UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
TAMPA DIVISION

In re: Case No. 02-19961

LARRY FAY HOSMER
and PAMELA RAE HOSMER,

Debtors. Chapter 7

FELICIA S. TURNER,
United States Trustee - Region 21,

Plaintiff,

vs. Adv. No. 8:03-ap-192-PMG

LARRY FAY HOSMER
and PAMELA RAE HOSMER,

Defendants.

FINDINGS OF FACT, CONCLUSIONS OF LAW,
AND MEMORANDUM OPINION

THIS CASE came before the Court for a final evidentiary hearing in the above-captioned adversary proceeding.

The Plaintiff, the United States Trustee - Region 21 (the UST), commenced this adversary proceeding by filing a Complaint Objecting to the Entry of the Debtors' Discharge. The Complaint contains four Counts: (1) a claim under §727(a)(2)(A) of the Bankruptcy Code to deny the Debtors' discharge based upon their prepetition transfer of property with the intent to defraud creditors; (2) a claim under §727(a)(2)(B) of the Bankruptcy Code to deny the Debtors' discharge based upon their postpetition concealment of property with the intent to defraud creditors; (3) a claim under §727(a)(4)(A) of the Bankruptcy Code to deny the Debtors' discharge based upon their false oaths in connection with the case; and (4) a claim under §727(a)(4)(D) of the Bankruptcy Code to deny the Debtors' discharge based upon their fraudulent withholding of information from the UST.

The Debtors, Larry Fay Hosmer and Pamela Rae Hosmer, filed a written Answer to the Complaint, and denied the material allegations.

Background

The Debtor, Larry Hosmer, was a practicing attorney in South Dakota. His practice was a general practice, and from 1968 to 1980, he was the State Attorney for the area in which he lived. He also served as an officer of his local bar association, and was active in service clubs in his community. (Transcript, pp. 16-19). Pamela Hosmer previously worked as an accountant for a manufacturing company in South Dakota. (Transcript, pp. 125-26).

The Debtors moved to Florida in 1999, and purchased a home in Belleair Beach. Two mortgages initially encumbered the homestead real property: (1) a first mortgage in the approximate amount of $130,000.00, and (2) a second mortgage in the approximate amount of $50,000.00.

The Debtors initially consulted an attorney regarding the filing of a bankruptcy case on September 24, 2002.

The Debtors filed a petition under chapter 7 of the Bankruptcy Code on October 9, 2002. The petition was accompanied by schedules of the Debtors' assets and liabilities, and also by a Statement of the Debtors' Financial Affairs.

Lauren Greene, the chapter 7 Trustee, conducted an initial §341 meeting of creditors on November 12, 2002, and a continued §341 meeting of creditors on December 2, 2002. Additionally, the chapter 7

Trustee conducted a 2004 Examination of the Debtors on March 10, 2003. The Debtors appeared at each of the examinations and responded to the chapter 7 Trustee's inquiries. (Transcript, Testimony of Lauren Greene, pp. 75, 77).

The UST filed the Complaint that commenced this adversary proceeding on March 21, 2003.

The Debtors filed amended schedules and an amended Statement of Financial Affairs on March 24, 2003.

The evidence at trial focused on the following assets owned by the Debtors, and the following transactions that occurred within the one-year period immediately preceding the filing of the bankruptcy petition:

1. <u>Checking Account No. 003438033206 at Bank of America</u>. The Debtors acknowledge that the Checking account was omitted from their original schedule of assets. (Transcript, p. 23). The Debtor testified that he didn't know why the account was omitted, but that their finances were "pretty much hand to mouth" for a period of time before filing the bankruptcy petition, and that "little or nothing" would have been in the account, because the petition date fell between paychecks. (Transcript, pp. 92-93). On the Amended Schedules, the Debtors listed the checking account as having a value of $3,828.00.

2. <u>Account No. CG 88892 GM at PaineWebber</u>. The account was not listed on the Debtors' original bankruptcy schedules. The Debtor testified that, at the time he filed his petition, he thought that all of the PaineWebber accounts had been liquidated pursuant to his instructions to his broker, and that he "didn't have anything in PaineWebber." (Transcript, pp. 93-94). Ultimately, PaineWebber wrote the Debtor a letter stating the account had been reviewed, and that the Debtor owed PaineWebber money. (Transcript, p. 94). On the Amended Schedules, PaineWebber is listed as an unsecured creditor in the amount of $110.00 based on an "overpayment."

