

**IN THE UNITED STATES BANKRUPTCY COURT FOR THE
EASTERN DISTRICT OF TENNESSEE**

In re

Case No. 00-32361

DAVID A. LUFKIN
a/k/a DAVID A. LUFKIN, ATTORNEY

Debtor

WILLIAM T. HENDON, TRUSTEE

Plaintiff

v.

Adv. Proc. No. 01-3059

DAVID A. LUFKIN

Defendant

MEMORANDUM ON MOTION TO DISMISS COMPLAINT

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RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

On April 27, 2001, the Chapter 7 Trustee, William T. Hendon, filed a Complaint objecting to the Debtor's discharge pursuant to 11 U.S.C.A. § 727(a)(2)(A), (3), (4)(D), and/or (5) (West 1993). The Debtor responded by filing a Motion to Dismiss Complaint on May 29, 2001. The Trustee then filed an Amended Complaint (Complaint) pursuant to FED. R. CIV. P. 15(a) and FED. R. BANKR. P. 7015 on June 29, 2001.¹ The Debtor renewed his objections by a Defendant's Response to Amended Complaint and Renewed Motion to Dismiss² filed on July 10, 2001. The parties have briefed their respective positions.

This is a core proceeding. 28 U.S.C.A. § 157(b)(2)(J) (West 1993).

I

By his Motion to Dismiss, the Debtor argues that the Trustee has failed to allege sufficient facts in support of each prong of his Complaint. See FED. R. CIV. P. 12(b)(6); FED. R. BANKR. P. 7012(b). Motions to dismiss for failure to state a claim are disfavored by the courts and are rarely granted. See, e.g., *Welch v. Mason & Dixon Lines, Inc.*, 507 F. Supp. 1064, 1066 (E.D. Tenn. 1978); *Joe Powell & Assocs., Inc. v. International Tel. & Tel. Corp.*, 22 B.R. 588, 592 (Bankr. E.D. Tenn. 1982). All doubts are resolved in favor of nondismissal. *Joe Powell & Assocs.*, 22 B.R. at 592. The Sixth Circuit has summarized the standard regarding motions to dismiss as follows:

¹ Rule 15(a) allows a party to amend its pleading "once as a matter of course at any time before a responsive pleading is served." FED. R. CIV. P. 15(a). The Debtor has not yet filed a responsive pleading in this adversary proceeding. See *Union Planters Nat'l Bank v. Harwell (In re Harwell)*, 80 B.R. 901, 903 (Bankr. W.D. Tenn. 1987) (A motion to dismiss is not a responsive pleading under Rule 15(a).); see also FED. R. CIV. P. 7(a); FED. R. BANKR. P. 7007.

² The Debtor's May 29, 2001, and July 10, 2001 motions will be collectively referred to herein as the Motion to Dismiss.

This Court must construe the complaint in the light most favorable to the plaintiff, accept all factual allegations as true, and determine whether the plaintiff undoubtedly can prove no set of facts in support of his claims that would entitle him to relief. A complaint need only give fair notice of what the plaintiff's claim is and the grounds upon which it rests. A judge may not grant a FED. R. CIV. P. 12(b)(6) motion to dismiss based on a disbelief of a complaint's factual allegations. While this standard is decidedly liberal, it requires more than the bare assertion of legal conclusions. In practice, a [] complaint must contain either direct or inferential allegations respecting all the material elements to sustain a recovery under *some* viable legal theory.

Allard v. Weitzman (In re DeLorean Motor Co.), 991 F.2d 1236, 1240 (6th Cir. 1993) (internal citations and quotations omitted) (emphasis in original). Applying this standard, and for the reasons discussed herein, the Debtor's Motion to Dismiss will be denied.

II

The Trustee first seeks a denial of the Debtor's discharge pursuant to 11 U.S.C.A. § 727(a)(2)(A). That section pertains to situations in which:

(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—

(A) property of the debtor, within one year before the date of the filing of the petition[.]

11 U.S.C.A. § 727(a)(2)(A) (West 1993). The Sixth Circuit has commented that this section is comprised of two primary elements: "1) a disposition of property, such as concealment, and 2) a subjective intent on the debtor's part to hinder, delay or defraud a creditor through the act disposing of the property.'" *Keeney v. Smith (In re Keeney)*, 227 F.3d 679, 683 (6th Cir. 2000) (citing and quoting *Hughes v. Lawson (In re Lawson)*, 122 F.3d 1237, 1240 (9th Cir. 1997)).

The Trustee first alleges that the Debtor, individually or through his law practice entities, misappropriated and then transferred client funds within one year of the commencement of his bankruptcy. The Debtor contends that this assertion does not state a claim under § 727(a)(2)(A). Tennessee law provides that a thief does not take title to stolen property. See *Lawrence v. Mullins*, 449 S.W.2d 224, 228 (Tenn. 1969) (Title cannot be acquired by a thief.); *Preston v. Moore*, 180 S.W. 320, 321-22 (Tenn. 1915) (An embezzler takes title in neither funds embezzled nor in property purchased with the embezzled funds.); *Godwin v. Taenzer*, 119 S.W. 1133, 1133 (Tenn. 1909) (Title cannot be acquired by a thief.); cf. *Kitchen v. Boyd (In re Newpower)*, 233 F.3d 922, 928-31 (6th Cir. 2000) (Federal courts must apply state law to determine whether a debtor and/or his estate has an interest in property stolen or embezzled by the debtor.). Therefore, because the funds allegedly misappropriated were not property of the Debtor, their transfer cannot properly support a claim under § 727(a)(2)(A). However, the Trustee also alleges that a portion of the funds represented the Debtor's attorney fee. Clearly, the Debtor had an interest in that portion of the allegedly misappropriated funds.

