

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF IDAHO

In re:

PAYROLL AMERICA, INC.

Debtor.

WAYNE DAVIS, an interested party,

Appellant,

v.

JEREMY GUGINO, Trustee,

Appellee.

District Case No. 1:10-CV-00610-EJL

**MEMORANDUM DECISION AND
ORDER**

Bankruptcy Case No. 10-00800-JDP

Pending before the Court in the above-entitled matter is the appeal by Wayne Davis (“Davis”) of the Bankruptcy Court’s Order granting the Trustee Jeremy Gugino’s (“Trustee”) Second Amended Motion for Rule 2004 Examination and Motion to Compel Testimony. Having fully reviewed the record, the Court finds that the facts and legal arguments are adequately presented in the briefs and record. Accordingly, in the interest

Jurisdiction over this appeal is conferred to the District Court pursuant to 28 U.S.C. § 158(a)(1). The Court finds the appeal of the Bankruptcy Court's oral order on the Second Amended Motion for Rule 2004 Examination and Motion to Compel Testimony announced on October 19, 2010 was timely filed pursuant to Fed.R.Bankr.Proc. 8002 on October 29, 2010. (Dkt. 108.)¹ The Court notes a written order identifying the specific questions to be answered by Davis was signed by the Bankruptcy Court on November 15, 2010. (Dkt. 114.) An Amended Notice of Appeal and 2.05 Certificate was filed on November 23, 2010. (Dkt. 117.)

Payroll America, Inc. (“PAI” or “Debtor”), an Idaho corporation filed a voluntary petition for Chapter 7 bankruptcy on March 30, 2010. (Dkt. 1.) Davis, as president and 100% shareholder of PAI, signed the petition and related schedules. The schedules indicate PAI has total assets of \$10,138,480 and total liabilities of \$12,078,348.31. *Id.* Of the assets originally listed, \$10,000,000 is a claim against Data Processing Systems (“DPS”) of Rome, GA described as “\$40,000,000 unaccounted for funds, Debtor

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estimates \$10,000,000 +/- claim for which litigation has been filed.” *Id.*

PAI provided payroll processing services including tax filing and tax payment services for third parties. Customers of PAI (primarily small businesses) authorized PAI to withdraw monies from their accounts in order to make payments owed by customers to the relevant local, state and federal taxing authorities. PAI hired DPS to handle the movement of monies electronically. PAI alleges there were problems with the services provided by DPS which lead to PAI being sued by certain customers. PAI made a claim on an insurance policy for errors and omissions related to PAI’s dealings with DPS. Litigation has been commenced regarding the insurance policy claim.

PAI has nearly 100 creditors listed in the bankruptcy schedules. (Dkt. 1.) At the § 341 creditors meeting, PAI was represented by a part-time consultant, Martin Headley, to answer the Trustee’s and creditors’ questions. Primarily because of the potential value of the pre-petition litigation involving DPS, the Trustee determined he needed to examine Davis and filed a motion and amended motion pursuant to Fed.R.Bankr.Proc. 2004. At the Rule 2004 examination on July 27, 2010, Davis appeared, identified himself and proceeded to plead the Fifth Amendment to approximately 60 questions asked by the Trustee.

The Trustee filed a second motion for a Rule 2004 examination and a motion to compel Davis to answer specific questions and reasonable follow up questions to the listed questions. Davis objected to the second motion on Fifth Amendment grounds. The

against Davis was filed in the District of Idaho (*United States v. Michael Wayne Davis, II*, Criminal Case No. 11-623-S-BLW, Dkt. 1). The Indictment charges Davis with eight counts of wire fraud, three counts of theft from health care benefit plan, and one count of criminal forfeiture related to the wire fraud and theft from health care benefit plan charges. *Id.* The charges are related to activities by Davis in operating Xpress and PAI. Davis has pled not guilty to the charges. (Criminal Case No. 11-623-S-BLW, Dkt. 8.). The trial in the criminal matter is currently set for May 27, 2012 in Boise, ID. (Criminal Case No. 11-623-S-BLW, Dkt. 13.)