3. Accounts receivable from the Debtor's former law practice. The Debtor testified that he worked as a sole practitioner at the end of his legal career in South Dakota, and that he had decided to retire about a year prior to leaving the practice. Consequently, he had attempted to wind down the practice by declining to take new cases and by closing his existing files. By the time he left in September of 1999, therefore, very few files remained active, and the Debtor turned those files over to his son, who is also an attorney. (Transcript, pp. 96-97). His son collected a few receivables totaling approximately $5,000.00 between September of 1999 and 2001, and only one problematic case remained open as of the date that the Debtors filed their chapter 7 petition. (Transcript, pp. 96-98). The receivable was not listed on the Debtors' schedules.

4. Interest in a contract for deed. In July of 1995, the Debtor and his son purchased a house in Tabor, South Dakota, as rental property, and executed a mortgage on the property in the amount of $16,500.00. (UST's Exhibit 21). On March 31, 1998, the Debtor and his son sold the property for the sales price of $29,000.00 pursuant to a Contract for Deed. (UST's Exhibit 20). The Debtor acknowledges that he and his son are entitled to payments under the Contract for Deed, but asserts that the claim is worthless, because the purchasers do not make the payments, and because the property would not yield any amount in excess of the mortgage in the event of foreclosure. (Transcript, pp. 62-65, 98-100).

The Debtor contends that he disclosed his interest in the Contract for Deed to the chapter 7 Trustee, and offered to surrender this interest to the chapter 7 Trustee. (Transcript, pp. 99-100). The Debtor's one-half interest in the Contract for Deed is listed in his Amended Schedule B.

5. The Fox Run Partnership. Prior to April of 2002, the Debtor held a one-fourth interest in the Fox Run Partnership, which owns a vacant lot in Yankton, South Dakota. In April of 2002, the Debtor sold

his one-fourth interest in the partnership to his son for the sum of $15,000.00. The Debtor's son paid the purchase price for the partnership interest in two installments on April 18, 2002, and May 2, 2002. (UST's Exhibits 12, 13). The Debtor contends that the sales price represented the fair value of the interest, based on the value of the underlying property, and the amount of the mortgage encumbering the property. (Transcript, p. 112). The sale was not disclosed on the Debtors' schedules.

6. The Sands Point Motel. The Debtors purchased a motel known as the Sands Point Motel in Clearwater in November of 1999, shortly after arriving in Florida. (Transcript, p. 114). They originally sold the Motel in 2001, but the purchasers surrendered the property to the Debtors in April of 2002 after failing to make any payments for eight months. (Transcript, pp. 107, 109). The Motel had not been properly maintained, however, and the Debtor used the $15,000.00 received from his son for his interest in the Fox Run Partnership to restore the Motel to operating condition. (Transcript, pp. 110-111).

The Debtors then resold the Motel in June of 2002. (Transcript, p. 115). The Debtors received net proceeds in the amount of $68,937.10 from the June 2002 sale of the Motel. (UST's Exhibit 16). The Debtors acknowledge that they used a portion of the proceeds from the sale of the Motel to pay off the second mortgage on their home. (Transcript, pp. 59, 115). The remaining proceeds were used for other home repairs, such as the purchase of an air conditioner. (Transcript, pp. 115-16; See also Joint Pretrial Statement dated July 1, 2003, Statement of Admitted or Uncontested Facts, p. 4).

Based primarily on these facts, the UST asserts that the issue is whether the Debtors are entitled to a discharge "where they (i) sold non-exempt property and applied the proceeds to their homestead, and (ii) failed to disclose significant transfers and other assets in their Schedules and Statement of Financial Affairs filed with the Court less than four months later." (UST's Post-Trial Memorandum, p. 1).

Discussion

As set forth above, the UST's Complaint contains four Counts, arising under §727(a)(2)(A), §727(a)(2)(B), §727(a)(4)(A), and §727(a)(4)(D), respectively. Those subsections of §727(a) of the Bankruptcy Code provide:

> **11 U.S.C. § 727. Discharge**
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> (a) The court shall grant the debtor a discharge, unless--
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> . . .
>
> (2) the debtor, <u>with intent to hinder, delay, or defraud a creditor or an officer of the estate</u> 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; or
>
> (B) property of the estate, after the date of the filing of the petition.
>
> . . .
>
> (4) the debtor <u>knowingly and fraudulently</u>, in or in connection with the case--
>
> (A) made a false oath or account;
>
> . . .
>
> (D) withheld from an officer of the estate entitled to possession under this title, any recorded information, including books, documents, records, and papers, relating to the debtor's property or financial affairs.

