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

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<tr><td>In re

TED CASWELL SMITH,

Debtor.</td><td>No. 99-21249
Chapter 7</td></tr>
<tr><td>JOHN P. SQUIBB and wife,
MARTHA JO SQUIBB, and
JAMES H. WIDENER,

Plaintiffs,

vs.

TED CASWELL SMITH,

Defendant.</td><td>Adv. Pro. No. 99-2038</td></tr>
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M E M O R A N D U M

APPEARANCES:

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

In this adversary proceeding the plaintiffs request that the debtor's discharge be denied based upon his alleged failure to satisfactorily explain loss of assets and to answer questions under oath. In addition, the plaintiffs have moved to dismiss the underlying bankruptcy case for alleged lack of good faith by the debtor. After carefully reviewing the evidence presented at a consolidated trial on the motion to dismiss and the adversary proceeding held on June 8, 2000, the court concludes that while grounds for denial of discharge have not been established, the case should be dismissed because it was not filed in good faith. This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(A),(J) and (O).

I.

The debtor, Ted Caswell Smith, filed for bankruptcy relief under chapter 7 on May 13, 1999, scheduling unsecured claims in the amount of $107,452 and one secured claim of $24,000. First American Bank is listed as the secured creditor holding a deed of trust on the debtor's residence which he values at $75,000. The unsecured obligations listed by the debtor includes credit card debt totaling $16,648 owed to five different companies and business debts owed to James Widener and John Squibb in the amount of $45,402 each. In his Schedules I and J, the debtor

indicates that he has current monthly expenditures of $1,012, but no income. In response to question no. 1 in his statement of financial affairs, the debtor lists $0 in income from Apple Homes Corporation in 1997, 1998 and 1999, and his wife's income in 1997 and 1998 from the Johnson City School System.

The plaintiffs, John and Martha Squibb and James Widener, filed a complaint initiating this adversary proceeding on August 12, 1999, along with a motion to dismiss pursuant to 11 U.S.C. § 707(a) in the chapter 7 case. The plaintiffs assert that the debtor did not file for bankruptcy relief in good faith and that grounds exist for a denial of discharge under 11 U.S.C. § 727(a).

As grounds for both the motion and the complaint, the plaintiffs allege that: (1) the filing of the bankruptcy was for the sole purpose of avoiding payment to the plaintiffs; (2) except for some credit card debt and a residential mortgage, the debtor scheduled no debts other than the debts owing to the plaintiffs; (3) the filing of the petition was in response to the plaintiffs' enforcement of their judgment lien against the debtor's one-half interest in a house and lot the debtor and his brother inherited in 1998 from their deceased parents; (4) the debtor has failed to make lifestyle adjustments or any effort to repay the plaintiffs; (5) at least since 1985, in an intentional

and fraudulent effort to evade creditors including the plaintiffs, the debtor has placed assets in the names of his children, yet has retained control over the assets and has enjoyed the products, proceeds, and benefits therefrom; (6) in connection with sworn testimony given on May 23 and November 11, 1997, the debtor has failed and refused to answer questions under oath and produce recorded information from which his financial condition might be ascertained; and (7) the debtor has failed to explain any loss of assets or deficiency of assets to meet his liabilities.

In his response to the motion to dismiss and answer to the complaint, the debtor generally denies the plaintiffs' allegations. He asserts that the bankruptcy filing "was precipitated by the open-heart surgery [he] underwent in January. When it became clear that he needed to eliminate the stress of his financial condition for his health, he decided to file this Petition." Although the debtor admits that the plaintiffs' action to enforce their lien against his inherited property was pending when his bankruptcy case was filed, he asserts that the timing was coincidental because he would not be able to retain the inherited property regardless. With respect to the assertion that the debtor has been placing assets in his children's names to defraud creditors, the debtor responds that

"[t]he Plaintiffs have had at least three years to challenge the propriety of these alleged transfers under the fraudulent conveyance laws of this state and have failed to successfully challenge the transfers."

Prior to trial, the parties stipulated to the following facts: As of May 13, 1999, when the bankruptcy case was commenced, the debtor was indebted to plaintiffs John and Martha Squibb in the amount of $88,739.23 and to plaintiff James Widener in the amount of $88,739.23. These obligations are based on judgments entered against the debtor on May 2, 1996, by the Chancery Court for Washington County, Tennessee. In his decision the chancellor stated that the debtor and his wife "decided to basically try to get property in the hands of their children and out of the reach of creditors."

The judgments which the plaintiffs hold against the debtor arose out of a relationship between the parties which dates back several years. The three gentlemen, Messrs. Smith, Squibb and Widener, were owners of the stock in Action Mortgage Company, a corporation which was obligated to First Tennessee Bank on a $2 million line of credit. Personal guaranties of that obligation were executed by the debtor on March 13, 1986, the Squibbs on November 4, 1986, and Mr. Widener on April 5, 1988. When Action Mortgage Co. defaulted on its obligation to First Tennessee

Bank, the Squibbs and Mr. Widener paid the debt and sought contribution from the debtor for his share of the indebtedness. The judgments awarded in 1996 were the result.

