UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF FLORIDA
ORLANDO DIVISION

In re	)	
	)	
WILLIAM ALLEN KLINGLESMITH,	)	Case No. 6:10-bk-00416-KSJ
	)	Chapter 7
Debtor.	)	
	)	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The Chapter 7 trustee, Carla Musselman, objects under § 522(o)(4) of the Bankruptcy Code[1] to debtor William Klinglesmith's claim of exemption for homestead property in the amount of $109,000.[2] She contends the debtor attempted to "launder" non-exempt cash into his exempt homestead in an effort to hide assets from his business partners, who later sued the debtor and are now judgment creditors. An essential element of a § 522(o)(4) objection is that the trustee must establish by a preponderance of the evidence that the debtor had the actual intent to "hinder, delay, or defraud a creditor." Because the trustee has not established[3] the debtor had the requisite fraudulent intent at the time he purchased the homestead property, the trustee's objection is overruled.

In 2006, troubles in the debtor's personal and financial life led him to rely heavily on his parents for financial and emotional support. His marriage to his first wife was falling apart, he drank heavily, and he lived with his parents and paternal grandmother at his grandmother's 1,200 square foot house on Hawthorne Court in Satellite Beach, Florida (the "Homestead"). The debtor's now ex-wife then lived at the couple's 2,100 square foot beach front condominium on

[1] All references to the Bankruptcy Code are to Title 11 of the United States Code.
[2] The debtor's claim of exemption arises under § 522(b)(3)(A) of the Bankruptcy Code and Article X, § 4(a)(1), of the Florida Constitution.
[3] The final evidentiary hearing was held on February 7 and 22, 2011. Witnesses included the debtor, his mother, Sharon Klinglesmith, and Nicole Colbert, the daughter of William Glover, one of the debtor's business partners and the businesses' accountant.

Highway A1A in Indian Harbour Beach, Florida (the "Beach Condo") until early 2007, when the parties' divorce was finalized. Even after his ex-wife moved out of the Beach Condo, the debtor continued to live primarily with his parents in the Homestead. The debtor credibly testified that he associated the Beach Condo with his ex-wife and their failed marriage and that he preferred his parents' company to living alone. The debtor also relied heavily on his parents for financial support because his income was unsteady.

The debtor owned and operated a real estate company, Landmark Realty. His income, however, was sporadic and, as detailed below, between 2005 through 2007, he borrowed substantial funds from his parents. He used some of these funds together with his income to invest in three real estate transactions relevant to these proceedings.

In 2005-2006, the debtor formed a business relationship with three men—Vaheed Teimouri, William Glover, and Jack Spira[4] (together with the debtor, the "Group")—to develop and finance three separate real property ventures. The debtor, as the real estate broker, found the properties to develop. The Group, in turn, formed two limited liability companies to develop two condominium projects—Harbor Gardens, LLC,[5] and Diamonte Sands, LLC.[6] Both entities incurred significant loans to finance their respective projects, which the Group members each personally guaranteed. On June 7, 2005, the Group members, in their capacity as member/managers of Diamonte Sands, LLC, each co-signed a promissory note to BankFirst/Bank of Brevard in the total principal amount of $843,750.[7] The debtor held a 20% membership interest in Diamonte Sands.[8] Likewise, on August 14, 2006, the Group members, each in his capacity as manager of Harbor Gardens, LLC, co-signed a promissory note in favor

[4] Mr. Spira did business through an entity named "O&S Partnership" with his partner C. Mario Oliveira.
[5] Debtor's Ex. 2.
[6] The Harbor Gardens and Diamonte Sands projects entailed buying and developing parcels for use as condominiums.
[7] Trustee's Ex. 6.
[8] The Diamonte Sands, LLC, operating agreement is not part of the record evidence but the debtor testified as to his 20% ownership interest and other evidence supports this. See Trustee's Ex. 50.

of Coastal Bank in the total principal amount of $1,853,400.[9] Because the debtor made a significant investment in the Harbor Gardens project before the Group's involvement, the debtor held a 30% membership interest in Harbor Gardens, LLC, while the other three members took a 23.333% interest.[10]

The third real estate project the debtor brought to the Group led ultimately to an irreparable rift between the debtor and the rest of the Group. After the Harbor Gardens and Diamonte Sands projects were under way and each of the members had signed large personal guarantees, the debtor, using a loan from his parents, made a $50,000 non-refundable deposit to purchase a property in Courtney Springs, Florida, for $1.5 million that was approved and zoned to develop units for assisted living facilities. The debtor made the deposit through an entity he formed called Island Towers Development, LLC. The debtor anticipated bringing the Group on for additional financing, but the Group was unable to reach an agreement regarding their financial participation. In short, the debtor wanted the Group to loan him a $500,000 "equity contribution" that would allow him to "true up" his outstanding capital call obligations with Harbor Gardens and Diamonte Sands. The other members of the Group declined, which left the debtor scrambling to find other financing.

