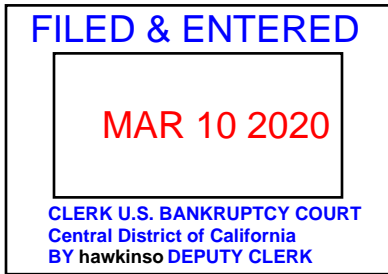


FOR PUBLICATION



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8 **UNITED STATES BANKRUPTCY COURT**
9 **CENTRAL DISTRICT OF CALIFORNIA**
10 **RIVERSIDE DIVISION**

11 In re:
12 Paul Gregory Katona
13 Gail Marie Katona
14 Debtor(s).

CHAPTER 7
Case No.: 6:16-bk-13150-MW
Adv No: 6:17-ap-01221-MW

15 United States Trustee for the Central
16 District of California, Region 16
17 Plaintiff(s),
18 v.
19 Paul Gregory Katona, Gail Marie Katona
20 Defendant(s).

**MEMORANDUM DECISION AND ORDER
FOLLOWING TRIAL**

TRIAL RE: COMPLAINT TO REVOKE DEBTORS'
DISCHARGE PURSUANT TO 11 U.S.C. § 727(d)(1)-(2)

Date: October 28-29, 2019
Time: 9:30 AM
Location: United States Bankruptcy Court
Courtroom 6C
411 W. Fourth Street
Santa Ana, CA 92701

21
22 For the Plaintiff, United States Trustee for the Central District of California, Region 16:
23 Everett L. Green, Trial Attorney.

24 For the Defendants, Paul Gregory Katona and Gail Marie Katona: Douglas A. Plazak, Esq.

25 **WALLACE, J.**

26 The United States Trustee's complaint, Docket No. 1, filed November 2, 2017
27 (the "Complaint"), against chapter 7 debtors Paul G. Katona ("Mr. Katona") and Gail M.
28 Katona ("Mrs. Katona") (jointly, the "Katonas") alleges that (1) the Katonas knowingly and

1 fraudulently failed to disclose on the schedules and amended schedules their ownership of
2 material assets constituting bankruptcy estate property, and (2) the Katonas acquired
3 postpetition material assets that constituted bankruptcy estate property and knowingly and
4 fraudulently failed to report the acquisition of such property. The United States Trustee
5 (the “UST”) asks the Court to revoke the Katonas’ discharge pursuant to 11 U.S.C.
6 § 727(d)(1)-(2).

7 This adversary proceeding was tried by the Court on October 28-29, 2019. At the
8 close of trial, the parties requested leave of Court to file post-trial briefs. The Court granted
9 the request. The UST filed its post-trial brief on February 3, 2020. The Katonas filed the
10 final version of their post-trial brief (with errata correcting certain errors) on February 4,
11 2020. The Court took this matter under submission and now renders its decision.

12 13 Jurisdiction and Venue

14 The Court has subject matter jurisdiction over this proceeding pursuant to 28 U.S.C.
15 § 1334 and General Order 13-05, filed July 1, 2013, of the United States District Court for
16 the Central District of California. This is a core proceeding under 28 U.S.C. § 157(b)(2)(J),
17 (O). Venue is proper pursuant to 28 U.S.C. § 1409.

18 The UST and the Katonas have consented on the record to this Court’s final
19 determination of the matters here in controversy under the rule of *Stern v. Marshall*, 564
20 U.S. 462 (2011) and *Wellness Intern. Network, Ltd. v. Sharif*, 575 U.S. 665 (2015).

21 22 Elements of 11 U.S.C. § 727(d) Causes of Action

23 11 U.S.C. § 727(d)(1) provides in relevant part that upon request of the United States
24 Trustee, and after notice and a hearing, the bankruptcy court shall revoke a discharge if the
25 discharge was obtained through the fraud of the debtor, and the United States Trustee did
26 not know of such fraud until after the granting of the discharge. 11 U.S.C. § 727(d)(2)
27 provides in relevant part that upon the United States Trustee’s request, the bankruptcy court
28 shall revoke a discharge if the debtor acquired property of the estate and knowingly and

1 fraudulently failed to report the acquisition of such property.