11 U.S.C. §727(a)(Emphasis supplied). "Before a debtor can be denied a general discharge under either of these sections [§727(a)(2) or §727(a)(4)], [the plaintiff] must show actual intent. *See In re Adeeb*, 787 F.2d 1339, 1342 (9th Cir. 1986)(stating that "discharge of debts may be denied under section 727(a)(2)(A) only upon a finding of actual intent to hinder, delay, or defraud creditors"). *See also* 4

Collier on Bankruptcy, ¶ 727.04[1] at 727-59 (15th ed. 1996)(stating that to deny a discharge under Section 727(a)(4), 'the statement must contain matter which the debtor knew to be false and the debtor must have included them willfully with the intent to defraud')." In re Mereshian, 200 B.R. 342, 345-46 (9th Cir. BAP 1996).

"A creditor alleging intent to defraud under §727(a)(2)(A) bears the considerable burden of demonstrating *actual fraudulent intent*; constructive fraud is insufficient." *See In re Wines*, 997 F.2d 852, 856 (11th Cir. 1993)." In re Miller, 39 F.3d 301, 306 (11th Cir. 1994)(Emphasis in original).

In this case, it is clear that various transfers of the Debtors' property occurred in the months preceding the filing of the their chapter 7 petition on October 9, 2002. Such transfers include, for example, the sale of the Debtor's one-fourth interest in the Fox Run Partnership to his son for $15,000.00 in April of 2002, the sale of the Sands Point Motel on June 28, 2002, and the use of a portion of the proceeds from the sale of the Motel to satisfy the second mortgage on the Debtors' home.

Further, it is also clear that various assets and transactions were not disclosed on the schedules and Statement of Financial Affairs originally filed by the Debtors. The omitted assets and transactions include the Debtors' checking account at Bank of America, the potential claim for any outstanding accounts receivable from the Debtor's former law practice, the Debtor's one-half interest in the Contract for Deed relating to the property in Tabor, South Dakota, the sale of the Sands Point Motel, the satisfaction of the second mortgage on the Debtors' home, and the transfer of the Debtor's one-fourth interest in the Fox Run Partnership to his son.

The transfers of the Debtors' property in the spring and summer of 2002 were significant, and the errors and omissions in the Debtors' schedules are equally significant. The Court views the transfers and errors seriously, since a "debtor's complete disclosure is essential to the proper administration of the bankruptcy estate," and since such disclosure "serves the purpose of providing reliable information to those with an interest in the bankruptcy estate, who are entitled to a truthful statement of the debtor's affairs." In re Perry, 252 B.R. 541, 549 (Bankr. M.D. Fla. 2000).

The Court cannot find, however, that the transfers were made with the actual intent to hinder, delay, or defraud creditors or the Trustee, within the meaning of §727(a)(2) of the Bankruptcy Code, or that the errors and omissions were made "knowingly and fraudulently" within the meaning of §727(a)(4) of the Bankruptcy Code.

Courts generally consider all of the evidence presented in a case to determine whether a debtor's transfers and nondisclosures were made with the actual intent to defraud his creditors. In re Parnes, 200 B.R. 710 (Bankr. N.D. Ga. 1996). A court "may look to all the surrounding facts and circumstances" to determine a debtor's actual intent under §727(a)(2) and §727(a)(4) of the Bankruptcy Code. In re Mereshian, 200 B.R. at 346.

In this case, the following factors were persuasive in the Court's determination that the Debtors did not act with actual fraudulent intent in connection with this case:

> 1. On their initial schedule of real property, the Debtors listed their home with a value of $250,000.00. Additionally, they listed personal property with a total value that exceeded $104,000.00. The personal property includes, for example, the cash surrender value of multiple life insurance policies, a PaineWebber account, and an Etrade account. Finally, the Debtors also disclosed certain "property held for another," including a separate bank account held for their daughter. In other words, the Debtors disclosed assets with significant value on their original schedules, which is indicative of their subjective intent to submit their property for the administration of the case.
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> 2. The Debtors did not consult with their bankruptcy attorney until September 24, 2002, after all of the transfers at issue in this case had already been completed.
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> 3. The Debtors appeared at three separate examinations, and testified under oath before the chapter 7 Trustee at each examination. The Trustee acknowledges that the Debtors responded to her inquiries, and that they produced documents that she requested.