On April 1, 1985, the debtor and his wife executed eight deeds conveying various parcels of real property, including 25 acres of land in Johnson County, Tennessee, to one or more of their three children, Theodore Craig Smith, Melissa Rose Smith and Robert Bryan Smith, who at that time were 19, 13, and 12 years of age, respectively. All three children were given the remainder interest in their parents' residence located at 1709 McClellan Drive, Johnson City, with the debtor and his wife retaining life estates. Also in April 1985, Action Mortgage Co. conveyed to the Smiths' older son, Craig, a lot located in Knox County, Tennessee. This lot had been acquired by Action Mortgage's predecessor from the debtor and his wife in 1979. In 1989, Craig conveyed the property to his sister Melissa, who subsequently transferred the property to a Duward W. Coleman through her attorney-in-fact, her father, the debtor. Each of the children granted their father a general power of attorney on January 25, 1994.

Notwithstanding legal title in their children's names, the debtor and his wife have at various times made representations as to their ownership of the properties. In a personal

financial statement dated March 30, 1986, provided by the debtor and his wife to Tri-City Bank, they listed their residence and the properties located in Johnson and Knox Counties as assets owned by them. In a financial statement dated July 18, 1988, provided by the debtor to First Tennessee Bank and introduced as Exhibit 3, the debtor represented that he had 100% ownership in both his residence and the Knox County property, but that the Knox County property was titled in his wife's name. Similarly, in a letter dated April 4, 1988, the debtor offered the Johnson County property as collateral for Action Mortgage's obligation to First Tennessee Bank.

In July 1989, the debtor and an individual named Robert S. Wilson acquired real property in Richmond County, Georgia. By deed dated June 15, 1996, the debtor conveyed his one-half interest in the property to his son Craig in consideration of love and affection. At the time of the conveyance, the real property was encumbered by a mortgage in the amount of $139,000. After Craig conveyed his interest to Apple Homes Corporation, the plaintiffs filed a lawsuit against the debtor, Craig, and Apple Homes Corporation in a Georgia state court to set aside the conveyances. The court concluded that Apple Homes Corporation was a bona fide purchaser because it had assumed an indebtedness in the amount of $113,000 and had issued stock to

Craig in consideration for the transfer.

The parties also made certain stipulations regarding three corporations, Economy Builders, Inc., Central Development, Inc. and Nashville Sound, Inc., owned by the debtor's children. The debtor has served as a board member and an officer of each of these corporations since their inceptions. The 1999 annual report for Economy Builders lists the debtor as its president. On a October 12, 1999 questionnaire for the state of Tennessee Alcoholic Beverage Commission, the debtor stated that he was vice-president of Nashville Sound and that he had been employed by Economy Builders, a home sales business, from 1990-1999. In a deposition given April 4, 1995, the debtor testified that he is the "man in charge" of Central Development Company, Economy Builders and Nashville Sound, drawing a salary from each.

Finally, with respect to the mortgage to First American Bank on the debtor's residence, the parties stipulated that the loan proceeds were used to help son Craig purchase a condominium and house in Nashville and that after the debtor's bankruptcy filing, the debt to First American Bank was paid by Nashville Sound.

II.

Other than the debtor, only one witness testified at the

trial, Cindy Winn. Ms. Winn is the owner and manager of Widener Insurance Agency, having purchased the company in 1995 from her father, James H. Widener, one of the plaintiffs in this action. Ms. Winn first became employed at the agency in March 1992. She testified that the agency provided homeowners insurance for the debtor for many years and insurance for a couple of buildings on Bristol Highway with which he was connected. She stated the agency also wrote workers' compensation and general liability insurance for Nashville Sound from 1992 to 1998. Introduced as Exhibit 6 was the application by Nashville Sound for workers' compensation insurance for 1996. Ms. Winn testified that she obtained the information for the application from the debtor over the phone and that he later came in and signed the form. The application indicated that the debtor was vice-president, owned 50% of the company, and that his remuneration was $30,000. Craig Smith was listed as president with 25% ownership, and Bryan Smith as secretary-treasurer with 25% ownership, with the remuneration of each listed at $25,000. Ms. Winn testified that ownership and officer information was important for workers' compensation applications since it was necessary to indicate whether these principals were being included or excluded from coverage. Also introduced was collective Exhibit 28 which consists of certain documents from the agency's file on

Nashville Sound. These records evidence that the insurance premiums for Nashville Sound's policy were written on checks signed by the debtor.

On cross examination, Ms. Winn admitted that Nashville Sound was regularly run by a manager. She stated that although in the early years most of the contact regarding Nashville Sound's insurance had been with the debtor, she had dealt with Bryan a lot during the last year of the policy, 1998, and that Bryan canceled the policy on March 16, 1999.