2 As a general rule, to obtain relief under section 727(d)(1), the plaintiff must prove that
3 the debtor committed fraud in fact. The plaintiff must also prove that it was unaware of the
4 fraud at the time the discharge was granted. *United States Trustee v. Valencia (In re*
5 *Guadarrama)*, 284 B.R. 463, 469 (C.D. Cal. 2002); *Bowman v. Belt Valley Bank (In re*
6 *Bowman)*, 173 B.R. 922, 924-25 (B.A.P. 9th Cir. 1994). The fraud must be material, that is,
7 it must have been sufficient to cause the discharge to be denied if such fraud were known at
8 the time of the discharge. *Jones v. U.S. Trustee*, 736 F.3d 897, 900 (9th Cir. 2013). A false
9 statement or omission is material if it contains information that would aid in understanding
10 the debtor's financial affairs. *Id.* It does not have to be of a type that will harm or prejudice
11 creditors. *United States Trustee v. Valencia (In re Guadarrama)*, 284 B.R. at 473. The
12 plaintiff may prove the debtor's fraud by evidence of the debtor's awareness of the omitted
13 asset and by showing that the debtor knew that failure to list the asset could seriously
14 mislead the trustee. *Matter of Yonikus*, 974 F.2d 901, 905 (7th Cir. 1992). The bankruptcy
15 court's finding of fraudulent intent may be based on inferences drawn from a course of
16 conduct. *Id.* Additionally, fraudulent intent may be inferred from all the surrounding
17 circumstances. *Id.* Section 727(d)(1) is construed against the objector and liberally in favor
18 of the debtor. *United States Trustee v. Valencia (In re Guadarrama)*, 284 B.R. at 469-70.

19 A knowing and intentional failure to disclose material assets on the bankruptcy
20 schedules constitutes "fraud" within the meaning of 11 U.S.C. § 727(d)(1). *United States*
21 *Trustee v. Mazzone (In re Mazzone)*, 510 B.R. 439, 444 (Bankr. D. Mass. 2014); *Trustee v.*
22 *Wilkerson (In re Wilkerson)*, 470 B.R. 398, 400 (Bankr. W.D. La. 2012) ("Courts have
23 repeatedly found that a debtor's failure to report assets on bankruptcy schedules is
24 sufficient to revoke the discharge under section 727(d)(1)"); *Lightfoot v. Landry (In re*
25 *Landry)*, 350 B.R. 51, 59 (Bankr. E.D. La 2006) ("The intentional omission of assets from the
26 debtor's schedules has been found to qualify as grounds for revocation of a discharge under
27 § 727(d)(1)").

28

1 To prove up a cause of action under 11 U.S.C. § 727(d)(2), a plaintiff must prove that
2 the debtor acquired or became entitled to acquire property of the estate and knowingly and
3 fraudulently failed to report or deliver the property to the trustee. Both elements must be
4 met, and the plaintiff must prove that the debtor acted with the knowing intent to defraud.
5 *Matter of Yonikus*, 974 F.2d 901, 905 (7th Cir. 1992); *Bowman v. Belt Valley Bank (In re*
6 *Bowman)*, 173 B.R. 922, 925 (B.A.P. 9th Cir. 1994).

7 With respect to causes of action under both section 727(d)(1) and section 727(d)(2),
8 the plaintiff must prove up the case by a preponderance of the evidence. *United States*
9 *Trustee v. Valencia (In re Guadarrama)*, 284 B.R. 463, 469 (C.D. Cal. 2002).

10 11 Contentions of the Parties

12 As discussed above, the Complaint seeks revocation of the Katonas' discharge
13 based upon a failure to schedule assets and report income.

