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US BANKRUPTCY COURT
EASTERN DISTRICT OF WI

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re:

Chapter 7

JOHN M. WILSON and
CHRISTINE A. WILSON,

Case No. 11-21802-jes

Debtors.

MOHNS, INC.,

Plaintiff,

-v-

Adversary No. 11-2334

JOHN M. WILSON and
CHRISTINE A. WILSON,

Defendants.

DECISION

There is a well-known saying: "Where there's smoke, there's fire." There also is a well-known song by George and Ira Gershwin: "It Ain't Necessarily So." These expressions vividly interact in this adversary proceeding.

Factual Background

On September 30, 2010, Mohns, Inc. ("Mohns") obtained a judgment in Waukesha County Circuit Court against John M. Wilson, one of the defendant-debtors in this adversary proceeding. This judgment resulted from a lawsuit brought by Mohns against John for breach of contract arising out of Mohns'

construction of a home for John located in Pewaukee, Wisconsin. At the time the home was constructed, John was single and owned the property solely in his name. Subsequently, John married Christine, the co-defendant-debtor in this adversary proceeding. John filed a counterclaim for $224,600 in this lawsuit. Following a 4-day trial, the Circuit Court found in Mohns' favor, awarding damages of $136,661.89 and also dismissing John's counterclaim. The judgment, as well as the dismissal of John's counterclaim, were appealed by John to the Wisconsin Court of Appeals. This appeal was pending when this bankruptcy petition was filed. Subsequently, the Wisconsin Court of Appeals summarily affirmed the Circuit Court's granting of the judgment and dismissal of the counterclaim. On February 14, 2011, Mohns began executing on its judgment by initiating garnishment proceedings against John and having his automobile seized. On the following day, February 15, 2011, John and Christine filed this Chapter 7 bankruptcy petition.

Mohns' judgment debt was listed in the debtors' bankruptcy schedule "D" as a secured debt for $142,899. However, the debt was never secured by a construction lien, and the parties have stipulated that the entire amount of Mohns' judgment is unsecured.

Mohns, the largest creditor in this case, filed this adversary proceeding, maintaining that certain actions taken by John and Christine shortly prior to the filing of this bankruptcy petition constituted a fraud on the bankruptcy court and that the debtors should be denied a discharge under §§ 727(a)(2), (4), and (5) of the Bankruptcy Code . These actions include:

1. Falsely scheduling The Jennie C. Bourke Trust claim as unsecured.

2. Failing to disclose the termination of a collateral assignment from John to The Jennie C. Bourke Trust.

3. Falsely claiming a homestead exemption for Christine under Wisconsin Law in the amount of $75,000.

4. Failing to list John's counterclaim against Mohns in the bankruptcy schedules.

5. Converting $6,000 cash into an exempt Roth IRA for Christine shortly prior to the filing of this bankruptcy petition.

6. Failing to list all of the debtors' assets in the bankruptcy schedules, including four life insurance policies owned by John, and undervaluing household goods, jewelry, and cars which were listed in the bankruptcy schedules.

This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(J), and this court has jurisdiction under 28 U.S.C. § 1334.

<u>Sec. 727(a)(2)(A) - Fraudulent Transfer or Concealment of Property</u>

This section is the heart of this case. A party seeking denial of discharge under this section must prove two things:

1. A disposition of property, such as transfer or concealment; and,

2. A subjective intent on the debtor's part to hinder, delay or

defraud a creditor through the act of disposing of the property. In re Retz, 606 F.3d 1189, 1200 (9th Cir. 2010); In re Grammenos, 469 B.R. 535, 546 (Bankr. D.N.J. 2012).

Mohns asserts that the scheduling of The Jennie C. Bourke Trust claim as unsecured was false and done with the intent to deprive Mohns of its rightful share of any dividends which will ultimately be distributed in this bankruptcy estate to unsecured creditors.

The Jennie C. Bourke Trust was created in 1988 for the benefit of John's sister, Jennie C. Bourke. Lucy Wilson, the mother of John and Jennie, was the sole settlor of this trust, and John was named its trustee. The evidence revealed that John borrowed funds from the trust from time to time. As collateral for these loans, he assigned to the trust two life insurance policies he owned, having a total cash value of $145,000. At the time this bankruptcy petition was filed, John was indebted to the trust in the amount of $102,800.

On February 12, 2011 – three days before this bankruptcy petition was filed – John arranged a meeting with his sister, Jennie. At John's request, Jennie signed a letter which John had prepared, terminating this assignment. John and Jennie also crossed out and initialed a provision in the promissory note dated January 22, 2006, which made the collateral assignment a condition of the loan.

