Discharge, objection to
11 USC § 727(a)(2)(A)
11 USC § 727(a)(4)(A)

Yaden v. Hales 94-6417-fra
In re Jim Bob Hales 694-61188-fra7

1/29/97 FRA Unpublished

The court granted judgment for the plaintiff, the Chapter 7 trustee in this case, denying the debtor's discharge on the following grounds: 1) that the debtor transferred assets within one year of bankruptcy with the intent to hinder, delay, or defraud creditors (§ 727(a)(2)(A)), and 2) by failing to list assets and make required disclosures, the debtor made a false oath respecting a material fact (§ 727(a)(4)(A)).

The debtor is a dentist who sold his practice in Texas for $211,800 and moved to Oregon. In 1994, the debtor, under pressure from creditors, sold the note from the sale of his practice which had a balance of over $176,000 for $93,000. The proceeds were transferred to the trustee of the debtor's self-settled trust, whom the debtor subsequently married. When the debtor filed his bankruptcy schedules with the help of a paralegal service, he failed to list the trust assets or disclose the transfer of assets to the trust or other transfers of property. Amended schedules were later filed by debtor's attorney disclosing the trust assets and other omitted information after inquiries were made at the meeting of creditors and the complaint in this case was filed.

The court held that the transfer of assets to the trust constituted a "transfer" for purposes of § 727(a)(2), even though a beneficial interest of equal value may have been created in favor of the debtor. There were sufficient "badges of fraud" present for the court to conclude that the transfer was made with fraudulent intent. The omission of the assets and other information in the schedules, when looked at as a whole, constituted a concealment such that discharge was also denied under § 727(a)(4)(A).

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

IN RE	)	
	)	
JIM BOB HALES,	)	Case No. 694-61188-fra7
	)	
Debtor.	)	
	)	
BOYD C. YADEN, Trustee,	)	
	)	
Plaintiff,	)	
vs.	)	Adversary No. 94-6417-fra
	)	
JIM BOB HALES,	)	
	)	MEMORANDUM OPINION
Defendant.	)	

Plaintiff, the bankruptcy trustee[1], seeks a judgment denying Debtor's discharge on two grounds: that the Debtor made a fraudulent transfer within the first year prior to his petition in this case, 11 U.S.C. § 727(a)(2)(A); and that the Debtor, by failing to list assets and make required disclosures in his schedules and statement of affairs, made a false oath respecting

[1]This case involves a trust created by Defendant. For clarity's sake, the bankruptcy trustee will be referred to as "Plaintiff", and the trustee of the private trust as "Trustee".

of material fact, 11 U.S.C. § 727(a)(4)(A). The matter was tried on January 23, 1997. Based on the testimony and exhibits of the parties, and for the reasons set forth below, the Court finds that Debtor's discharge should be denied.

I. PROCEDURAL BACKGROUND

The sole issue in this case is whether Debtor's discharge should be denied pursuant to 11 U.S.C. § 727. For that reason it is a core proceeding. 28 U.S.C. § 157(b)(2)(J). The adversary proceeding was initiated on the complaint of Fahimeh Maynard, a creditor. Debtor and Ms. Maynard agreed to settle the Maynard claim. Prior to dismissal of the case notice of the parties' intention was given to the Plaintiff and the United States Trustee, as required by Bankruptcy Rule 7041. Thereafter the Plaintiff was given leave to intervene to continue prosecution of the § 727 claims.

II. FACTS

Prepetition Activities

In his own words, Dr. Hales was an "accomplished person", maintaining a successful dentistry practice in Dallas, Texas. In 1989 things started to go badly, due to a number of unwise investments. Still, Debtor was able to sell his dental practice in late 1989 to a Dr. Borgman, who gave Debtor a promissory note for $211,800.00. (The record is silent as to whether any down payment was made.).

A few weeks later, in January 1990, Debtor executed a document purporting to create the "Jim Hales Family Trust." The

instrument states that "grantor [Jim Hales] has irrevocably conveyed, assigned, transferred and delivered to trustee full and complete title to the property described in Exhibit "A" hereto, "trust property", the receipt of which is hereby acknowledged by the trustee." Exhibit A to the trust instrument refers to the note receivable from Dr. Borgman, a profit sharing trust account and an IRA account, and a partnership in a dental clinic in Irving, Texas. Of the four, the note was by far the most significant asset.

The original trustee resigned in September 1993. Thereafter Rene' Morgan was designated successor trustee. It is unclear whether she was designated by the Debtor, or by her predecessor as the terms of the trust require.