Ms. Winn was also questioned regarding insurance provided by her agency on Montclaire Apartments, which was one of the parcels of real estate conveyed by the debtor and his wife on April 1, 1985, to one of their children. The records for this policy included a July 11, 1991 policy amendment which changed the name of the insured from "Ted C. Smith dba Montclaire Apartments" to "Theodore Craig Smith dba Montclaire Apartments." Premiums in 1991 were paid by checks drawn on the personal bank account of Theodore C. Smith, which apparently referred to Craig, but were signed by the debtor. The 1992 application for insurance listed Craig as the insured and the debtor as the contact person. Premiums in 1993, 1994, and 1995 were paid by Economy Builders on checks signed by the debtor. Invoices in 1994 and 1995 listed Ted C. and Rose E. Smith as the insured due

to the fact, according to Ms. Winn, that the account had originally been set up in their names. Ms. Winn admitted that the agency knew that Craig was the insured but explained that some of the correspondence regarding the policy was addressed to the debtor because he was the one with whom she always dealt and he paid the premiums.

Similarly, Ms. Winn was questioned regarding property and liability insurance on buildings owned by Central Development, Inc. The September 16, 1993 application for insurance initially listed the debtor as the insured, but the debtor's name was struck through and the name of Central Development, Inc. was inserted with the notation that the debtor was the contact person. In the remark section, it was noted that the agency had "controlled the account since 9/25/88" and "Please change name to Central Dvlpt, Inc." The application was signed by the debtor as vice president. Thereafter, premiums were paid on Central Development's checks which were signed by the debtor. As with respect to Nashville Sound, Ms. Winn testified that all of her contact regarding the Central Development account was with the debtor until 1998. Beginning then, Bryan would on occasion return the call when she had telephoned and left a message for the debtor.

At the time of trial, the debtor was 62 years of age. The

debtor testified that he and his wife made the conveyances of real property to their children in 1985 after he had read an article about inheritance taxes. He stated that different parcels were conveyed to different children in order to give each child the property that was best suited for him or her. For example, he gave the 25 acres which had been his grandfather's to his son Bryan because the land was good for hunting and Bryan liked to hunt. The debtor testified that at the time of the conveyances, he was not personally obligated on the First Tennessee Bank debt and "wasn't worried about it because there was plenty of collateral to take care of that debt." He stated that he was worth $1.5 million at that time, had money in the bank, owned stock and four or five other parcels of real property, and had the businesses, Action Mortgage Co., A-1 Builders, and Colonial Homes.

The debtor and his wife began operating Action Mortgage Co. in 1976. Because they did not have the resources on their own to borrow the amount of money needed to expand the business, John Squibb was brought into the business in 1985 when he purchased Mrs. Smith's 50% ownership interest. On March 8, 1985, Action Mortgage Co. became obligated on a $2 million line of credit promissory note to First Tennessee Bank. Apparently the note had a one year term and upon the renewal of the note,

First Tennessee Bank asked the principals to sign personal guaranties, which they did in 1986. In 1988, James Widener obtained one-half of John Squibb’s interest in Action Mortgage Co. and executed a guaranty of the company’s obligation to First Tennessee Bank. During the same time period, Messrs. Smith and Squibb transferred a 50-acre tract of land jointly owned by them in Washington County, Tennessee to Action Mortgage Co., which thereafter attempted to grant First Tennessee Bank a lien on the property to secure its line of credit promissory note. Because of a defect in the conveyance, First Tennessee Bank released the lien in November 1988.

Although the debtor’s testimony was not clear on the subject, it appears that at some point the debtor ceased managing Action Mortgage Co. and relinquished his majority interest. By mid-1988, Action Mortgage Co. was out of business although it still owed First Tennessee Bank over $200,000, which the debtor and Messrs. Squibb and Widener agreed to repay. Notwithstanding this agreement, the debt to First Tennessee Bank was eventually paid off in 1991 by Messrs. Squibb and Widener only. The judgments which they obtained against the debtor in 1996 was for 1/3 of the sums paid by them to First Tennessee Bank.

The debtor testified that by 1995 his assets were gone. He

stated that one of his businesses, Colonial Homes, ceased operations due to a fire, leaving him with a personal liability to First American Bank of $100,000 to $200,000 which he paid by cashing in IRA's and selling other property owned by the debtor. The debtor also testified that his income has substantially reduced over the years. According to the debtor and his wife's joint federal income tax returns, their income in 1985 was $88,491 and $104,339 in 1986. Thereafter, their income was significantly less: $47,775 in 1987, $42,376 in 1988, $57,861 in 1989, $52,991 in 1990, $47,424 in 1991, and less than $40,000 for each of the years from 1992-1997.