John testified that the decision to terminate the assignment was on the advice of his bankruptcy counsel, Attorney Robert M. Waud. Attorney Waud corroborated John's testimony and stated that he concluded the assignment was not

properly perfected because the insurer of the two life insurance policies was never provided with a copy of the assignment. Attorney Waud recommended to John two options to resolve this problem: either have the assignment properly perfected by conveying the assignment to the insurer; or have Jennie voluntarily terminate the assignment. Attorney Waud recommended termination of the assignment as the better of the two options, explaining that if the assignment was perfected within 12 months before filing of debtors' bankruptcy, it could be avoided by a bankruptcy trustee as an insider preference. Attorney Waud informed John that if a bankruptcy trustee avoided the assignment, not only would Jennie's claim become unsecured, but John also would no longer be able to claim the insurance policies as exempt. See In re Wade, 466 B.R. 20, 23 (Bankr. D.D.C. 2012); ("If the trustee avoids the lien, the lien is preserved for the benefit of the estate even if the debtor had claimed the entire property exempt.") In re Witt, 273 B.R. 573 (Bankr. W.D.Wis. 2000); In re Nersinger, 361 B.R. 32 (Bankr. W.D.N.Y 2007).

Jennie testified that John informed her at their meeting that he might have to file for bankruptcy (Tr. p. 80) and that if the assignment was terminated, it would change the trust's claim in the bankruptcy estate "from a preferred to a general creditor." (Tr. p. 93) Jennie also stated that she knew there was a strong possibility that John would be unable to pay off any loan balance remaining to the trust after receipt of dividends from the bankruptcy estate, but added that she was "more concerned with his state of mind and how he was." (Tr. p. 96)

Attorney Waud also explained that he advised John to convert $6,000

in cash into an exempt Roth IRA and to have Christine claim a separate $75,000 homestead exemption.

Attorney Waud added that he was not initially informed of John's counterclaim against Mohns when he prepared the bankruptcy schedules. He said that upon learning of this counterclaim, he amended the schedules to list the counterclaim. John testified that the reason he did not disclose the counterclaim to Attorney Waud was because it was his understanding that when the counterclaim was dismissed by the Circuit Court, it was "gone". (Tr. p. 70)

Attorney Waud also elaborated on the values placed on the household goods, jewelry, and cars listed in the bankruptcy schedules. He recognized that valuation would be an issue in this case, which caused him to obtain independent appraisals rather than rely upon subjective values provided by the debtors. He used Betthauser's Auction Service to appraise the household goods and Sullivan's Jewelers to appraise the jewelry. He also relied upon Edmunds, a vehicle valuation publication, to value the cars.

Regarding Christine's homestead exemption claim, Attorney Waud testified it was his opinion that she was entitled to claim this exemption. In a separate proceeding which arose in this bankruptcy case, this court disallowed Christine's homestead exemption, based upon an agreement entered into by John and Christine before their marriage entitled, "Agreement to Keep Properties Separate". This Court rejected the argument that this agreement terminated upon their marriage. Although the Court disallowed Christine's exemption, Atty Waud's

argument was not meritless.

The debtors' conversion of the $6,000 cash into an exempt Roth IRA on the eve of the bankruptcy did not involve an excessive amount. In In re McCarthy, 418 B.R. 745 (Bankr. E.D.Wis. 2009), this court concluded that a conversion of $9,900 cash into exempt assets on the eve of bankruptcy was proper pre-bankruptcy planning and the exemption was allowed. Conversion of assets from non-exempt status to exempt status within a year preceding the filing of a bankruptcy petition is not necessarily fraudulent. In re Smiley, 864 F.2d 562, 566 (7th Cir. 1989).

The court finds that all of these actions taken by the debtors were upon the advice of their counsel, in good faith, and not done with any actual intent to defraud. Although the termination of the collateral assignment to the trust may well reduce the amount of dividends which Mohns will receive, that was not the debtors' objective in carrying out their actions.

Sec. 727(a)(4)(A) - False Oath

An alternative argument for denial of discharge is § 727(a)(4)(A), which requires proof of the following elements:

1. Debtor made a statement under oath,
2. Which was false,
3. Debtor knew statement was false,
4. The statement was made with a fraudulent intent, and
5. Statement related materially to the bankruptcy case.

Stamat v. Neary, 635 F.3d 974, 978, (7th Cir. 2011). In re Hamilton, 390 B.R. 618,

625 (Bankr. E.D.Ark. 2008). Although omissions from bankruptcy schedules and Statement of Financial Affairs can constitute a false oath for purposes of § 727(a)(4), such omissions must be made knowingly and with fraudulent intent. In re Glenn, 335 B.R. 703, 707 (Bankr. W.D.Mo. 2005); In re Bostrom, 286 B.R. 352, 360 (Bankr. N.D.Ill. 2002). In In re Agnew, 818 F.2d 1284 (7th Cir. 1987), the court held that intent to defraud must have been actual and must relate to a material matter.

Mohns asserts that there were numerous omissions from the debtors' schedules. It specifically notes the omissions of John's counterclaim and the omission of four life insurance policies owned by John with a combined cash value of approximately $2,750.