After creating the trust Debtor continued to treat the Borgman note as his own property. Until the note was assigned to a third party, he received monthly payments of principal and interest directly from Dr. Borgman. In January 1994 -- a time when he was under increasing pressure from creditors -- Debtor sold the note for $93,000.00. At the time it had a remaining principal balance of over $176,000.00. $71,000.00 of the sale price was paid in cash which was delivered to Ms. Morgan as trustee. The remaining $22,000.00 was paid in the form of various antiques. The record is unclear as to whether these antiques were under the Debtor's control or Ms. Morgan's. Although the Debtor claims that Ms. Morgan was in control, it was

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ultimately the Debtor who arranged for the Plaintiff's liquidator to take possession.

Debtor filed his petition for relief in this case on March 29, 1994.

Debtor's Schedules

The Debtor has filed three sets of schedules, each accompanied by a statement of financial affairs, over the life of the case. The first set was prepared and signed by the Debtor on March 25, 1994, and filed with his initial petition. He was aided by a paralegal service; however, the paralegal refused to render any legal advice. The second set was prepared with the assistance of an attorney late in November of 1994. The third set was filed after the case had been converted to Chapter 13 and reconverted to Chapter 7, in June 1995. It is significant that the amended schedules were filed after inquiries into discrepancies in the first set at the first meeting of creditors and a subsequent Rule 2004 exam, and after the initial complaint was filed in this case.

The first set of schedules and statement of affairs were inaccurate in many respects, including (but not limited to) the following:

1. The schedules revealed a $10.00 balance in a First Interstate Bank account. The second schedule revealed a balance of $23,667.00.

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2. The schedules did not disclose any interest, either legal or beneficial, in the proceeds of the sale of the Borgman note. This was corrected in subsequent schedules.

3. The schedules revealed no accounts. It was subsequently determined that the Debtor had approximately $5,500.00 in accounts receivable from his Oregon dental practice, which amount was reflected in subsequent schedules.

4. The schedules listed only $100.00 worth of office equipment, furnishing and supplies, which figure was later increased to $1,600.00.

Total personal property listed in Schedule B of the original schedules was $9,200.00; the November amendments showed total personal property of $90,789.74.

5. Notwithstanding the delivery of the proceeds of the sale of the Borgman note to Rene' Morgan, the statement of affairs fails to disclose any prepetition transfers to insiders. The statement of affairs, at Paragraph 2, did disclose income of $19,418.00, with a source described as "1992 trust--note receivable (Dr. Borgman)." Another entry shows income of $18,218.00, described as "1993--trust--note receivable (Dr. Borgman)."

III. DISCUSSION

Fraudulent Transfer

There is no evidence that, when he created the family trust in 1990, Debtor actually accomplished a transfer of the Borgman note to the trust. On the contrary, it is clear that he treated

the note and the proceeds as his own, through and including the time he sold the note for cash and the antiques. Only then, about four months prior to commencing this bankruptcy case, were these assets actually put in the hands of the trustee (and Debtor's future wife) Ms. Morgan. While the terms of the trust give absolute authority in the distribution of principal and income to the trustee, Dr. Hales testified that "certainly I had influence" over the trustee's decisions.

The antiques were eventually recovered by Plaintiff and liquidated. Of the $71,000.00 in cash proceeds, $21,000.00 were paid by Ms. Morgan to the taxes owed by the Debtor. $32,000.00 was recovered by the Plaintiff. The remaining $18,000.00 has not been accounted for.

Bankruptcy Code § 727(a)(2)(A) provides that:

> (a)The Court shall grant the debtor a discharge unless--
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> (2) 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 --
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> (A) property of the debtor, within one year before the date of filing of the petition.

A "transfer" is defined by the Code as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and

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foreclosure of the debtor's equity of redemption." 11 U.S.C. § 101(54).

The burden of proof in an action to deny discharge lies with the Plaintiff. Federal Bankruptcy Rule 4005. Each element of the objection must be established by a preponderance of the evidence. Grogan v. Gerner, 498 U.S. 279, 111 S.Ct. 654, 112 L.Ed.2d 755 (1991). However, once the Plaintiff presents evidence sufficient to establish a prima facie case, the burden then shifts to the Debtor. In re Deavers, 759 F.2d 751, 754 (9th Cir. 1985); In re Sicari, 187 B.R. 861 (Bankr. S.D. N.Y. 1994).