The Trustee also alleges that the Debtor transferred his personal income to family members, or mischaracterized that income as a business expense, in an effort to hinder, delay, or defraud his creditors. The Trustee does not, however, specifically allege in his Complaint that this conduct took place within one year of the commencement of this case. The Complaint alleges that client funds, but not the Debtor's income, were transferred to family members within one year. Nonetheless, construing the Complaint in the light most favorable to the Trustee requires that the court deny the Motion to Dismiss on the Trustee's § 727(a)(2)(A) grounds.

III

The Trustee next cites § 727(a)(3), which prohibits discharge where:

(3) the debtor has concealed, destroyed, mutilated, falsified, or failed to keep or preserve any recorded information, including books, documents, records, and papers, from which the debtor's financial condition or business transactions might be ascertained, unless such act or failure to act was justified under all of the circumstances of the case[.]

11 U.S.C.A. § 727(a)(3) (West 1993). The Complaint clearly states a claim under this section.

The Trustee alleges an extensive scheme whereby the Debtor, individually and through his law practice entities, falsified accounting records in order to mask the misappropriation of client funds. According to the Complaint, it is now extremely difficult for the Trustee to ascertain the Debtor's true financial condition and business practices due to this pattern of falsification. In addition, the Complaint alleges that the actions of the Debtor and his law practice entities are sufficiently intertwined that the Debtor should be found personally responsible for the businesses' conduct. *See, e.g., Foster Wheeler Energy Corp. v. Metropolitan Knox Solid Waste Auth., Inc.*, 970 F.2d 199, 202-03 (6th Cir. 1992) (Under Tennessee law, the corporation-shareholder distinction may be disregarded in the interest of justice.). These allegations, accepted as true and viewed in the light most favorable to the Trustee, are sufficient to state a claim under § 727(a)(3).

IV

The Trustee next invokes § 727(a)(4)(D), which would bar the Debtor's discharge if:

(4) the debtor knowingly and fraudulently, in or in connection with the case—

(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.A. § 727(a)(4)(D) (West 1993). The Complaint alleges that the Debtor has withheld from the Trustee various requested financial documents, in part through an improper assertion of Fifth Amendment rights. *See, e.g., In re Blan*, 239 B.R. 385, 392 (Bankr. W.D. Ark. 1999) (A debtor cannot offer blanket assertions of Fifth Amendment privilege, but must instead "substantiate his claim that responding to the specific requests for information may tend to incriminate him.").

The Debtor correctly points out that, to date, no court has found that he improperly invoked his privilege against self-incrimination. However, at this stage of the proceedings no such finding is necessary. To survive the Debtor's Motion to Dismiss, the Complaint "need only give fair notice of what the plaintiff's claim is and the grounds upon which it rests." *DeLorean Motor Co.*, 991 F.2d at 1240. By alleging the improper withholding of financial documentation from the Trustee, the Complaint contains "direct or inferential allegations respecting all the material elements" of § 727(a)(4)(D), thereby surviving the Debtor's Motion to Dismiss. *See id.*

V

Lastly, the Trustee objects to the Debtor's discharge pursuant to § 727(a)(5), which pertains to situations in which "the debtor has failed to explain satisfactorily, before determination of denial

of discharge under this paragraph, any loss of assets or deficiency of assets to meet the debtor's liabilities[.]" 11 U.S.C.A. § 727(a)(5) (West 1993). This section is "broad enough to include any unexplained disappearance or shortage of assets." *Solomon v. Barman (In re Barman)*, 244 B.R. 896, 900 (Bankr. E.D. Mich. 2000).

The relevant portion of the Complaint alleges only that the Debtor has failed to adequately explain the dissipation of funds purportedly misappropriated through his law practice entities. Section 727(a)(5) pertains to "assets." The word "assets" is not defined by the Bankruptcy Code but is characterized elsewhere as "[a]ll the property of a person (especially a bankrupt or deceased person) available for paying debts." BLACK'S LAW DICTIONARY 112 (7th ed. 1999). "Assets" and "property of the debtor" are therefore coextensive.

As previously noted, under Tennessee law misappropriated funds do not become property of the wrongdoer. However, because the Trustee's § 727(a)(5) allegations, accepted as true, may also be construed to the deficiency/loss of income referenced in his § 727(a)(2)(A) allegations (transferred to family members), the § 727(a)(5) portion of the Complaint will not be dismissed.

For the above reasons, the Debtor's Motion to Dismiss the Trustee's Amended Complaint will be denied. An appropriate order will be entered.

FILED: August 9, 2001

BY THE COURT

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE

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ORDER

For the reasons set forth in the Memorandum on Motion to Dismiss Complaint filed this date, the court directs that to the extent the Defendant's Response to Amended Complaint and Renewed Motion to Dismiss filed by the Defendant on July 10, 2001, moves for dismissal of the Plaintiff's Amended Complaint filed June 29, 2001, the motion is DENIED.

SO ORDERED.

ENTER: August 9, 2001

BY THE COURT

RICHARD STAIR, JR.
UNITED STATES BANKRUPTCY JUDGE