The omission of the counterclaim and four life insurance policies did not, however, constitute a false oath under § 727(a)(4). The counterclaim was worthless and the four life insurance policies, while not worthless, were not of a value constituting a badge of fraud. Fraudulent intent takes into consideration the monetary value of the assets in question In re Zhang, 463 B.R. 66, 79 (Bankr. S.D.Ohio 2012). Bankruptcy courts have found that omitting assets with a *de minimis* value is not normally sufficient to deny discharge. In re Morris, 58 B.R. 422, 429 (Bankr. N.D.Tex. 1986). Debtors' omissions were inadvertent. A debtor's discharge will not be denied under § 727(a)(4) when the omissions were due to honest error or mere inaccuracy. In re Vigil, 414 B.R. 743 (Bankr. D.N.M. 2009); In re Sever, 438 B.R. 612 (Bankr. C.D.Ill. 2010).

The key element missing from this case under § 727(a)(4) is fraudulent

intent. As this court observed in its analysis of § 727(a)(2), if the element of fraudulent intent is not established, § 727(a)(2) has not been proven. The court reaches that same conclusion under § 727(a)(4); there was no fraudulent intent by the debtors.

Sec. 727(a)(5) - Failure to Explain Loss or Deficiency of Assets

The party objecting to discharge under this section must prove:

1. Debtor at one time not too remote from the bankruptcy petition owned substantial and identifiable assets,
2. on the date the bankruptcy petition was filed, and
3. the bankruptcy pleadings or statement of affairs do not reflect an adequate explanation for the loss of the assets.

Retz, 606 F.3d 1189; In re Coley, 433 B.R. 476 (E.D.Pa. 2010); and Grammenos, 469 B.R. 535 (the plaintiff's initial burden is to identify assets that are unaccounted for and show that the debtor at one time had the assets but they are no longer available for the debtor's creditors). Only after this has first been shown must the debtor then respond with a satisfactory explanation for such loss. Bostrom, 286 B.R. 352.

Mohns has not met its initial burden of identifying specific substantial assets that are no longer available to John's creditors. Mohns only has made a general assertion that the debtors' discharge should be denied under § 727(a)(5) without specifying which assets were owned by John prior to the filing of bankruptcy but were no longer available upon the filing of the debtors' bankruptcy

petition. These vague assertions do not justify denial of discharge under § 727(a)(5).

Conclusion

The court concludes that the debtors are entitled to a discharge. A denial of discharge is by far the most severe penalty a chapter 7 debtor can receive in the life of a bankruptcy case. Grammenos, 469 B.R. at 546.

Although this case is based largely on suspicion, it presents a very close call. The court acknowledges it has some reservations. Its main concern is that John, as the trustee of The Jennie C. Bourke Trust, did not recommend to his sister that she consult an attorney before agreeing to terminate the collateral assignment. John is a college graduate and worked as an insurance broker before he retired. Nevertheless, upon a review of the entire picture in this case, the court does not believe a discharge should be denied to either debtor. The court was impressed with John's testimony and demeanor and found him to be a very credible witness. This court also cannot ignore Jennie's explanation that, when she signed the document terminating the assignment, she was mostly concerned with John's "state of mind and how he was." In addition, Atty Waud, whose testimony was crucial, is a well-respected attorney. He has practiced before this court and other courts in this district on numerous occasions. This court is confident that his advice to the debtors was given in good faith.

Bankruptcy courts have discretion in deciding whether or not to deny a discharge and may grant a discharge even though there may be grounds established for denial. Union Planters Bank, N.A. v. Connors, 283 F.3d 896, 901 (7th Cir. 2002)

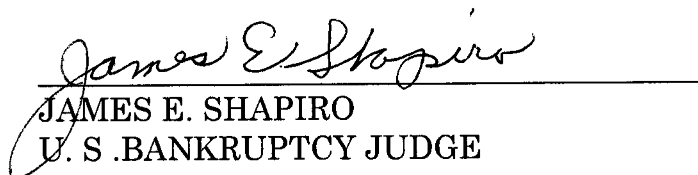
("It remains within the discretion of the bankruptcy court to grant a discharge even when grounds for denial of discharge are demonstrated to exist."). See also, In re DiGesualdo, 463 B.R. 503 (Bankr. D.Colo. 2011).

For all of these reasons, and keeping in mind that § 727(a) should be construed in favor of the debtors, the court dismisses this adversary proceeding and grants each debtor a discharge.

This decision constitutes the court's findings of fact and conclusions of law, pursuant to Federal Bankruptcy Procedure 7052. A separate order shall be issued.

Dated at Milwaukee, Wisconsin, this 31st day of July, 2012.

BY THE COURT:



JAMES E. SHAPIRO
U. S .BANKRUPTCY JUDGE