



SO ORDERED.

SIGNED this 28 day of July, 2006.

Dale L. Somers

Dale L. Somers
UNITED STATES BANKRUPTCY JUDGE

**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF KANSAS**

In Re:

**THOMAS JAMES OUELLETTE and
SHERYL ANN OUELLETTE,**

DEBTORS.

**CASE NO. 03-41144
CHAPTER 7**

**FELICIA S. TURNER,
United States Trustee,**

PLAINTIFF,

v.

ADV. NO. 04-7030

**THOMAS J. OUELLETTE and
SHERYL ANN OUELLETTE,**

DEFENDANTS.

**MEMORANDUM AND ORDER DENYING UNITED STATES TRUSTEE'S MOTION
FOR SUMMARY JUDGMENT**

The matter before the Court is the motion of Plaintiff, United States Trustee¹, for summary judgment on a complaint to revoke discharge pursuant to § 727(d)(1).² United States Trustee (hereafter "Trustee") appears by William F. Schantz. Defendants, Debtors Thomas James Ouellette and Sheryl Ann Ouellete, appear by Wesley F. Smith and Todd A. Luckman of Stumbo, Hanson and Hendricks, LLP. There are no other appearances. This Court has jurisdiction.³

I. NATURE OF THE CASE.

Debtors filed for relief under Chapter 7 on April 28, 2003. The bankruptcy petition, schedules, and statement of financial affairs (hereafter collectively "Bankruptcy Pleadings") were prepared with the assistance of counsel and signed under oath by the Debtors. The deadline for filing a complaint to deny discharge was August 1, 2003, no objection was filed, and discharge was granted on March 4, 2004. On April 12, 2004, the Trustee filed a "Complaint to Revoke Discharge Pursuant to 11 U.S.C. § 727" (hereafter "Complaint"). Trustee alleged that the Debtors' Bankruptcy Pleadings contained material

¹ This case was initially brought by Mary E. May in her official capacity as United States Trustee. The Court substitutes Felicia S. Turner for Ms. May as the Plaintiff in this case pursuant to Fed. R. Civ. P. 25(d)(1), which is made applicable to this adversary proceeding by Fed R. Bankr. P. 7025.

² 11 U.S.C. § 727(d)(1) (2004). This case was filed before October 17, 2005, when most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 become effective. All statutory references to the Bankruptcy Code are to 11 U.S.C. §§ 101-1330 (2004), unless otherwise specified. All references to the Federal Rules of Bankruptcy Procedure are to Fed. R. Bankr. P. (2004), unless otherwise specified.

³ This Court has jurisdiction pursuant to 28 U.S.C. § 157(a) and §§ 1334(a) and (b) and the Standing Order of the United States District Court for the District of Kansas that exercised authority conferred by § 157(a) to refer to the District's Bankruptcy judges all matters under the Bankruptcy Code and all proceedings arising under the Code or arising in or related to a case under the Code, effective July 10, 1984. A complaint to revoke discharge is a core proceeding which this Court may hear and determine as provided in 28 U.S.C. § 157(b)(2)(A), (J), and (O). There is no objection to venue or jurisdiction over the parties.

errors and omissions, specifically failure to disclose significant losses relating to Debtor Thomas Ouellette's gambling and failure to disclose transfer of Debtors' interest in real estate and a home in Michigan to Thomas Ouellette's mother for \$12,000 two months prior to the Debtors' filing for bankruptcy relief. The Complaint alleged three counts: Objection to Discharge under § 727(a)(2); objection to discharge under § 727(a)(4); and objection to discharge under § 727(3)(2). The Debtors filed an answer, followed by a motion to dismiss.