14 The Katonas do not deny that they failed to disclose certain material assets on their
15 bankruptcy schedules or failed to timely disclose the postpetition acquisition of material
16 assets constituting bankruptcy estate property. They insist, however, that these failures
17 were innocent and inadvertent as opposed to knowing and fraudulent. Consequently, a
18 resolution of this adversary proceeding requires the Court to make findings and
19 determinations regarding the Katonas' states of mind with respect to their failure to schedule
20 the assets here at issue. This is an inquiry into human consciousness – an ethereal,
21 intangible thing that perhaps possesses qualities or components beyond those of physical
22 existence.¹

23 Inadvertence and Forgetfulness Versus Fraud: How Are They to Be Differentiated?

24 Human memory is fallible, and certainly a failure to list an asset on the schedules or
25 in the statement of financial affairs can be a result of mere forgetfulness as opposed to
26

27 ¹ See *Mind & Cosmos: Why the Materialist Neo-Darwinian Conception of Nature Is Almost*
28 *Certainly False*, Thomas Nagel (Oxford University Press, 2012) at 13 (“ . . . there are doubts about
whether the reality of such features of our world as consciousness, intentionality, meaning, purpose,
thought, and value can be accommodated in a universe consisting at the most basic level only of
physical facts – facts, however sophisticated, of the kind revealed by the physical sciences.”).

1 arising from an intent to deceive.

2 Events can jog a person's memory and lead the person to recall things that had been
3 temporarily forgotten. In a bankruptcy context, a panel trustee's question to the debtor at a
4 section 341(a) meeting may jog a debtor's memory and prompt the debtor to recall an asset
5 that hadn't been scheduled. A receipt of money or other property during the pendency of a
6 bankruptcy case may jog a debtor's memory and prompt a recollection of an unscheduled
7 asset. If a debtor is put to the task of amending his or her schedules, the mental work
8 involved in such a task in some instances can jog the debtor's memory and lead the debtor
9 to remember the existence of assets temporarily forgotten at the time the schedules were
10 initially prepared.

11 In determining whether an omission from the schedules is innocent forgetfulness or a
12 product of a deliberate attempt to defraud and deceive, a bankruptcy court can look at all
13 the surrounding circumstances and consider the entire record in the case. In this vein, a
14 pattern of multiple omissions of assets from the schedules and statement of financial affairs
15 tends to look more suspiciously like fraud than a single, isolated omission. An omission of a
16 major, valuable asset may be more significant than an omission of a minor asset of
17 relatively trivial value. If repeated memory jogs occur during a bankruptcy case and an
18 asset still remains undisclosed, this tends to more strongly indicate fraud than a situation
19 where there are no or few memory jogs.

20 21 Case History

22 The Katonas filed a voluntary joint petition for relief under chapter 7 on April 7, 2016.
23 Their retained bankruptcy counsel, Manfred Schroer, Esq., provided them with a client
24 questionnaire to assist in the preparation of their schedules. The questionnaire asked
25 questions about whether the Katonas owned stocks, bonds, warrants and certain kinds of
26 other property and whether they expected to receive a trust payment, tax refund, insurance
27 payment and other kinds of payments. In each instance, they checked the "no" box. The
28 Katonas filed Schedules A/B, D, E/F, G, H, I and J and a Statement of Financial Affairs on

1 April 19, 2016. They checked the “no” boxes for lines 18 (bonds, mutual funds or publicly
2 traded stocks), 25 (trusts), 26, 30-35, 38 and 53 (other property of any kind not already
3 listed) on Schedule A/B. Additionally, they answered “\$0.00” with respect to inquiries made
4 in Schedule I concerning interest and dividends and “other monthly income” (other than a
5 listing of \$217 with respect to a son’s contribution to a car payment). The relevant
6 documents were signed by the Katonas under penalty of perjury.