The debtor stated that his main and probably only reason for filing bankruptcy was that he began experiencing health problems and had heart surgery in January 1999. He said that he did not believe that he could hold down a job now because he is a diabetic, has high blood pressure, and has to go to the Veterans Administration hospital every other week. He stated that he lives off his social security income and his wife's salary. When asked why he was requesting a discharge, he stated that it would be a load off his mind, he could sleep at night and would not be harassed. When asked to explain what changes had taken place in his lifestyle, the debtor testified that previously he was financially able to vacation in Hawaii, Portugal, the

Caribbean, and Myrtle Beach with the children, but that it had been at least ten years since he had taken such a trip. Previously he was able to buy his wife nice presents, but he had hardly purchased anything for her in last five years and had not purchased a new suit for himself in ten years.

The fortunes of the debtor's children have been more favorable. One of the parcels of real property conveyed by the debtor and his wife to their children in 1985 was condemned in 1989 by the state and the children received $205,000 in compensation. With this money, the debtor purchased a portion of a shopping center in Johnson City and placed title to the property in the name of Central Development, Inc. At about the same time, the debtor formed the corporation Nashville Sound because his son Craig wanted to open a country nightclub. In 1991, the debtor formed Economy Builders, Inc., a corporation that sells modular and mobile homes. The stock for all three of these corporations is held by the debtor's children.

Despite his incorporation of these businesses, the debtor testified that he has never owned any interest in the corporations and that he has just managed them for his children while they were away attending college out of town. The debtor testified that his son Craig ran Nashville Sound for a while until he decided to go to college and that he has just now

graduated from law school. The debtor further testified that his son Bryan has been back in Johnson City for two years and that he has been running all of the businesses since his return. Daughter Melissa went to college in Kentucky and continues to live there. The debtor testified that the money for all three to go to college came from the operations of these three businesses.

The debtor testified that at times in the past he received small, but irregular salaries from his children's corporations. He stated that he did not receive salaries on a regular basis because money not always there and he really did not need more because his wife had a good income. The debtor's 1991 tax return indicates that he received $3,200 that year from Economy Builders and $11,000 from Nashville Sound. His 1992 return lists income of $4,500 from Nashville Sound.

The debtor denied that he ever told Ms. Winn that he owned 50% of Nashville Sound or was receiving $30,000 a year income from the corporation. He said that James Widener had carried his insurance for twenty years and that often, he would just drop by the insurance agency, pay the premium, and sign the application in blank.

When questioned concerning the real property in Georgia which he and Robert Wilson purchased in 1989, the debtor

testified that he participated in this purchase at Mr. Wilson's request in order to help his friend out. The debtor stated that mobile homes for rent were located on the property, that Mr. Wilson collected the income and paid the expenses, and that he had never received any income from the property. The debtor acknowledged that he transferred his interest in the Georgia property less than two months after the plaintiffs obtained their judgment against him, even though he testified in a November 1997 deposition that he had made no property transfers after the judgments. The debtor explained that he had been mistaken at the time of the deposition and thought that the transfer had taken place before the judgments rather than after.

The debtor was questioned extensively by plaintiffs' counsel concerning his motivation for the transfers to his children, his involvement in his children's corporations, and the basis for his bankruptcy filing. The debtor was reminded that he had testified in a September 1993 deposition that he made the 1985 transfers to his children because he was advised to do so for estate purposes by attorneys Mark Dessauer and Robert Carter. Yet in his December 1999 deposition, the debtor stated that he got the idea to make the transfers after reading an article about inheritance taxes. When asked about the discrepancy, the debtor explained that Messrs. Dessauer and Carter had not

actually advised him on this subject, that he had just mentioned it to them while making conversation at a deposition and they had indicated that it was a good idea. The debtor conceded that he had not filed gift tax returns to reflect the transfers, but explained that he left this up to his accountants.

The debtor admitted that his bankruptcy attorney had counseled him as early as November 1997 about filing bankruptcy, but that he did not file bankruptcy at that time because no one in his family had ever filed for bankruptcy and he did not want to embarrass them. The debtor also acknowledged that he had made no effort to pay the plaintiffs, but noted that his attorney had attempted to obtain a settlement amount from the plaintiffs. He also observed that in 1999, the plaintiffs received $20,000 after they attached his one-half interest in a house which he and his brother had inherited from their parents. Although the debtor denied that his bankruptcy filing had been prompted by the plaintiffs' collection efforts, he did concede that in a November 1997 deposition taken in connection with plaintiffs' collection efforts he had stated that in his heart he did not feel that he owed the money. The debtor also stated in that deposition that he spent his days doing different things, that every day was different, that sometimes he would go out of town, and that he had made trips to Roanoke, Virginia and

Washington, D.C. He financed these trips with four or five thousand dollars which he had saved, having won $700 or $800 in a pool tournament and $500 on a Tennessee football game.