STANDARD OF REVIEW

The Bankruptcy Court's "findings of fact are reviewed under the clearly erroneous standard, and conclusions of law are reviewed de novo." Fed.R.Bankr.Proc. 8013; *Sigma Micro Corp. v. Healthcentral.com (In re Healthcentral.com)*, 504 F.3d 775, 783 (9th Cir. 2007).

ISSUES PRESENTED

The Court finds the issues presented in this appeal can be narrowed down to what is the scope of Fifth Amendment privilege Davis can assert in this particular bankruptcy proceeding.

The Court begins its analysis by adopting the Bankruptcy Court's factual finding that in this particular case the Trustee has a compelling need for further information about this debtor, PAI. PAI's bankruptcy filing for Chapter 7 relief was voluntary. When PAI

In its oral ruling, the Bankruptcy Court acknowledged the general purposes of the Fifth Amendment and its application to bankruptcy proceedings. The Court stated a corporation has no Fifth Amendment privilege and the custodian of corporate records may not decline to produce such records on the grounds that the content of the records may tend to incriminate the custodian. The Court also held Davis could not assert a Fifth

Amendment privilege connected with document production requests for corporate books and records of the corporation. The Bankruptcy Court acknowledged the privilege against self-incrimination could be waived in one proceeding and still claimed as applicable in a separate proceeding. The Bankruptcy Court ruled that Davis would be required to answer most of the proposed questions and reasonable follow up questions as Davis had “waived” his personal privilege against self-incrimination with respect to any inquiry as to the matters set forth in the petition and schedules to the extent the questions were addressed to the business and financial affairs of PAI. Finally, the Bankruptcy Court acknowledged that Davis could still raise a Fifth Amendment privilege but it would be his burden to establish that the privilege applied and that Davis could not state a blanket Fifth Amendment objection to the allowed questions (and reasonable follow up questions).

Davis objects to the Bankruptcy Court’s rulings in that he argues he has not waived his Fifth Amendment privileges when PAI filed for bankruptcy. The Court finds that Davis may be construing the oral ruling by the Bankruptcy Court too restrictively. The Bankruptcy Court was generally correct as to all statements regarding the law related to the Fifth Amendment privilege. However, now that Davis has been indicted with criminal charges, the impact of answering certain questions about specific actions and transactions of PAI financial affairs may also implicate Davis personally and he may be able to assert his Fifth Amendment privilege to such questions. In this case, it appears there is a very fine line between the legal and financial information that the Trustee is

entitled to under Rule 2004 and Davis' personal right to protect against disclosures Davis reasonably believes could be used in his prosecution. If a question about PAI does not implicate Davis personally or is not testimonial in nature, then the Bankruptcy Court may rule the Fifth Amendment is not applicable and could direct Davis to respond to a certain question. This Court cannot determine based on the record before it, whether or not Davis will be able to carry his burden in establishing the privilege is appropriate.

For clarification, the Court will state the law that should be applied by the Bankruptcy Court in this matter.

1. The Fifth Amendment right against self-incrimination protects against disclosures "which the witness reasonably believes could be used in a criminal prosecution or could lead to other evidence that might be so used." *Kastigar v. United States*, 406 U.S. 441, 444-45 (1972). This applies to answers that support a criminal conviction or provide a link in the chain of evidence needed to prosecute for a crime. *Hoffman v. United States*, 341 U.S. 479, 486 (1951). The existence of the actual indictment against Davis is a strong showing of a risk of self-incrimination. *In re Fekos*, 148 B.R. 10, 11 (Bkrcty. W.D. Pa. 1992).

2. The Fifth Amendment applies to bankruptcy proceedings. *In re Gi Yeong Nam*, 245 B.R. 216, 224 (Bkrcty. E.D. Pa. 2000); *In re French*, 127 B.R. 434, 435 (Bkrcty. D. Minn. 1991).