4. The assets and transfers at issue appear to have little or no value to the estate. The chapter 7 Trustee has neither administered nor pursued any of the property or causes of action discussed above, such as the one-fourth interest in the Contract for Deed relating to the property in Tabor, South Dakota, for example, or any of the accounts receivable relating to the Debtor's former law practice.

Although the chapter 7 Trustee filed an Objection to the Debtors' original claim of exemptions, that Objection was overruled, and no additional pleadings or claims have been asserted by the Trustee for the purpose of recovering any assets for the estate.

5. The Debtor's testimony at trial was candid and credible, and he offered satisfactory explanations as to the present status of the assets, and the reason for many of the transactions. He testified that he sold his one-fourth interest in the Fox Run Partnership, for example, to raise money for the Sands Point Motel, which was in need of immediate repair and restoration.

He also testified that the proceeds from the sale of the Motel were used to pay off the second mortgage on his home, because all of the proceeds of the second mortgage had been invested in the Motel when he bought it, and "we figured that that's where the money from the equity line of credit went in the first place was into the motel." (Transcript, pp. 115-16). Generally, of course, it is well-settled that the transfer of non-exempt property to exempt property is not inherently fraudulent, absent extrinsic signs of fraudulent intent. In re Segal, 227 B.R. 191, 195 (Bankr. S.D. Fla. 1998).

6. The Debtor was under considerable stress at the time that the original schedules were prepared. It appears, for example, that Mrs. Hosmer has suffered from an illness for an extended period of time, and the Debtors' financial situation had deteriorated significantly since moving to Florida. At least five lawsuits had been filed against the Debtors at the time that the petition was filed, and the Debtors listed unsecured debt in an amount exceeding $245,000.00. Additionally, the parties stipulated that the Debtors "have not received any income, and have lost their entire investment, in the following businesses: a.) Fox Run Partners, b.) Detail Express, Inc., c.) Hard Drive Central, Inc., d.) Sands Point Motel, e.) The Law Partnership in South Dakota." (Joint Pretrial Statement, Statement of Admitted or Uncontested Facts, pp. 4-5).

Based on the evidence, the Court is satisfied that the Debtors' transactions and nondisclosures were not the result of any scheme or design on their part to retain any assets for their own benefit at the expense of their creditors.

On the contrary, this case is similar to the circumstances in In re Smith, 278 B.R. 253 (Bankr. M.D. Ga. 2001), where the Court concluded that the debtor lacked the fraudulent intent required under §727(a)(2) and §727(a)(4), even though various transactions and assets had not been disclosed in the chapter 7 case.

> A fraudulent concealment potentially results in a benefit to the debtor by retaining the property otherwise required to be surrendered to the Trustee. However, Debtor's "concealment" would not result in any gain from retention of otherwise defunct property.

In re Smith, 278 B.R. at 258. The Court concluded that the debtor in Smith "lacked the actual fraudulent intent to warrant a denial of discharge." Id. at 259.

Conclusion

The UST commenced this action to deny the Debtors' discharge under §727(a)(2)(A), §727(a)(2)(B), §727(a)(4)(A), and §727(a)(4)(B) of the Bankruptcy Code. The Court finds that the Debtors' discharge should not be denied. Although the evidence shows that several transfers occurred within the months that preceded the filing of the chapter 7 petition, and that significant errors and omissions appeared on the Debtors' schedules, the transfers and nondisclosures were not made with the actual intent to defraud the Debtors' creditors or the representative of the estate.

Accordingly:

IT IS ORDERED that:

1. A Final Judgment should be entered in this adversary proceeding in favor of the Debtors, Larry Fay Hosmer and Pamela Rae Hosmer, and against the Plaintiff, Felicia S. Turner, as United States Trustee - Region 21.

2. The Debtors, Larry Fay Hosmer and Pamela Rae Hosmer, shall receive their Discharge pursuant to §727 of the Bankruptcy Code.

DATED this 29 day of July , 2004.

BY THE COURT

/s/ Paul M. Glenn
PAUL M. GLENN
Chief Bankruptcy Judge