On August 26, 2004, the Court heard argument on Debtors' motion to dismiss. Debtors argued, among other things, that the Complaint did not state a claim for relief under §§ 727(a)(2), (a)(4), or (3)(2). The Court "reformed" the Complaint to be only a claim for revocation of discharge under § 727(d)(1), which provides for revocation of a previously granted discharge if "such discharge was obtained through fraud of the debtor and the requesting party did not know of such fraud until after the granting of such discharge." Because discharge had already been granted, the Court held the Trustee could not directly object to discharge under §§ 727(a)(2) or (a)(4). As to the merits of the § 727(d)(1) claim, the Court denied the motion to dismiss.⁴ Because generally fraud must be determined upon examination of the totality of the circumstances, whether Debtors' discharge was obtained by fraud could not be determined on a motion to dismiss without testimony. The Court also declined to dismiss the Complaint because of the Trustee's admitted knowledge in January 2004, prior to the grant

⁴ Doc. 16. The order incorporates but does not state the findings of fact and conclusions of law made and recorded in open court. In preparing this memorandum, the Court has reviewed the recording of the hearing, including those findings and conclusions.

of discharge, of the acts complained of in the Complaint.⁵ However, based upon the arguments of counsel, the Court noted there appeared to be an issue of fact of when the Trustee knew of the alleged fraud based upon the fact that the Chapter 7 Trustee had knowledge of possible undisclosed transfers when moving for an extension of time to object to discharge on June 10, 2003,⁶ raising an issue of whether this knowledge was shared by or should be imputed to the United States Trustee.⁷

Section 727(d) provides:

- (d) On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if-
 - (1) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;

Generally, in order to revoke discharge under this section, the Trustee must show three elements: (1) The discharge was procured by fraud; (2) sufficient grounds existed which would have prevented the discharge, had they been known and presented at that time; and (3) lack of knowledge of the fraud prior to discharge.⁸ "The fraud which must be shown is fraud 'in fact', such as the intentional omission

⁵ The Trustee alleges in the Complaint that he knew of the transfer in January, 2004, after the expiration of time to object to discharge but before the entry of discharge. The Court when ruling on the motion to dismiss declined to dismiss based upon knowledge during this "gap" period. *See Citibank, N.A. v. Emery (In re Emery)*, 132 F.3d 892 (2nd Cir. 1998); *Ross v. Mitchell (In re Dietz)*, 914 F.2d 161 (9th Cir. 1990).

⁶ Case No. 03-41144, Doc. 5.

⁷ *See State Bank of India v. Kaliana (In re Kaliana)*, 202 B.R. 600, 604 (Bankr. N.D. Ill. 1996) (holding the burden is on the objecting party to diligently investigate any fraud before discharge).

⁸ *See Lawrence Nat'l Bank v. Edmonds (In re Edmonds)*, 924 F.2d 176, 180 (10th Cir. 1991); *Miller v. Ping (In re Ping)*, 96 B.R. 96, 97 (Bankr. E.D. Ky 1988).

of assets from the schedules, and must involve intentional wrongdoing.⁹ Implied fraud or mistake in law is insufficient.¹⁰ Material omissions from the debtor's schedules, without more, cannot be the basis to find the requisite fraudulent intent.¹¹ "The process of revocation is restricted to those frauds that are discovered after the discharge."¹² This requirement assures that a complaint for revocation is not equivalent to a retrial before appeal.¹³ The statute permitting revocation of discharge is construed strictly in favor of the debtor, and the party seeking a revocation has the burden of proof on all elements by a preponderance of the evidence.¹⁴

The Court pauses to address the relationship of elements one and two - that the discharge was obtained by fraud and that sufficient grounds existed which could have prevented the discharge, if they had been known and presented in opposition to discharge. In some cases, such as where the basis to deny discharge is the debtor's having been granted a discharge in a case filed within six years of the filing of the petition under § 727(a)(8), the two elements would generally be clearly distinct, and evidence in support of one element would not support the second. However, when the alleged basis

⁹ *Pelletier v. Donald (In re Donald)*, 240 B.R. 141, 146 (1st Cir. BAP 1999), citing 6 *Collier on Bankruptcy* ¶ 727.15[2] (Lawrence B. King, et al. 15th ed. rev. 1999).

¹⁰ *Wendel v. Daugherty (In re Daugherty)*, 14 B.R. 1, 2 (Bankr. S.D. Fla. 1981).

¹¹ *Miller-Claborn Distr., Co., Inc. v. Richard (In re Richard)*, 165 B.R. 642 (Bankr. W.D. Ark. 1994).