Not wanting to lose his $50,000 down payment and believing the Island Towers project to be financially very sound, the debtor arranged a $500,000 loan from his parents, secured by a junior lien on the project property,[11] and a $1,000,000 loan from Coastal Bank, secured by a first mortgage lien, which together enabled him to close on the property in the fall of 2006. By investing in the Island Towers project without Group financing, the debtor acknowledged he was unable to meet capital calls with the two Group projects, and required loans of $550,000 from his

[9] Trustee's Ex. 7.
[10] Debtor's Ex. 2.
[11] Trustee's Ex. 61.

parents (as well as the loan with Coastal Bank) to proceed on his own. The debtor testified that he hoped financial success with Island Towers would allow him to settle up all debts and start life anew after his divorce was finalized.

The debtor's bet in the Island Towers development paid off the next year. On December 14, 2007, the debtor, through Island Towers Development, LLC, sold the property for a cash settlement of $3,000,175.90.[12] Of this amount, the debtor directed $1,010,651.88 to Coastal Bank in repayment of its first mortgage on the project property. He further directed $930,000 to repay his parents' $550,000 junior secured loan and an additional $380,000 in unsecured debt he owed them for various living expenses, including previously made capital contributions to Harbor Gardens and Diamonte Sands. After deducting these loan repayments and standard settlement and closing costs, the debtor received $1,024,546.15 cash at closing.[13]

With the cash from closing the debtor paid off approximately $850,604.29 in outstanding secured and unsecured debt. He paid off the first mortgage encumbering the Beach Condo ($460,698), paid off the second mortgage held by Chase Bank on the Beach Condo ($274,918.04), paid personal taxes owed to the IRS ($23,745.60), paid personal credit card debt ($48,991.76), paid Landmark Realty's credit card debt ($11,576.32), and paid off his car loan ($30,674.31). The debtor also donated approximately $130,000 to the Jehovah's Witness church and gave approximately $20,000 to his brother and sister (for reasons that are unclear). In total, the debtor transferred or withdrew $1,029,093.96[14] from the Island Towers Development SunTrust bank account in the period from the Island Towers closing on December 14, 2007, to December 31, 2007.[15]

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[12] Trustee's Ex. 15.
[13] *Id.*
[14] The debtor may have paid off other debt but his testimony and the SunTrust bank statement (Trustee's Ex. 17) provide evidence only as to these particular debt repayments. The Court assumes the debtor used the balance remaining after deducting the established payments to pay other normal living expenses.
[15] Trustee's Ex. 17.

Contemporaneous with the debtor's debt repayment spree, on December 27, 2007, the debtor sold the Beach Condo to his parents in exchange for $356,250 cash,[16] title to the Homestead (where he and his parents had been living),[17] and approximately $44,000 in repairs his parents had made to the Homestead.[18] The debtor received approximately $500,000 in aggregate value in exchange for the Beach Condo, as his parents paid his grandmother $100,000 for title to the Homestead as part of the transaction.[19]

The debtor did not use any of the cash from the Island Towers settlement to make capital contributions to Harbor Gardens, LLC, or Diamonte Sands, LLC, though he owed each a considerable sum. As of December 31, 2007, the debtor's total shortfall to Harbor Gardens, including the debtor's 30% share of the company's obligations on the Coastal Bank loan, was $855,303.41.[20] Likewise, as of December 31, 2007, the debtor's total capital shortfall to Diamonte Sands, LLC, including the debtor's 20% share of the company's obligations on the BankFirst loan, was $281,571.24.[21] As of the Island Towers closing on December 14, 2007, the debtor knew he had sizeable outstanding obligations to both Harbor Gardens and Diamonte Sands, but the Group had not yet begun to insist the debtor "true up" his positions. The Group's accountant, Nicole Colbert, credibly testified she emailed the debtor in the fall of 2007 to remind him of his outstanding capital call contributions.