7 At a section 341(a) meeting of creditors held on May 11, 2016, an attorney for
8 judgment creditor Royce Napoli asked Mrs. Katona whether she was a beneficiary of any
9 trust. She answered “no.” The attorney then asked, “Not a, not a Proulx family trust?” She
10 again answered “no.”²

11 The Katonas filed an amended Statement of Financial Affairs on April 27, 2016, and
12 an amended Form 122A-1 Means Test and amended Schedules A/B, G, I, J on May 25,
13 2016. An amended Schedule C was filed December 14, 2016. None of the amendments
14 described above disclosed the omitted assets discussed below.

15 The Katonas received a discharge on November 2, 2016.

17 Assets Omitted From the Katonas’ Schedules and Statement of Financial Affairs

18 1. Interest in Prudential Common Stock.

19 Prior to the petition date, Mrs. Katona and her siblings owned a brokerage account
20 (the “Account”) at Prudential Financial, Inc. (“Prudential”) which held Prudential common
21 stock. Mrs. Katona owned 960 of the 1963 shares held in the Account. The Joint Pretrial
22 Stipulation states that from at least 2014 to 2018, Prudential issued dividend checks
23 payable to Mrs. Katona and her siblings on a quarterly basis, including but not limited to
24 January 4, 2016, March 17, 2016, June 21, 2016, September 21, 2016 and December 20,
25 2016. Each year from 2014 through 2018, Prudential issued IRS Form 1099-DIVs to Mrs.
26 Katona reflecting the payment of dividends to Mrs. Katona. In 2016, Mrs. Katona and her
27 siblings received \$5,496.40, and Mrs. Katona’s allocation was \$1,374.10. Mrs. Katona
28

² UST Exhibit 8 at page 194.

1 provided to her accountant the IRS Form 1099-DIVs reporting payment of Prudential
2 dividends to Mrs. Katona.

3 The Prudential stock was not listed on the schedules, amended schedules or the
4 statement of financial affairs, and the Chapter 7 Trustee did not become aware of the
5 Prudential common stock owned by Mrs. Katona until after the discharge was granted. The
6 Joint Pretrial Stipulation states in numbered paragraph 36 that as of December 2018, the
7 Prudential common stock had a value of approximately \$90 per share and that Mrs.
8 Katona's 960 shares had a value of "approximately \$45,700." This seems to be an obvious
9 mathematical error. However, for purposes of this decision, the Court will regard the value
10 of Mrs. Katona's Prudential common stock to be in the range of \$45,700 instead of \$86,400.

11 At trial, Mrs. Katona testified that she had been receiving money in respect of the
12 Prudential common stock since 2002. She asserts that she did not understand that she was
13 an owner of Prudential common stock. Instead, she would meet periodically with her sister
14 and her sister would give her a share of the dividends. Furthermore, she authorized her
15 sister to sign the dividend checks and cash them on her behalf. However, she may have
16 signed one or two checks herself.

17 The periodic quarterly income from the Prudential common stock owned by Mrs.
18 Katona was not listed in the schedules, amended schedules or the statement of financial
19 affairs as either dividend income or under an alternative description, such as "miscellaneous
20 income" or "other income."

21 2. Interest in the Proulx Family Trust.

22 Mrs. Katona is a beneficiary of a trust established by her parents, the Proulx Family
23 Trust of 1989 (the "Proulx Trust"). The Katonas did not list Mrs. Katona's interest in the
24 Proulx Trust in the schedules, the amended schedules or the statement of financial affairs.
25 At the section 341(a) meeting of creditors, Mrs. Katona was asked if she was a beneficiary
26 of a trust. She answered "no." More pointedly, she was then asked whether she was a
27 beneficiary of the Proulx Family Trust. In her sworn testimony, she again answered "no."
28 UST Exhibit 8 at page 194.

1 The Proulx Trust liquidated a life insurance policy for \$485,538.34 in 2012. On
2 December 22, 2016, Mrs. Katona received a check from the Proulx Family Trust for the
3 additional cash surrender value of a life insurance policy. At the time of the Katonas'
4 bankruptcy filing, the Proulx Trust owned property having a value of several million dollars.³
5 Much of this property was held free and clear.⁴

6 3. Interest in Katona Family Trust.