¹² 6 *Collier on Bankruptcy* ¶ 727.15[3] (Alan N. Resnick and Henry J. Summer, eds-in-chief 15th ed. rev. 2006). Future references to this authority shall be by volume and paragraph number only .

¹³ *Id.*

¹⁴ *In re Kaliana*, 202 B.R. at 603 (collecting cases); see *First Nat'l Bank of Gordon v. Serafini (In re Serafini)*, 938 F.2d 1156, 1157 (10th Cir. 1991) (applying the preponderance of the evidence standard to objection to discharge under § 727(a)(2)).

for denial of discharge is fraud within one year prior to filing pursuant to § 727(a)(2)(A), both elements include fraud and may overlap. Careful consideration shows, however, that they remain conceptually distinct. First, the Trustee must establish fraudulent intent to obtain a discharge; such intent will usually exist at the time of preparing and filing the schedules, testifying at the 341 meeting, and taking other actions related to the bankruptcy proceeding. As to the basis to deny discharge because of a fraudulent prepetition transfer, evidence of intent relating to the transfer, not the bankruptcy, would be required. When the Trustee contends that discharge was fraudulently obtained and would not have been granted because of knowingly and fraudulently making a false oath in or in connection with the case under § 727(a)(4)(A), the two elements merge. The debtor's fraudulent acts in obtaining the discharge may be the same fraudulent acts that establish nondischargability based upon a false oath knowingly and fraudulently made in or in connection with the case.

II. SUMMARY JUDGMENT STANDARDS.

Summary judgment is appropriate “if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.”¹⁵ Genuine issues of material facts are factual disputes that may affect the outcome of the case and are ones that a reasonable trier of fact could find in favor of either party.¹⁶ Therefore, in order for the nonmoving party to defeat a motion for summary judgment it need only present evidence from which a trier of fact might

¹⁵ Fed. R. Civ. P. 56(c). Future references to the rules in the text shall be to the rule number only.

¹⁶ *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

return a verdict in his or her favor.¹⁷ In determining this, all evidence and inferences are viewed in the light most favorable to the nonmoving party.¹⁸

Summary judgment is generally not appropriate when the issue requires a determination of the state of mind.¹⁹ It is important, and ordinarily essential, that the trier of fact be afforded the opportunity to observe the demeanor, during direct and cross-examination, of a witness whose subjective motive is at issue.²⁰ “[T]he plain language of Rule 56(c) mandates the entry of summary judgment . . . against a party who fails to make a showing sufficient to establish the existence of an element essential to that party’s case, on which that party will bear the burden of proof at trial.”²¹

III. UNCONTROVERTED FACTS.

The Trustee moves for summary judgment based upon the following facts, which the Debtors do not controvert. Debtors filed a voluntary petition for relief under Chapter 7 on April 28, 2003. The Bankruptcy Pleadings were signed by the Debtors under penalty of perjury prior to the filing. Question 8, “Losses,” and Question 10, “Other Transfers,” in the Statement of Financial Affairs were checked “None.” A Chapter 7 Trustee was appointed. The Debtors’ meeting of creditors pursuant to § 341 was originally set for June 2, 2004. The meeting was convened as scheduled, the Debtors appeared,

¹⁷ *Id.* at 257.

¹⁸ *Id.* at 255.

¹⁹ *Consolidated Electric Co. v. United States*, 355 F.2d 437, 438 (9th Cir. 1966).

²⁰ *Id.* at 438-39.

²¹ *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986).

were placed under oath, and testified that they had read the schedules, were familiar with the information and that all information was correct and there were no errors or omissions.

