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In Chapter 7, Lowballing Your Assets Can Cost You Your Bankruptcy Discharge

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The United States Court of Appeals for the Fourth Circuit—which covers North Carolina—recently decided a case that will have bankruptcy debtors thinking twice about how they complete their bankruptcy Petition and Schedules.

In *Robinson v. Worley*, the Fourth Circuit affirmed a North Carolina Bankruptcy Court's denial of a Chapter 7 debtor's discharge because the debtor intentionally lowballed the value of his interest in a real estate investment company. The Fourth Circuit affirmed the Bankruptcy Court's holding that the debtor's conduct violated the false oath provision of the Bankruptcy Code ("Code"). The ruling is a warning to Chapter 7 debtors and ammunition for creditors who suspect debtors are being less than fully transparent about their assets.

Jason Worley was a financial advisor with a finance degree and an MBA. He also invested in real estate. In 2006, he contributed $65,000 for a minority interest in Gemini Land Trust, LLC. Gemini was a minority investor in Pelham Land Group, LLC, which acquired 587 acres of Georgia farmland to flip to a developer. In 2012, the land was worth an estimated $1.32 million dollars. The property generated nominal annual income from farming, hunting, and timber leases. Worley fell on hard times financially and, in 2013, filed a Chapter 7 "no asset" bankruptcy. A "no asset" case means a debtor has no non-exempt assets to distribute to creditors. In his Bankruptcy Schedules, he valued his interest in Gemini as $2,500. When some of his creditors found out about Worley's stake in Gemini and Pelham, they sued to deny his discharge.

Chapter 7 of the Code is designed to provide the honest but unfortunate debtor with a fresh start by discharging the debtor of his or her debts. But the bankruptcy court may deny discharge for several reasons, like when a debtor makes an intentional and material false statement under oath with intent to defraud creditors or the court. False information on a Bankruptcy Schedule or in the Statement of Financial Affairs—signed under penalty of perjury—counts as an "oath" under the Code. Bankruptcy courts construe the Code liberally in favor of debtors. A technical error will not result in denial of a discharge. But if a debtor wants the clean slate that comes with discharge, he must provide candid, good faith disclosure of all financial affairs. A "catch me if you can" approach will not fly.

After conducting a trial, the Bankruptcy Court concluded that Worley violated the false oath provision when he valued his interest in Gemini as $2,500. Worley used a valuation method that did not apply to speculative

real estate and was designed to lowball the value. To arrive at $2,500, Worley capitalized the nominal income he received from the Georgia farmland. The Bankruptcy Court found this inappropriate because the capitalization rate method is best suited to value income-producing property with stabilized income. Worley knew the farmland was acquired to be flipped at a premium. He did not invest for the nominal revenue he received from farming and hunting licenses. The Fourth Circuit also emphasized that Worley was a sophisticated financial professional who—if acting forthrightly —knew better than to value his interest using capitalization rates.

Worley did not seek corroboration of his $2,500 estimate from other investors or finance professionals. Rather, other investors in Gemini testified that the interest was worth considerably more than $2,500. Worley's initial contribution was $65,000 and a 2012 K-1 reflected a capital account of $67,555. Worley produced no evidence to explain how his investment depreciated to 4% of his initial capital contribution. Finally, before trial, Pelham sold most of the land and planned to distribute $100,000 to Gemini.

When the Bankruptcy Court rejected Worley's argument that his $2,500 valuation was proper, he tried the "blame the lawyer" and "no harm, no foul" defenses. The Bankruptcy Court rejected both arguments. A debtor cannot argue that he relied on bad advice from counsel if the debtor does not provide counsel with all facts and information or when the debtor knows or should know that counsel's advice is "patently inappropriate." If his counsel advised him to use the capitalization rate method and submit a $2,500 valuation, Worley, a sophisticated investor, should have known that the advice was wrong. On the materiality of the false statement, the Fourth Circuit held that the bar is low. A single, material fraudulent statement is grounds for denial of discharge.

A Bankruptcy Court will not deny a debtor's discharge over an honest difference of opinion on an asset's value. But a debtor cannot play fast and loose with his assets. If a debtor is cavalier with the truth or intentionally tries to short-change creditors and dupe the trustee, then this case sends a clear message that the Bankruptcy Court can and will deny discharge.

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