7 Mr. Katona was a beneficiary with respect to the Katona Family Trust. The Katona
8 Family Trust held title to real property in Hermosa Beach, California and sold such property
9 for \$1.23 million in 2009. In 2012, the Katona Family Trust distributed approximately
10 \$83,000 to Mr. Katona. Three months after the petition date, on July 23, 2016, Mr. Katona
11 received a check from the "Sale of Gold from Katona Trust" in the amount of \$1,140.

12 Mr. Katona did not disclose the existence of the Katona Family Trust or his right or
13 entitlement to receive income from the Katona Family Trust in his original or amended
14 schedules or statement of financial affairs or in his testimony at the section 341(a) meeting
15 of creditors.

16 4. Undisclosed Prepetition Vehicle Sales.

17 Numbered paragraph 18 on the statement of financial affairs asks a debtor, "Within 2
18 years before you filed for bankruptcy, did you sell, trade, or otherwise transfer any property
19 to anyone, other than property transferred in the ordinary course of your business or
20 financial affairs?" The Katonas answered this question "no." As it turns out, however, they
21 did transfer various items of property: a 2003 Toyota, sold for \$8,300 on February 21, 2015;
22 a 2005 Ford, sold for \$8,450 on March 17, 2015; a Ford Expedition, sold for \$8,700 on
23 March 26, 2015; and a furnace, sold for \$5,250 on November 2, 2015. These sales
24 transactions were not disclosed either the original or in the amended statement of financial
25 affairs. Joint Pretrial Stipulation at numbered paragraphs 47 - 54. The combined gross
26 selling price of these items tallies to over \$30,000 – certainly not an immaterial amount.
27

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³ Reporter's Transcript, Docket No. 77, at page 175 of 243, lines 8-12.

⁴ Reporter's Transcript, Docket No. 77, at page 176 of 243, lines 19-24.

1 Mr. Katona testified that he believed he was not required to list these transactions in
2 his bankruptcy petition “[b]ecause we didn’t sell them below value, and it was like the
3 ordinary course of business.”⁵ (The record in this case reflects that Mr. Katona is a
4 construction contractor, not a car dealer or furnace retailer).

5
6 Analysis

7 Earlier in this Memorandum, the Court referred to “memory jogs” – events that might
8 serve to jog a person’s memory with respect to forgotten matters. The memory jogs for the
9 Katonas in this case were numerous and frequent. First, there was their attorney’s client
10 questionnaire, inquiring into the Katonas’ income and assets. Page 11 of the questionnaire
11 called for the Katonas to list “interest & dividends” as well as “payments from any source.”
12 The Katonas listed zero in each instance. Second, there were the original schedules and
13 the original statement of financial affairs. As discussed above, the Katonas failed to list their
14 interests in the Prudential stock, the Proulx Family Trust, and the Katona Family Trust in the
15 schedules or in the statement of financial affairs. Third, there was the section 341(a)
16 meeting of creditors, where questions were asked about the Katonas’ property and income
17 (and, quite specifically, the Proulx Family Trust). Fourth, fifth and sixth were the
18 amendments of the schedules and/or statement of financial affairs on April 27, 2016, May
19 25, 2016 and December 14, 2016. In each instance, an event occurred that could
20 reasonably have been expected to focus the Katonas’ minds and attention on the assets
21 they owned but had not disclosed. The Katonas would have the Court believe that they just
22 continued to “forget” or “overlook” their ownership of Prudential stock and interests in the
23 Proulx Family Trust and Katona Family Trust (and the income therefrom), not merely once
24 but on six separate occasions.

25 The same forgetfulness or inattention to detail does not seem to have been operating
26 when it came to listing creditors holding claims. This is evidenced by the fact that no party
27 has produced any credible evidence that the Katonas forgot to list any of their creditors.