The Trustee discovered that Debtors had owned a partial interest in real property in Gaylord, Michigan and had transferred it within one year of the bankruptcy filing to Debtor Thomas Ouellette's mother, Ruth Ouellette.²² The following history of Debtors' interest in the property is uncontroverted. Debtors purchased the residence under contract in or around 1991 for \$32,000. In or around 1993, the Debtors purchased for approximately \$9,000 or \$10,000 another piece of property, across the street from the residence, on which a garage is located. In 1993, Debtor Thomas Ouellette's father, Frank Ouellette, purchased the real estate contract from the seller, and the property was placed in the names of Frank, Ruth, and the Debtors. Debtors made payments to Thomas's parents for the property.²³ Despite the prior death of Frank Ouellette, the property remained in the names of those four individuals until on or about February 6, 2003, at which time Debtors transferred to Ruth Ouellette their interest in the property for \$12,000. In 2003 and 2004, Debtors spent their summers living in the Michigan property, and in the year preceding the filing of the bankruptcy, Debtor Thomas Ouellette spent 11 of 12 months living in the Michigan house. They paid no rent. Both prior to and since the time of transfer of the real estate, Debtors have made the tax payments and paid the utilities.

²² The Trustee's Statement of Uncontroverted Facts submitted in support of the Motion for Summary Judgment does not include a date on which the Trustee learned of the transfer, but the Complaint alleges that the Trustee did "did not learn of the real estate in Michigan or the transfer of said real estate until the review of bank statements in January, 2004, long after the objection deadline on August 8, 2003." Doc. 1. The uncontroverted facts do include some of the actions taken by the Trustee which resulted in his knowledge of the transfer, but those specific acts are not necessary to the Court's resolution of the pending motion.

²³ It is controverted whether the Debtors paid the entire contract price.

The deadline for filing a complaint to deny discharge was at the request of the Chapter 7 Trustee, extended to August 1, 2003, and no objections were filed.²⁴ Debtors filed an Amendment to Statement of Affairs on January 21, 2004. It amended Question 8, Losses, to disclose gambling losses of \$404,919 total for years 2000 through 2002. Debtors received their discharge on March 4, 2004.²⁵ The Complaint to revoke discharge was filed on April 12, 2004.

When replying to the Trustee's motion, the Debtors stated the following as additional uncontroverted material facts, to which the Trustee did not respond in his reply brief. The \$12,000 proceeds from the transfer of the property were placed in a bank account. Subsequent to such deposit, Debtors paid the United's States Treasury and the Kansas Department of Revenue \$10,320.19 from the proceeds of the sale on account of 2001 and 2002 income taxes owed.

Debtors controvert the Trustee's position that the failure to disclose was an intentional concealment. They provide evidence that the transfer of the property by Debtors was disclosed to their attorney prior to filing and he determined the transfer did not need to be disclosed in the Statement of Affairs, as he considered the matter to be in the ordinary course of the business or financial affairs of Debtors. Debtors assert they relied upon professional advice of their attorney in completing the schedules.

²⁴ The Trustee did file a Motion to Dismiss pursuant to 11 U.S.C. § 707(b) on August 1, 2003, the date on which the time to object to discharge expired. Case no. 03-41144, Doc. 13. During the course of discovery, the Trustee found that the facts did not support the action, and the motion was withdrawn on February 17, 2004. Case no. 03-41144, Doc. 35.

²⁵ Doc. 39.

The value of the Gaylord, Michigan property at the time of its transfer is controverted. The property was valued by Bagley, Township in 2002 at \$35,500. Debtors state that they transferred the property for \$12,000 because it needed some repairs, including to the roof, septic tank and well. Recently, Debtors have obtained estimates of professionals regarding the costs of necessary repairs, which appear to be in excess of \$30,000. It is also controverted whether Debtors owned the entire property or a partial interest. The Chapter 7 Trustee has filed an adversary complaint to avoid transfers and to determine interest in the Michigan property.²⁶

IV. ANALYSIS.

The Court denies the Trustee's Motion for Summary Judgment. First, the Trustee has not presented uncontroverted facts or argument in support of the necessary element that the Trustee acquired knowledge of the Debtors' alleged fraud in obtaining the discharge prior to the entry of discharge. This omission appears to be the result of a misunderstanding of the Court's denial of the Debtors' motion to dismiss. The Trustee states, "this court denied Defendants' Motion to Dismiss Complaint and determined that the United States Trustee has met the requirements to revoke a discharge if she can prove fraud in one of the exceptions to discharge in subsection (a) by order entered September 9, 2004."²⁷ As discussed above, Court did not make these findings. Rather, it declined to dismiss the Complaint because it found issues of fact as to when the Trustee obtained knowledge of the alleged fraud, whether the discharge was obtained by fraud, and whether sufficient grounds existed to

²⁶ Case no. 03-41144; Adv. no. 05-07040.