Nonetheless, the debtor never made further capital contributions to the LLCs. The debtor incorrectly assumed he could simply stop making contributions under the terms of the LLC operating agreements as long as he was willing to relinquish his equity interests. Moreover, the

[16] Trustee's Ex. 18.
[17] Trustee's Ex. 21.
[18] The debtor and his mother testified as to this amount.
[19] Debtor's Ex. 4. The debtor and his mother testified that his parents paid grandmother for the house instead of the debtor because his paternal grandmother wanted only to deal with her son, the debtor's father, regarding her financial affairs.
[20] Trustee's Ex. 51.
[21] Trustee's Ex. 50.

debtor's relationship with the Group soured as a result of their refusal to participate in the Island Towers development. Contact between the debtor and other Group members became sporadic in 2007, and only got worse in 2008, when the debtor began spending significant time in the Philippine Islands courting a woman he met online. After receiving an email from Nicole Colbert requesting the debtor attend a meeting with the other Group members, on April 7, 2008, the debtor emailed the Group in anticipation of their phone conference to explain why he had not kept up on his capital contributions.[22] On April 8, 2008, while in the Philippines, he spoke to the Group by telephone conference for what appears to be the last time. During the conversation, he explained the position outlined in his email that he did not believe he owed the Group further capital contributions, relying on Spira's oral explanation of the operating agreements. As he understood Spira's explanation, he believed his equity shares in the LLCs would simply be reduced by a formula for any shortfall in his contributions and that the other members could have simply bought his membership interests after he stopped contributing.[23] On this basis the debtor refused to make further contributions to the Group's projects.

In May 2009, after over a year of silence from the Group and no further contributions or communications from the debtor, Group member William Glover sued the debtor in the Circuit Court for Brevard County, Florida. The debtor did not hire an attorney to defend the action, confident, again incorrectly, that the operating agreement would speak for itself and absolve him from monetary liability as long as he gave up his equity positions. On July 14, 2009, the debtor filed a four paragraph letter to the court with attached supporting documentation, arguing that under the operating agreements arbitration was mandatory, the only collateral for a member's

[22] Trustee's Ex. 14.

[23] The debtor believed sections 4.4.2 (Default in Payment) and 4.5.1.2 (Creation of Member's Capital Accounts) of the Harbor Gardens, LLC, Operating Agreement (Debtor's Ex. 2) embodied in writing his understanding of Spira's explanation. Though both provide for a reduction in a member's equity share upon default of payment of any capital call, they do not relieve a member from liability on loans co-signed by such member. The debtor's understanding of these provisions was therefore mistaken, though not entirely unreasonable given his level of sophistication and apparent misapprehension of Spira's oral representations.

shortfall were the member's pro rata shares in the LLCs, and that the sale price of the two projects would more than cover the debtor's 20% and 30% respective equity positions in each project.[24] On August 24, 2009, the circuit court entered summary judgment in favor of Glover, finding the debtor liable in the aggregate amount of $438,205.[25]

Based on the debtor's refusal to make further capital contributions, and the fact that the debtor paid off all his other creditors, the trustee now argues the debtor's intentions in selling the Beach Condo and purchasing the Homestead were fraudulent. Relying on the provisions of § 522(o)(4) of the Bankruptcy Code, the trustee contends that the debtor essentially attempted to "launder" the Island Tower proceeds into the Homestead to avoid paying his outstanding debts to the Group. The trustee's argument goes like this. First, the debtor converted approximately $735,000 of the non-exempt Island Tower sale proceeds into exempt homestead property by paying off the first and second mortgages on the Beach Condo. Next, the debtor used the equity in the Beach Condo to purchase the Homestead. Because this was a transaction from exempt homestead assets to other exempt homestead assets, the debtor believed he could hide the fact that the value of the Homestead ultimately came from the fraudulent conversion of non-exempt to exempt assets.

The trustee accordingly argues the debtor's fraudulent intent in converting non-exempt assets into exempt homestead assets precludes him under § 522(o)(4) of the Bankruptcy Code from taking advantage of the homestead exemption provided in § 522(b)(3)(A) of the Bankruptcy Code and the Florida Constitution. Section 522(o)(4) of the Bankruptcy Code provides that the value of a debtor's homestead exemption claimed under § 522(b)(3)(A)

> …shall be reduced to the extent that such value is attributable to any portion of any property that the debtor disposed of in the 10-year period ending on the date of the filing of the petition with the intent to hinder, delay, or defraud a creditor and that the debtor could not exempt, or that portion that the debtor could not

[24] Trustee's Ex. 69.
[25] Trustee's Ex. 40.