The transfer by Debtor of property to a self-settled trust constitutes a "transfer" under the Bankruptcy Code, even if the effect of the transfer is to create a beneficial interest in the debtor/transferor of equal value. Debtor argues that there is no "transfer" if the assets are placed in a trust which continues to be subject to the claims of Debtor's creditors, relying on In re Harris, 101 B.R. 210 (Bankr. E.D. Cal. 1989). However, a better application of Code § 101(54) is advanced by Judge Brandt in In re Wallaert, 149 B.R. 665, 668 (Bankr. W.D. Wa. 1992): "Section 101(54) does not speak in terms of an effect on creditors: rather, it focuses on what, if anything, the debtor parted with. The all encompassing language unambiguously comprehends any disposition of any interest in property." Debtor's delivery of the proceeds of the Borgman note to the family trust constituted a "transfer" for purposes of Code § 727. In addition, the combination of delivery of the assets to the trustee and the

failure to reveal the existence of the assets or the transfer constitute a "concealment."

The remaining inquiry is whether the transfer and/or concealment were made with fraudulent intent. Plaintiff's burden of establishing a prima facie case may be carried through proof of sufficient "badges of fraud." In re Coombs, 193 B.R. 557 (S.D. Ca. 1996). Such badges of fraud are abundant in this case:

1. The transfer was to an insider;

2. The transfer was made at a time when the Debtor was experiencing severe financial difficulty;

3. The transfer was of all or substantially all of the Debtor's remaining property; and

4. The Debtor received inadequate consideration for the transfer.

See In re Woodfield, 978 F.2d 516, 518 (9th Cir. 1992).

Debtor presents no credible evidence rebutting the inference that both the intent and effect of his transfer of assets to Ms. Morgan was to defraud, hinder and delay creditors.

False Oath

Code § 727 prohibits discharge where "the debtor knowingly and fraudulently, in or connection with the case--(A) made a false oath or account."

Bankruptcy schedules and statements of affairs are submitted under oath, and the conscious and fraudulent inclusion of false information, or omission of material information, is grounds for

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denial of discharge. See In re Haverland, 150 B.R. 768 (Bankr. S.D. Cal. 1993); In re Tully, 818 F.2d 106 (1st Cir. 1987).

It is clear from this record that the first set of schedules and statement of affairs contain many material errors and omissions. The Debtor's principal defense is that he was inexperienced and unaware of what was required of him, and that all the errors amount to no more than honest and innocent mistakes.

Many of the Debtor's conscious decisions in filling out the schedules and statements reflect, at very least, an inappropriate indifference to the importance of the questions and the truth of the responses. For example, Debtor testified that he (falsely) stated that he had made no transfers to insiders, because he did not understand what the term "insider" meant, although he assumed that the term did not apply in his case. He apparently was not curious enough -- and certainly not diligent enough -- to look the term up or seek competent advice.

In other respects the defense is simply not credible. Having been well educated, a principal in a significant professional practice, and engaged in estate planning with personal trusts, the Debtor is simply not to be believed when he now argues that he did not understand that he had a duty to disclose the trust assets. The extensive efforts to redocument the case after meetings of creditors, examinations, and the filing of a lawsuit do nothing to lend credence to Debtor's protestations of innocence.

Debtor asserts that there was sufficient information in the schedules to alert the Plaintiff to the existence of the family trust. He points to the reference to income from the family trust, and the fact Plaintiff was able to track down additional details at the first meeting of creditors and during subsequent discovery. However, leaving a trail for the bankruptcy trustee to find and follow is not a substitute for the Debtor's duty to provide complete and informative schedules to the trustee and creditors. If it was, omissions and falsehoods in schedules would only be the basis for denial of discharge when so complete as to prevent the Bankruptcy trustee from discovering that the falsehoods are there in the first place.

While any one of the errors or omissions might have been the result of inexperience or mistake, the cumulative effect of all of the falsehoods together establishes that the Debtor was unconcerned with the truth or accuracy of his schedules. Such a "reckless and cavalier disregard for the truth" is sufficient to satisfy the fraud element of § 727 (a)(4)(A). In re Diodati, 9 B.R. 804, 808 (Bankr. D.Ma. 1981), In re Mazzola, 4 B.R. 179 (Bankr. D.Ma. 1980).

IV. CONCLUSION

Debtor, within a year prior to the commencement of this bankruptcy case, transferred assets intending to defraud creditors. Debtor filed schedules with intentional and material omissions. For these reasons his discharge should be denied.

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The forgoing constitutes the Court's findings of fact and conclusions of law, which will not be separately stated. Counsel for Plaintiff shall submit a form of judgment consistent with this memorandum opinion.

FRANK R. ALLEY, III
Bankruptcy Judge

cc: Mr. Keith Boyd
Mr. James Dietz