²⁷ Doc. 49, p. 9.

deny the discharge if the Trustee had known of and presented the newly discovered evidence prior to discharge. The Trustee's failure to address this element is fatal to the motion for summary judgment.

Second, material issues of controverted fact preclude the Court from finding that Debtors obtained their discharge through fraud. The Trustee's memorandum does not separately address the element of fraud in obtaining the discharge, within the meaning of § 727(d), and therefore the Debtors' responsive memorandum also fails to directly present their position. Nevertheless, the Court surmises that the Trustee asserts fraud based upon evidence that Debtors failed to disclose the transfer of the Michigan property in the Bankruptcy Pleadings; Debtors were not, in the view of the Trustee, completely forthcoming when inquiry was made; and Debtors failed to disclose gambling losses until an amended statement of affairs was filed. The Court also surmises that the Debtors would deny that they acted fraudulently when obtaining their discharge and rely on their evidence of reliance upon the advice and assistance of counsel when preparing Bankruptcy Pleadings and responding to inquiries of the Trustee. The Court finds disputed issues of material fact concerning the Debtors' intention preclude the entry of summary judgment on this element.

The Court also denies summary judgment on the issues briefed by the parties, whether the uncontroverted facts satisfy the standards to deny discharge under § 727(a)(2) or § 727(a)(4). "Section 727(a)(2) is intended to prevent the discharge of a debtor who attempts to avoid payment to creditors by concealing or otherwise disposing of assets."²⁸ In order for a debtor to be denied discharge under this subsection, "the objector must show by a preponderance of the evidence that (1)

²⁸ 6 *Collier on Bankruptcy* at ¶ 727.02[1].

the debtor transferred, removed, concealed, destroyed, or mutilated, (2) property of the estate, (3) within one year prior to the bankruptcy filing, (4) with the intent to hinder, delay, or defraud a creditor.’²⁹ Trustee contends that the Debtors’ transfer of the Gaylord, Michigan property satisfies all of these elements. The Debtors agree that elements one, two, and three are satisfied but contend that controverted issues of fact preclude finding that the Debtors acted with intent to hinder, delay, or defraud a creditor.

When arguing the unconverted facts establish intent to hinder, delay, or defraud, the Trustee relies upon badges of fraud as identified by the first circuit in *In re Watman*³⁰ as follows:

(1) insider relationships between the parties; (2) the retention of possession, benefit or use of the property in question; (3) the lack or inadequacy of consideration for the transfer; (4) the financial condition of the party sought to be charged both before and after the transaction at issue; (5) the existence or cumulative effect of the pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors; (6) the general chronology of the events and transactions under inquiry; and (7) an attempt by debtor to keep the transfer secret.³¹

Trustee contends that all elements except number five are satisfied by the circumstances of the Debtors’ sale of the Gaylord, Michigan property to Ruth Ouellette, Debtor Thomas Ouwlette’s mother, for \$12,000 approximately 3-months prepetition. Debtors agree that it is uncontroverted that the transfer was made to an insider and they had possession of the property after the transfer.

²⁹ *Gullickson v. Brown (In re Brown)*, 108 F.3d 1290, 1293 (10th Cir. 1997).

³⁰ *Groman v. Watman (In re Watman)*, 301 F.3d 3 (1st Cir. 2002).

³¹ *Id.*, 301 F.3d at 8 (citations omitted).