28

⁵ Reporter’s Transcript, Docket No. 77, at page 125 of 243, lines 20-21.

1 An additional memory jog was Mrs. Katona's periodic receipt of Prudential dividend
2 moneys from her sister. Each time she pocketed this money, she had an occasion to think,
3 "should I disclose either this income or the underlying asset in connection with my
4 bankruptcy case?" And then there were the IRS Form 1099-DIVs from Prudential that Mrs.
5 Katona provided to her accountant.

6 There occurred in this case multiple failures to disclose material assets despite
7 multiple opportunities to do so. Importantly, the assets not disclosed are of the type that
8 readily lend themselves to concealment: cash payments (from Mrs. Katona's sister in
9 respect of the Prudential stock) and interests in trusts making occasional but not regular
10 distributions.

11 For these reasons, and having had an opportunity to observe the demeanor of the
12 Katonas when they testified at trial, the Court does not regard as credible the testimony of
13 the Katonas that mere inadvertence or forgetfulness caused their failure to timely disclose
14 their interests in the Prudential stock, the Proulx Family Trust and the Katona Family Trust.
15 Fraudulent intent may be inferred from the surrounding circumstances, and here the Court
16 draws this inference based upon the considerations discussed above. The Court concludes
17 that such failures to disclose were both knowing and fraudulent in nature.

18 The fraud that occurred here was material. If these matters had been brought to the
19 Court's attention before the discharge was granted, the Court would have denied the
20 discharge under 11 U.S.C. § 727(a)(2) (concealment of property with intent to hinder, delay
21 or defraud) and 11 U.S.C. § 727(a)(4)(A) (knowing and fraudulent making of a false oath).
22 Equally true, the omissions also related to information that would have aided the Chapter 7
23 Trustee in understanding the Katonas' financial affairs. The Chapter 7 Trustee, John
24 Pringle, was seriously misled by the Katonas' false and fraudulent schedules, amended
25 schedules and statement of financial affairs. He testified at trial about the adverse effect of
26 Mrs. Katona's conduct on his administration of the case, noting that he had been led by the
27 schedules to believe that there were no assets to administer.⁶

28

⁶ Reporter's Transcript, Docket No. 77, at pages 55-58 of 243.

1 The record in this case shows that the UST, plaintiff herein, did not know of the fraud
2 occurring in this case until after the granting of the discharge on November 2, 2016.
3 Judgment creditor Royce Napoli became suspicious of schedules filed by the Katonas and
4 moved for a Rule 2004 examination on September 22, 2017. The Prudential stock was
5 found as a result of this examination, leading Ms. Napoli to notify Abraham Feuerstein, an
6 attorney for the UST.⁷ The UST commenced this adversary proceeding on November 2,
7 2017.

8 Based upon the foregoing analysis, the Court concludes that the UST has proved up
9 all the elements of a cause of action under 11 U.S.C. § 727(d)(1) and therefore revokes the
10 discharge granted to the Katonas.

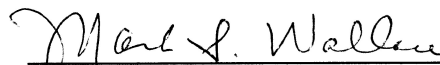
11 As an alternative ground for its decision, the Court determines that Katonas acquired
12 property that was property of the estate, namely, the dividends paid on the Prudential stock
13 on June 21, 2016 and September 21, 2016 and \$1,140 from the Katona Family Trust on
14 July 23, 2016. They then knowingly and fraudulently failed to report the acquisition and
15 entitlement to such property to the Chapter 7 Trustee. The Court therefore determines that
16 the discharge is also subject to revocation pursuant to 11 U.S.C. § 727(d)(2).

17 The UST shall lodge a form of judgment within ten (10) days of the date of filing and
18 entering of this Memorandum Decision and Order Following Trial.

19 IT IS SO ORDERED.

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27 Date: March 10, 2020


Mark S. Wallace
United States Bankruptcy Judge

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⁷ Reporter's Transcript, Docket No. 77, at pages 184-185 of 243.