The debtor acknowledged testifying in a 1995 deposition that he was the "man in charge" of Central Development, Economy Builders, and Nashville Sound as far as the day-to-day business of these corporations was concerned and that he drew a salary from each. While admitting at trial that neither his 1994 nor his 1995 federal income tax return listed any income from these corporations, the debtor nonetheless testified that all of his income from the corporations had been reported on his federal income tax returns.

When one of the buildings owned by Central Development burned in 1995, the debtor sued Shelby Insurance agency due to its refusal to pay out insurance proceeds. The debtor testified that he was a plaintiff in that action because he had been mistakenly listed as an owner on the policy. In a deposition given in connection with that lawsuit, the debtor stated that he collected the rent from the various tenants who leased property from Central Development. With respect to the May 25, 1999 building permit which listed the debtor as the owner and contractor of a building located at 505 Orleans Street in Johnson City, the debtor explained that the building is actually

owned by Central Development. He stated that the building had been damaged by fire and was in the process of being repaired when the building inspector came by and informed them that unless they had a permit right after lunch the work would be shut down. The debtor testified that later that day he went to the building inspector's office and paid the premium and that the office personnel already had the permit waiting for him. He denied that he informed them that he was the owner of the building.

The debtor acknowledged that he had been the applicant for Nashville Sound's liquor license each year from the Tennessee Alcoholic Beverage Commission. The debtor testified that he did this because the applicant had to be someone who was there part of the time. He also admitted advising the Tennessee Alcoholic Beverage Commission by letter in March 1995 that he was the manager of Nashville Sound, but explained that he did this because the manager and assistant manager had resigned and it was a requirement that the Commission be notified of management changes. The debtor stated that he was manager for only a couple of months.

Similarly, the debtor acknowledged listing Economy Builders as his employer from 1990-1999 in Nashville Sound's 1999 liquor license application to the Tennessee Alcoholic Beverage

Commission, but testified that he did not get income every year from Economy Builders. He also acknowledged that Economy Builders' 1999 annual report to the Tennessee Secretary of State listed him as president, but stated that Economy Builders was a dormant corporation: it had no employees and was not doing any work. The debtor further acknowledged that he signed the affidavit of value in a quitclaim deed dated February 28, 2000, from his daughter to Economy Builders and that the next day as vice-president of Economy Builders, he signed a warranty deed transferring the property to a third party. This property was one of the parcels conveyed by the debtor and his wife to their children in 1985. The debtor testified that his son Bryan had placed a mobile home on the lot prior to its sale and that other than handling the paperwork, he had no connection with the transaction and received none of the income from the sale.

The debtor admitted that all three corporations use the same post office box but denied that he personally uses this box. He acknowledged that several years ago for a short period of time his personal bank statements were mailed to that box. The debtor also admitted that several years ago he endorsed a partial pay agreement with respect to a tax lien against Nashville Sound.

The debtor was questioned regarding the 25 acres which he

conveyed to his son Bryan in April 1985 and his December 1999 deposition wherein he stated that this real property had never been titled in his name, that it had always been titled in Bryan's name. The debtor admitted that this deposition testimony was incorrect, but stated that he must have misunderstood the question because he has never denied previously owning that property.

Notwithstanding the debtor's pretrial stipulation that "[i]n a letter dated 04/04/88 by Hal J. Dunning, Vice-President of First Tennessee Bank National Association, as executed by Ted C. Smith, John Squibb and Jim Widener, Ted C. Smith offered the Johnson County property ... as collateral for a loan from First Tennessee Bank," the debtor denied at trial that he had made any such offer. He testified that he told the bank officer that "Bryan might put up the property if he had to." The debtor also observed that the letter did not state that he personally owned the 25 acres.

The debtor testified that he drives a 1990 Infiniti Automobile that is owned and was paid for by Economy Builders. In his 1997 deposition, he opined that the car was owned by Nashville Sound. With respect to the mortgage to First American Bank on his residence which was listed in his schedules, the debtor testified that he and his wife had borrowed the money in

1994 to help his son Craig purchase a home in Nashville. He stated that it was at this time his children gave him a general power of attorney since it was necessary for them to sign the deed of trust due to their remainder interest in the residence. After the bankruptcy filing, the mortgage was paid by Nashville Sound. The debtor admitted that he did not disclose in his schedules that the debt to First American Bank was incurred for the benefit of his son.

The debtor was questioned regarding the fact that he filed an amended 1997 tax return listing interest income of $10,000 from Apple Homes Corporation, yet his statement of financial affairs listed $0 income from Apple Homes. He explained that in completing the statement he thought the question referred to salary, and that he had never received any salary from Apple Homes. The debtor stated that he made a loan to the corporation ten or twelve years ago and the $10,000 referenced in his amended tax return was interest on this loan. When asked why he listed Apple Homes as a source of income but with $0 amount, the debtor testified that this was done at the direction of his attorney since he had been involved in a lawsuit with the corporation.