> exempt, under subsection (b), if on such date the debtor had held the property so disposed of.

Thus, under this section a debtor may not claim as exempt homestead property any portion of the homestead that was (1) acquired with assets not exempt under § 522(b), and (2) acquired with actual fraudulent intent to defraud a creditor. A debtor's Florida homestead exemption is presumptively valid.[26] The trustee therefore must establish by a preponderance of the evidence the claim of exemption is invalid.[27]

Given the difficulties of discerning a debtor's subjective state of mind, courts typically assess whether the debtor had the requisite fraudulent intent by looking to the badges of fraud.[28] The presence of one badge of fraud does not necessarily establish fraudulent intent, while "a confluence of badges can constitute conclusive evidence of an actual intent to defraud."[29]

Here, even assuming the trustee has shown the debtor acquired the Homestead with assets ultimately "attributable to" non-exempt assets (i.e. the Island Tower sale proceeds), the trustee initially fails to establish that the debtor had the requisite fraudulent intent at the time he purchased the Homestead. Indeed, analysis of the badges of fraud strongly supports the debtor's position. The debtor (1) did not maintain possession or control of the Beach Condo after he sold it to his parents, (2) did not hide the transfer, (3) did not sell the Beach Condo while he was

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[26] *Colwell v. Royal Int'l Trading Corp. (In re Colwell)*, 196 F.3d 1225, 1226 (11th Cir. 1999).
[27] Fed. R. Bankr. P. 4003(c); *In re Mohammed*, 376 B.R. 38, 41 (Bankr. S.D. Fla. 2007).
[28] *Addison v. Seaver (In re Addison)*, 540 F.3d 805, 811 (8th Cir. 2008); *In re Booth*, 417 B.R. 820, 823 (Bankr. M.D. Fla. 2009) (Briskman, J.). Badges of fraud include, but are not limited to: (1) the transfer was to an insider; (2) the debtor retained possession or control of the property after the transfer; (3) the transfer was concealed; (4) before the transfer was made the debtor had been sued or threatened with suit; (5) the transfer was of substantially all of the debtor's assets; (6) the debtor absconded; (7) the debtor removed or concealed assets; (8) the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred; (9) the debtor transferred the essential assets of the business to a lienor who transferred the asset to an insider of the debtor. *Dionne v. Keating (In re XYZ Options, Inc.)*, 154 F.3d 1262, 1272 (11th Cir. 1998).
[29] *Keating*, 154 F.3d at 1272 (quoting *In re Sherman*, 67 F.3d 1348, 1353 (8th Cir. 1995)).

under threat of a lawsuit from the Group, which sued him nearly a year and a half after the house swap, and (4) sold the Beach Condo for reasonably equivalent value.

Moreover, the trustee's "laundering" theory makes little sense. In exchange for the (arguably exempt) Beach Condo the debtor received *substantially* less value in homestead assets—$109,000—than the amount of *non*-exempt cash he received—$356,250. This is significant. If the debtor was really trying to launder or hide assets from the Group by taking advantage of the homestead exemption, he could have sold the Beach Condo and paid cash for another equally expensive home. Or, if he were trying to simply hide behind Florida's homestead exemption, he could have simply kept the Beach Condo, which undisputedly was his homestead long before his family and business problems began. But he did neither. Instead, he sold the Beach Condo to his parents for $356,250 non-exempt cash, the $100,000 Homestead, and the cost of repairs made to the Homestead. The fact that the debtor sold an exempt homestead, in part, for $356,250 non-exempt cash is significant evidence the debtor did not at this time intend to defraud the Group by purchasing the Homestead.

The debtor's explanation for the house swap is a much more credible and reasonable explanation than the trustee's unlikely theory. The debtor no longer wanted to live in the Beach Condo because he associated it with his ex-wife and their failed marriage. He also needed to simplify his financial affairs and live within his now limited means. The property taxes on the Homestead are much less than the Beach Condo's. The smaller, easier to maintain home is cheaper in every way, and, with the house swap, was not encumbered with any debt. With the cash from closing the Island Tower deal he was able to effect a fresh start. Downsizing his home was part of this new beginning. Swapping the Beach Condo for the Homestead, where the debtor already was living most of the time, thus gave him a smaller but familiar and comfortable house free and clear of liens and with lower property taxes. His parents, on the other hand, were looking for a home with more space and wanted a place on the beach to retire in comfort. After

selling their prior home, they had been living in the Homestead for nearly a year while searching for a beachfront property. The Beach Condo provided exactly what they were looking for, and buying it also helped their son. Even the debtor's grandmother, who soon before this transaction had moved into an assisted living facility, got what appears to have been fair market value to sell her house (ultimately) to her grandson. The house swap was therefore a mutually beneficial and sensible exchange between the debtor and his parents that was undertaken by all parties for legitimate reasons and which caused no prejudice to any creditor of the debtor.