However, Debtors argue, and the Court agrees, that there are material issues of controverted fact as to the presence or absence of intent to defraud, hinder or delay creditors. As to the third badge of fraud, the important element of the adequacy of consideration, Debtors have provided evidence controverting the Trustee's contention that the \$12,000 payment evidences fraud. The fourth element, the transferor's financial condition before and after transaction, is not conclusively established as indicating fraudulent intent. Debtors' evidence suggests their financial condition remained essentially unchanged or possibly improved after the transfer because they liquidated the property to pay priority tax claims, thereby negating the implication of fraud which might otherwise arise. Debtors point out that the Trustee does not address the fifth badge of fraud, possibly because there is no evidence of a series of transactions. As to the sixth badge of fraud, the general chronology of the transaction, the Debtors again highlight that the sale provided revenue for the payment of taxes. As to the final element, keeping the transfer secret, Debtors provided evidence they relied upon the advice of counsel when completing their schedules, which resulted in the failure to disclose the sale. Reasonable reliance upon the advice of counsel as a reason for failure to disclose assets and/or transactions in bankruptcy pleadings is a recognized defense.³² The Court further notes that the Trustee does not identify a creditor who was allegedly defrauded by the transfer.

³² *Thomas v. Haneke (In re Haneke)*, No. 02-5244 (Bankr. D. Kan. April 11, 2005), citing *American State Bank v. Montgomery (In re Montgomery)*, 86 B.R. 948, 958 (Bankr. N.D. Ind. 1988) (collecting numerous cases addressing the reliance on the advice of counsel defense).

This case is a prime example of the general rule that summary judgment is seldom appropriate when intent is in issue.³³ Without a benefit of live testimony and more complete evidence of the transaction, the Court cannot determine the Debtors' motivations and cannot conclude that the transfer of the Michigan property was made with intent to hinder, delay, or defraud creditors within the meaning of §727(a)(2)(A).

Likewise, the Court concludes that material issues of controverted fact preclude summary judgment in favor of the Trustee on his contentions that the Debtors' actions satisfy the standard for denial of discharge under § 727(a)(4)(A). That subsection of the Code provides, "The court shall grant the debtor a discharge, unless . . . the debtor knowingly and fraudulently, in or in connection with the case . . . made a false oath or account."³⁴ "In order to deny a debtor's discharge pursuant to this provision, a creditor must demonstrate by a preponderance of the evidence that the debtor knowingly and fraudulently made an oath and that the oath relates to a material fact."³⁵ The Trustee contends that Debtors knowingly and fraudulently omitted required information on the Statement of Financial Affairs when not disclosing the transfer of the Gaylord, Michigan property and gambling losses, even though they made oaths that such statements were true and correct.

Debtors respond with evidence that the transfer of the Michigan property was, in the view of their counsel, in the ordinary course of their affairs and for this reason did not need to be disclosed.

³³ See *First Nat'l Bank, Larned v. Davison (In re Davison)*, 296 B. R. 841, 847 (Bankr. D. Kan. 2003) (denying summary judgment on claim of denial of discharge based on § 727(a)(2)(A) where debtor's testimony negated inference of fraud arising from circumstances of transfer).

³⁴ 11 U.S.C. § 727(a)(4)(A).

³⁵ *In re Brown*, 108 F.3d at 1294.

Assuming disclosure was required, Debtors assert any inference of knowing and fraudulent omission is refuted by evidence they relied upon the advice of their counsel. Debtors admit the gambling losses were not disclosed on the initial statement of affairs, but they deny fraudulent intent. They assert that the losses were shown on tax returns provided by the Debtors, that the schedules were amended, and that in related litigation the Trustee did not regard the omission material.

The Court finds that controverted facts preclude summary judgment under § 727(a)(4)(A). Omissions alone are not grounds for denial of discharge; the Trustee must establish that they were knowingly and fraudulently made. The circumstantial evidence of intentional misconduct by the Debtors arising from the uncontroverted facts is insufficient in the face of Debtors' evidence.³⁶

V. CONCLUSION.

For the foregoing reasons, the Court denies the Trustee's motion for summary judgment. There are controverted issues of fact which preclude the Court from finding in favor of the Trustee on any of the three elements the Trustee is required to prove to establish revocation of discharge pursuant to § 727(d)(1). A status conference will be scheduled to determine the future course of litigation.

IT IS SO ORDERED.

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³⁶ See *In re Davison*, 296 B.R. at 847-48 (summary judgment granted on allegation of denial of discharge based upon omissions from schedules under § 727(a)(4)(A) where the debtors offered no explanation for the omissions).