In addition to the testimonies of the debtor and Ms. Winn, also admitted into evidence were numerous exhibits including the

deposition transcript of the debtor taken on December 15, 1999, in connection with this adversary proceeding, the transcript of the debtor's deposition taken on November 11, 1997, in connection with the plaintiffs' collection efforts, the transcript of the deposition given by the debtor on April 4, 1995, in the *Ted C. Smith v. Shelby Ins. Co.* state court action, the debtor's pretrial deposition transcript dated September 16, 1993, in the state court action by the plaintiffs against the debtor, the deposition of Bryan Smith dated May 23, 1997, and the transcript for the April 8 and 9, 1996 state court trial which produced the judgments held by the plaintiffs.

III.

The court will first address the plaintiffs' arguments regarding the denial of discharge. Plaintiffs do not cite any particular subsection of 11 U.S.C. § 727(a) as the basis for the denial of discharge, nor do they argue the discharge issues in their pretrial brief other than in a conclusory statement at the end. Plaintiffs did assert in closing argument at trial that the debtor should be denied a discharge under subsections (4)(A),(D) and (5) of § 727(a). Each of these will be discussed in turn.

The plaintiffs bear the burden of establishing grounds for

an objection to discharge by a preponderance of the evidence. *Barclays/American Bus. Credit, Inc. v. Adams (In re Adams),* 31 F.3d 389, 394 (6th Cir. 1994). In order to preserve the fresh start policy underlying the Bankruptcy Code, exceptions to discharge should be construed strictly against the objector and liberally in favor of the debtor. *Hendon v. Oody (In re Oody),* 249 B.R. 482, 487 (Bankr. E.D. Tenn. 2000).

Subsection (4)(A) of § 727(a) provides an exception for discharge if "the debtor knowingly and fraudulently, in or in connection with the case ... made a false oath or account." To prevail under this subsection, the plaintiffs must prove that: (1) the debtor made a false statement under oath; (2) the debtor knew the statement was false; (3) the debtor made the statement with fraudulent intent; and (4) the statement related materially to the bankruptcy case. *Id.* "Statements in bankruptcy schedules are given under oath, and a fact is material if it concerns discovery of assets, business dealings or the existence or disposition of property." *Hamo v. Wilson (In re Hamo)*, 233 B.R. 718, 724 (B.A.P. 6th Cir. 1999). A false oath is knowing and fraudulent if "the debtor knows the truth and nonetheless willfully and intentionally swears to what is false." *Pigott v. Cline (In re Cline)*, 48 B.R. 581, 584 (Bankr. E.D. Tenn. 1985). Proof of intent may be inferred from circumstantial evidence or

from the debtor's conduct. *In re Hamo*, 233 B.R. at 724. A false statement resulting from ignorance or carelessness is not one that is knowing and fraudulent. *See, e.g.,* 6 Collier on Bankruptcy ¶ 727.04[1][a] (15th ed. rev. 2000).

The plaintiffs contend that the following constitute false statements under oath: (1) the debtor's failure to list in his schedules that he received income of $10,000 from Apple Homes Corporation in 1997 and his denial of income from Apple Homes in his December 1999 deposition; (2) statements in the debtor's December 1999 deposition as to the motivation for his 1985 transfers to his children; (3) the debtor's failure to disclose in his schedules that the home equity loan on his residence was for the benefit of his son Craig; and (4) the debtor's denial in his December 1999 deposition that the 25 acres in Johnson County presently owned by son Bryan had ever been in the debtor's name. Clearly, the debtor's failure to disclose in his schedules that he received income from Apple Homes Corporation is a false statement under oath, as is the denial in the December 1999 deposition. Furthermore, statements regarding sources of income as a general rule are materially related to the bankruptcy case. *See Neugebauer v. Senese (In re Senese)*, 245 B.R. 565, 574 (Bankr. N.D. Ill. 2000).

However, the court does not conclude that the evidence

establishes that the debtor knowingly and fraudulently made the false statements. He testified that the income was the result of interest paid on a loan to Apple Homes Corporation which he had made ten or twelve years previously. He stated that the receipt of this money had slipped his mind and that he thought the question in the statement of financial affairs was referring to salary. The debtor's attorney also assumed responsibility for the error stating that she had failed to request copies of the debtor's amended tax returns. Because there was no evidence that the debtor would be receiving any additional money from Apple Homes Corporation, the debtor had nothing to gain by keeping this information secret. Furthermore, it appears that receipt of this income had already been disclosed to the plaintiffs in connection with their collection efforts. Accordingly, false statements made by the debtor regarding his income from Apple Homes Corporation do not provide a basis for denial of discharge under § 727(a)(4)(A).