3. A corporation cannot assert a Fifth Amendment right. *United States v. White*,

5. The waiver of a Fifth Amendment right by a witness in another legal proceeding does not result in the automatic waiver of a Fifth Amendment in a separate proceeding. Stated another way, the “separate proceeding” doctrine does not preclude a party from asserting the Fifth Amendment in a separate proceeding even where that person has

waived their Fifth Amendment privilege by testifying in a different proceeding. *In re Gi Yeon Nam*, 245 B.R. 216, 228 (Bkrtcy. E.D. Pa. 2000); (*Interim Investors Committee v. Jacoby*, 90 B. R. 777, 779 (W.D. N.C. 1988) (substantial authority supported the Bankruptcy Court's determination that defendant's testimony at a hearing in the main bankruptcy case was ineffective to waive her assertion of her Fifth Amendment right against self-incrimination in a separate adversary proceeding), *order aff'd* 914 F.2d 1491 (4th Cir. 1990). In this case, the Bankruptcy Court was correct that the prior testimony by Davis in the PAI civil litigation involving DPS does not result in a waiver of his assertion of his Fifth Amendment rights in the bankruptcy proceeding. Additionally, Davis' prior statements to the FBI do not support a finding that Davis knew his prior statements would be interpreted as a waiver of his Fifth Amendment rights in PAI's bankruptcy proceedings.

6. While the Court agrees with the Bankruptcy Court that Davis' signing of PAI's petition and related schedules under oath was voluntary and knowing, the Court does not agree that in signing the petition and schedules as President of PAI, Davis was personally waiving any Fifth Amendment rights he could assert during the Rule 2004 examination. Disclosing information in bankruptcy filings which is not of itself incriminating in its nature does not constitute a waiver of Fifth Amendment privileges. *McCarthy v. Arndstein*, 262 U.S. 355, 358 (1923); *In re Hulon*, 92 B.R. 670, 675 (Bkrtcy. N.D. Tex. 1988) (debtor had answered limited questions at § 341 hearing but

refused to answer questions at 2004 examination based on Fifth Amendment privilege assertion).

The Court acknowledges that the bankruptcy case law is not clear on whether the Rule 2004 examination would or would not be considered a “separate proceeding” from the filing of the bankruptcy petition and schedules. However, the Court finds it does not need to answer this question to resolve the appeal as there is nothing in the petition or related schedules signed by Davis that indicate he was aware he was making a voluntary, knowing and intelligent waiver of his personal Fifth Amendment rights when he signed such documents on behalf of the corporation or that he was aware of consequences of such a waiver. *Brady v. United States*, 397 U.S. 742, 748 (1970) (constitutional privileges may not be waived except where there is an awareness of the consequences of the waiver). Further, the signing of the petition and schedules for the corporation does not appear to have contained incriminating matters so as to have resulted in a waiver of the personal privilege of Davis during the Rule 2004 examination.

The Bankruptcy Court was correct that the signing of the petition and schedules does subject Davis (as the designated debtor) to answer to questions related to the corporation’s financial affairs, but the Bankruptcy Court acknowledged there was a limit when the affairs of the corporation were also the personal affairs of Davis that may subject him to criminal liability. In reviewing the Bankruptcy court’s oral ruling, the Court is convinced that Davis is construing the Bankruptcy Court’s ruling too restrictive

in arguing the ruling violates Davis' constitutional rights.

The Bankruptcy Court's ruling is consistent with the case law discussed above to the extent a question about PAI's financial affairs may require an answer that could subject Davis to criminal liability, Davis is free to raise a Fifth Amendment privilege to that specific question. After the privilege is raised, the Trustee could seek a ruling by the Bankruptcy Court as to whether the privilege was properly raised to that question and/or whether any immunity provision applies.

7. The production of corporation books, documents and records is not protected by the Fifth Amendment unless production would involve compulsion of incriminatory evidence of a testimonial nature. *Fisher v. United States*, 425 U.S. 391 (1976). Generally, the corporate records of a debtor in bankruptcy are not privileged under the Fifth Amendment. *In re Harris*, 221 U.S. 274 (1911). A corporate custodian cannot claim the Fifth Amendment privilege with regard to corporate records, even if the records or act of producing them might incriminate him personally. *United States v. Blackman*, 72 F.3d 1418, 1427 (9th Cir. 1995); *In re Cotillion Invs., Inc.*, 343 B.R. 344, 350 (Bankr. S.D. Fla. 2006) .