The trustee relies heavily on the debtor's conduct *after* he acquired the Homestead to establish the debtor's fraudulent intent. She spent much of her presentation attempting to show the debtor hid or cannot account for much of the $356,250 cash his parents paid him for the Beach Condo. Indeed, the trustee presented numerous transfers and transactions the debtor could not explain.[30] The best explanation the debtor had for many of the transfers was that the monies went to an MB Trading account he used to conduct currency trading to make a living after the real estate bubble burst. The trustee argues the debtor's inability to account for every penny of the $356,250, combined with the facts that the debtor held a grudge against the Group for backing out of the Island Tower project and that the debtor spent significant amounts of time in the Philippine Islands in 2008 (which the trustee insinuates the debtor did to avoid service from the Group), presents enough evidence for the Court to conclude the debtor engaged in a fraudulent pattern of conduct that included the debtor's purchase of the Homestead.

Although the debtor's inability to account for the $356,250 cash is somewhat troubling, the trustee has not established that any of the debtor's financial decisions were aimed at hiding

[30] For example, the day after the debtor had a contentious phone conversation with the Group, on April 9, 2008, Sharon Klinglesmith obtained a cashier's check drawn on the debtor and his mother's joint account in the amount of $250,000, made payable to the debtor. Trustee's Ex. 29 and 30. The debtor apparently deposited the check into a Landmark Realty account with SunTrust on June 3, 2008 and withdrew $200,000 cash the same day. Trustee's Exs. 31 and 33. The debtor had no explanation for why he had his mother obtain the cashier's check or why he later deposited the funds in the Landmark Account.

assets from the Group in anticipation of a lawsuit. The debtor instead appears to have used most of the cash to trade currency, which ultimately failed to provide sufficient income to the debtor. Moreover, throughout this time the debtor credibly believed he was not liable to the Group based on his misunderstanding of the LLC operating agreements. His actions, including his April 7, 2008, email to the Group and his filing with the circuit court, are consistent with this misunderstanding. So while the trustee did her best to put a suspicious gloss on the debtor's irregular 2008 financial activity, the Court cannot find on a hunch that the debtor's purpose was to avoid making contributions to the Group's LLCs.

The trustee also questioned the debtor's choice to pay off in full all of his secured and unsecured creditors, rather than simply catch up on arrears and use the remainder of the Island Tower proceeds to invest. The debtor's choice, however, was not unreasonable given the uncertainty of his future income. Indeed, before the Island Tower closing the debtor relied almost exclusively on his parents for financial support. In fact, the Island Tower deal itself would not have happened but for his parents' $550,000 loan. The Court cannot find, given the debtor's track record and the chance to "start fresh" by paying off all of his creditors, that the debtor's decision to pay off his creditors in full is indicative of intent to defraud the Group.

In sum, the evidence fails to support the trustee's argument that the debtor's purchase of the Homestead was part of an overarching pattern of fraudulent behavior. Instead, over a year before Glover sued the debtor, the debtor paid off significant debts to numerous legitimate creditors, reduced his living expenses by swapping houses with his parents for a significant amount of *non*-exempt cash, and used a large portion of that cash to attempt to make a living starting anew. The Court therefore finds the debtor did not intend to hinder, delay, or defraud the Group's LLCs when he sold his $500,000 Beach Condo to his parents in exchange for the $100,000 Homestead and $356,250 in non-exempt cash.

Accordingly, because the trustee has failed to establish by a preponderance of the evidence that the debtor had the requisite intent to defraud a creditor at the time he acquired the Homestead, the Court will overrule her objection.[31] The debtor's claim of exemption under § 522(b)(3)(A) of the Bankruptcy Code and the Florida Constitution for the Homestead is allowed. A separate order consistent with this memorandum opinion will be entered simultaneously.

DONE AND ORDERED in Orlando, Florida, this 2nd day of June, 2011.

KAREN S. JENNEMANN
United States Bankruptcy Judge

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[31] Doc. No. 28.