The next category of alleged false statements by the debtor pertain to responses he gave when asked about his 1985 transfers to his children. The plaintiffs allege that the debtor's statements in his December 1999 deposition regarding the impetus for his 1985 transfers were false because they conflicted with the statements given him in a 1993 deposition. The plaintiffs

maintain that because the 1993 statements were closer in time to the transfers, those statements were true and the 1999 statements were false. In the 1993 deposition, the debtor testified that he and his wife transferred the property "for estate purposes" and that attorneys Mark Dessauer and Robert Carter "advised me to do it this way." In his 1999 deposition, the debtor responded as follows when asked, "Who first came up with the idea to make those conveyances? Do you recall?"

> No, Sir. I just, I just don't recall. Like I was telling Ms. Fugate one time, I still have an article I've got. It says come see us or something, don't give all your assets, 50% of your assets to the government. I think maybe me and B.K. Barker was going over that. I've still got it, that ad. And that's one of the main reasons I remember, I just wanted to get my estate planning right, rather than to wait til I died and my wife died and go through the inheritance taxes and the hassle and everything you go through."

The court is unable to conclude that this statement was in fact false or that even if false, the debtor made the statement knowingly and fraudulently. Granted, the debtor's 1999 deposition testimony differs from his 1993 testimony, but that alone does not indicate that one was false and the other true, even if one was closer in time to the transfers. Furthermore, it is clear from a fair reading of the response quoted above that the debtor was not making an unequivocal statement in his 1999 deposition. He first states that he can't recall who came

up with the idea and then says that he **thinks** he and B.K. Barker discussed the article and estate planning. There is no indication that the debtor intended to mislead anyone with these statements.

Similarly, the court does not find a basis for a denial of discharge for false oath due to the debtor's failure to disclose that the loan from First American Bank was to enable the debtor's son to purchase a home. Although this fact should have been disclosed as a potential asset of the debtors, again the absence of this information appears to have been the result of inadvertence rather than a deliberate attempt on the part of the debtor to mislead or defraud his creditors since the asset would have been offset by the obligation to First American Bank resulting in a net recovery of $0 for the estate.

The plaintiffs' remaining argument regarding false oath refers to the debtor's misstatement in his December 1999 deposition that he had never owned the 25 acres in Johnson County, Tennessee presently titled in the name of son Bryan. At trial the debtor explained that he must have misunderstood the question because he had never denied that he owned the property previously. While from a review of the transcript of the deposition it is difficult to understand how the question could have been misunderstood, there is no evidence that the debtor

knowingly and fraudulently made the false statement. It has been known throughout the course of litigation between the parties that the 25 acre farm was one of the parcels of real property transferred by the debtor and his wife in April 1985. The debtor had nothing to gain by denying that he had ever owned the property. Accordingly, no grounds for denying the debtor a discharge under 11 U.S.C. § 727(a)(4)(A) have been established.

Likewise, the court finds no basis for denying a discharge under subsection § 727(a)(4)(D). This subsection provides that a discharge will be denied if "the debtor knowingly and fraudulently, in or in connection with the case ... 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." The plaintiffs have alleged generally that the debtor withheld recorded information relating to his financial affairs. No evidence was offered, however, as to what recorded information the debtor has failed to provide. Accordingly, this claim is without merit.

Paragraph (5) of § 727(a) provides that a discharge shall be denied if 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." "The plaintiff has the burden of introducing evidence of the disappearance of assets or of unusual transactions. The burden then shifts to the defendant to satisfactorily explain the loss or deficiency of assets." *Montey Corp. v. Maletta (In re Maletta)*, 159 B.R. 108, 116 (Bankr. D. Conn. 1993). "The test under this subsection relates to the credibility of the proffered explanation, not the propriety of the disposition." *Id.*

As the basis for their argument that the debtor's discharge should be denied under § 727(a)(5), the plaintiffs point to the debtor's many representations of ownership in property which is titled in his children's names. They note that the debtor listed the properties located in Knox and Washington Counties in his 1986 and 1988 financial statements and offered the Washington County property as collateral even though title to this property was conveyed to the debtor's children in 1985. The plaintiffs also cite the building permit signed by the debtor on May 25, 1999, which lists him as the owner of a building titled in the name of Central Development.

In essence, the plaintiffs are alleging that the debtor continues to own these properties and that the transfer of title to his children was a scam or fraud. Even if true, this type of conduct does not fall within confines of § 727(a)(5). "The

proper question the court must ask under Section 727(a)(5) is **what** happened to the assets, not **why** it happened." *Minsky v. Silverstein (In re Silverstein),* 151 B.R. 657, 663 (Bankr. E.D.N.Y. 1993)(emphasis in original). "The court need only decide whether the explanation satisfactorily describes what happened to the assets, not whether what happened to the assets was proper." *Id.* From the paper trail introduced at trial, it is clear who has record title of the real property conveyed by the debtor. Because plaintiffs' complaint only attacks the propriety of those transfers. there is no basis for a denial of discharge under § 727(a)(5). *See In re Silverstein*, 151 B.R. at 663 (although debtor's transfer of his interest in his home provided basis for denial of discharge under § 727(a)(4), it did not properly fall within § 727(a)(5) as its disposition was satisfactorily explained).