The contents of a document may not be privileged, but the act of producing the document may be. *Fisher v. United States*, 425 U.S. 391 (1976). While the Court agrees with Davis that the "act of producing" documents can in certain situations rise to the level of "testimonial evidence," the record before this Court does not allow the Court to

determine if the act of producing PAIs corporate records relating to the property of the bankruptcy estate infringes upon Davis' Fifth Amendment rights. There has been no showing Davis prepared PAI pre-bankruptcy documents under governmental compulsion and possession of business records (which are property of the bankruptcy estate) is not a crime. *In re Ross*, 156 B.R. 272, 278 (Bkrctcy. Idaho 1993). Therefore, the Bankruptcy Court may have to rule on whether or not in this particular case an assertion of a Fifth Amendment privilege is applicable to the Trustee's request for PAI's books and records from Davis.

8. Davis' assertion of the Fifth Amendment privilege must be on a question by question basis. *United States v. Bodwell*, 66 F.3d 1000, 1001 (9th Cir.1995). The Bankruptcy Court will determine if the privilege is properly asserted as to a particular question.

9. The Bankruptcy Court has authority to exercise civil contempt power to ensure Davis attends the Rule 2004 examination. 11 U.S.C. § 105(a). The Court correctly applied the law in requiring Davis to attend the Rule 2004 examination in Idaho and in making himself available to assist the Trustee is the ongoing litigation involving PAI. The Court finds no authority for the proposition that Davis has a right to have his expenses associated with appearing reimbursed by the Trustee. Davis choose to file bankruptcy for PAI in Idaho even though he does not live in Idaho. As the principal of PAI, he is not relieved of his duties to appear on behalf of the debtor when reasonably

requested. The Bankruptcy Court did not abuse its discretion in ordering Davis to appear in Idaho for the Rule 2004 exam and to remain in Idaho while the Court deals with any challenges to the questions posed by the Trustee. Davis' argument that the Court's order constitutes imposition of involuntary servitude is rejected.

CONCLUSION

In this case, the landscape has changed dramatically now that Davis has been charged personally with criminal charges relating to his activities as President of PAI and other entities. While criminal charges against Xpress may have been anticipated when the Bankruptcy Court reviewed this matter, now Davis has been charged personally. The Court finds that the signing of the petition and schedules by Davis does not result in a complete waiver of Fifth Amendment privileges he may claim. The Bankruptcy Court was correct when it ruled that Davis waived his Fifth Amendment rights to answer questions about the debtor's (PAI's) financial affairs, but Davis still had the right to invoke the Fifth Amendment as to any questions that may also impact Davis as an individual.

In ruling in this manner, the Court is mindful it has not resolved whether specific questions need to be answered. This case may require some micro management by the Bankruptcy Court if the Fifth Amendment privilege is raised by Davis on certain questions. Or the Trustee may decide that in light of the ongoing criminal proceedings, the Fifth Amendment privilege is most likely appropriate to certain questions and the

Bankruptcy Court need not rule on the appropriateness of the privilege.

PAI cannot seek the protections of the Bankruptcy Court and then have its principal decide what questions regarding PAI it will answer and will not answer. Davis may assert the Fifth Amendment privilege against self-incrimination, but the Bankruptcy Court will have the final say on whether or not an assertion of the Fifth Amendment privilege is appropriate or whether any immunity applies.

ORDER

IT IS ORDERED:

The appeal of the Bankruptcy Court's ruling on the Second Amended Motion for Rule 2004 Examination and Motion to Compel Testimony is AFFIRMED. This matter is remanded back to the Bankruptcy Court to resolve any specific assertions of Davis' Fifth Amendment rights related to the specific questions the Trustee has been allowed to ask Davis.



DATED: **March 30, 2012**

A handwritten signature in black ink, appearing to read "Edward J. Lodge".

Honorable Edward J. Lodge
U. S. District Judge