial, was worth only \$2,800.00) as \$500.00 camping equipment. At the §341 hearing and at trial, the debtor stated that his girlfriend helped him financially; she often paid the rent. However, Ms. Haley testified that Mr. Chulew paid the rent, and she only purchased food and paid for the utilities. Paying the rent, plus the child support and other expenses that he admittedly paid, would have been impossible for the debtor on his stated income. This court believes Ms. Haley. At trial, the debtor admitted to at least one source of income (furniture deliveries) that was undisclosed on the schedules. The evidence also demonstrates that Mr. Chulew helped himself to business assets (discussed below).

The court is satisfied that these assets and other income were deliberately omitted from the schedules. Thus, the court concludes that Mr. Chulew violated § 727(a)(4)(A).

D. 11 U.S.C. § 727(a)(7)

Finally, the plaintiff alleges that the debtor violated §727(a)(7). Section 727(a)(7) provides that the debtor shall be granted a discharge unless

the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider. . . .

11 U.S.C. § 727(a)(7). Section 727(a)(7) applies only if the debtor of the other case was an insider of the present debtor when the relevant conduct occurred. *In re Krehl*, 86 F.3d 737, 741 (7th Cir. 1996). Thus, the initial inquiry is whether Midwest was an insider of Mr. Chulew.

Section 101(31) of the Bankruptcy Code defines an individual debtor's "insider," among

other things, as a "corporation of which the debtor is a director, officer, or person in control." 11 U.S.C. § 101(31)(A)(iv). The term also includes "anyone with 'a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor.'" *Krehl*, 86 F.3d at 741 (quoting S. Rep. No. 989, 95th Cong. 2d Sess., reprinted in 1978 U.S.C.C.A.N. 5787, 5810). "In ascertaining insider status, then, courts have looked to the closeness of the relationship between the parties and to whether any transactions between them were conducted at arm's length." *Krehl*, 86 F.3d at 742.

Clearly, Midwest is an insider of the debtor. Max Chulew is a fifty percent owner and an officer of Midwest. He had control of the financial records of the company before Mark Dechant became involved, and he had control of the records of the Milwaukee store when it was opened. Nevertheless, no sales records were produced. He testified that invoices and bank records were the exclusive record keeping devices, but no invoices were produced. Another practice of Midwest was to transfer odd or out of date merchandise to Mr. Chulew's sister, which she would sell at garage sales. She stated she gave the money to the debtor, but there is no record of where it went from there.

The business appears to have been run out of the debtor's hip pocket. This corresponds to a violation under § 727(a)(3) with respect to an insider of the debtor.

Additionally, Brenda Haley, Mr. Chulew's former girlfriend, testified that she witnessed the debtor tear up an invoice when a customer paid for furniture in cash. Since there was no sales ledger, he could take the cash without leaving a trail. She further testified that he customarily brought home cash and checks from the store. The debtor and Mark Dechant confirmed the practice. She knew these were store receipts because she could see the cash and checks mixed

together in Mr. Chulew's wallet. He would then pay for dinners out with the cash, and much of the remainder went into the secret compartment or under the carpet. He admitted to taking cash from the register for lunches, which would cause sales and proceeds not to balance, if anyone bothered to try. Obviously, these practices render Midwest's records totally useless.¹ See 11 U.S.C. § 727(a)(3). Furthermore, they represent a pillage of the business to the detriment of creditors, and they present a probable explanation for Mr. Chulew's ability to live on very little legitimate income.

Ms. Haley said the debtor kept the cash at home because he feared a "raid on the vault" at the store, and \$4,500.00 had once been garnished from the store's checking account. This, and unaccounted for transfers of cash from Midwest to the debtor, correspond with a § 727(a)(2) violation with respect to an insider of the debtor and justify denial of the debtor's discharge. 11 U.S.C. § 727(a)(7).

IV. CONCLUSION

The totality of the debtor's mismanagement of his and Midwest's financial affairs, his lack of records, his concealment of his and Midwest's assets during the year prior to filing the petition, and his false statements on his personal schedules and at the § 341 meeting of creditors justify this court's denial of the debtor's discharge under 11 U.S.C. § 727(a)(2), (3), (4)(A), and (7).

This decision constitutes the court's findings of fact and conclusions of law under Fed. R.

¹The financial records that did exist were not very carefully reviewed. Midwest's schedules list payments to the IRS and Wisconsin Department of Revenue between March and July of 1995 totaling \$14,253. This court found two additional payments of \$1,025.56 and \$2,392.28 during the same period in Ex. 21.

Bankr. P. 7052. A separate order denying the debtor's discharge will be entered.

Dated at Milwaukee, Wisconsin, October 25, 1996.

BY THE COURT

A handwritten signature in dark ink, consisting of several loops and a long horizontal stroke, positioned above a solid horizontal line.

Honorable Margaret Dee McGarity
United States Bankruptcy Judge