IV.

Lastly, the court turns to the plaintiff's motion to dismiss the bankruptcy case under 11 U.S.C. § 707(a) for lack of good faith. Section 707(a) of the Bankruptcy Code provides as follows:

> The court may dismiss a case under this chapter only after notice and a hearing and only for cause, including—

> (1) unreasonable delay by the debtor that is prejudicial to creditors;
> (2) nonpayment of any fees or charges required under chapter 123 of title 28; and
> (3) failure of the debtor in a voluntary case to file, within fifteen days or such additional time as the court may allow after the filing of the petition commencing such case, the information required by paragraph (1) of section 521, but only on a motion by the United States trustee.

Although lack of good faith is not specifically listed as a ground for dismissal under this section, the Sixth Circuit Court of Appeals has recognized that the word "including" as used in the preamble to § 707(a) "is not meant to be a limiting word" and that grounds other than those delineated in the statute may provide a basis for dismissal when cause exists. *Industrial Ins. Serv., Inc. v. Zick (In re Zick)*, 931 F.2d 1124, 1126 (6th Cir. 1991). In *Zick*, the court concluded that a good faith requirement is inherent in the purposes of bankruptcy relief and that, therefore, "lack of good faith is a valid basis of decision in a 'for cause' dismissal by a bankruptcy court." *Id.* at 1127. The Sixth Circuit observed that "the facts required to mandate dismissal based upon a lack of good faith are as varied as the number of cases." *Id.* The court, however, also cautioned that:

> [d]ismissal based on lack of good faith must be undertaken on an ad hoc basis. [cite omitted]. It should be confined carefully and is generally utilized only in those egregious cases that entail concealed or

> misrepresented assets and/or sources of income, and excessive and continued expenditures, lavish lifestyle, and intention to avoid a large single debt based on conduct akin to fraud, misconduct, or gross negligence.

Id. at 1129.

In the aftermath of *Zick*, bankruptcy courts in this circuit have developed a list of factors to consider in determining lack of good faith. The bankruptcy court for the Western District of Kentucky in *In re Spagnolia*, 199 B.R. 362, (Bankr. W.D. Ky. 1995), has found the following factors to be relevant:

> 1. The debtor reduced his creditors to a single creditor in the months prior to filing the petition.
>
> 2. The debtor failed to make lifestyle adjustments or continued living an expensive or lavish lifestyle.
>
> 3. The debtor filed the case in response to a judgment pending litigation, or collection action; there is an intent to avoid a large single debt.
>
> 4. The debtor made no effort to repay his debts.
>
> 5. The unfairness of the use of Chapter 7.
>
> 6. The debtor has sufficient resource to pay his debts.
>
> 7. The debtor is paying debts to insiders.
>
> 8. The schedules inflate expenses to disguise financial well-being.
>
> 9. The debtor transferred assets.
>
> 10. The debtor is over-utilizing the protection of the Code to the unconscionable detriment of creditors.

> 11. The debtor employed a deliberate and persistent pattern of evading a single major creditor.
>
> 12. The debtor failed to make a candid and full disclosure.
>
> 13. The debts are modest in relation to assets and income.
>
> 14. There are multiple bankruptcy filings or other procedural "gymnastics."

Id. at 365; *see also In re Emge*, 226 B.R. 396, 399-400 (Bankr. W.D. Ky. 1998).

With respect to factors two and eight, there was no evidence that the debtor was living a lavish lifestyle or that he had inflated his expenses. The debtor lives in a modest home and drives a ten year-old car. He testified that his standard of living has declined over the years, such that he is no longer able to take nice trips or buy his wife expensive presents. The debtor is 62 years of age, had heart surgery in January 1999, and is a diabetic. According to the debtor, his only current sources of income are $800 per month in Social Security and his wife's teaching salary.

On the other hand, the bankruptcy does appear to have been filed primarily to discharge the obligations to the plaintiffs, factor three in the *Spagnolia* list. The judgments held by the plaintiffs represent 91% of the debtor's total outstanding debt. Although the debtor denies that the plaintiffs' collection

efforts prompted the bankruptcy filing, the plaintiffs' attachment of the debtor's inherited property took place within a few months preceding the bankruptcy filing. The debtor testified that he was asking the court to grant him a discharge in order to stop the plaintiffs' harassment and there was no evidence that any of the debtor's other creditors had initiated collection activity.

Furthermore, the debtor admittedly has made no effort to pay the judgments held by the plaintiffs, factor four. To the contrary, in the debtor's words, he believes in his heart that he doesn't owe the judgments. As stated by the debtor in his 1997 deposition, "[i]n my opinion, I don't owe them nothing." The debtor's testimony that he has not paid the judgment because he has not had the money to do so is discredited by the fact that after plaintiffs obtained their judgments against him, the debtor gave his property in Georgia to his son, sold an antique car for $3,500, and received $10,000 as interest on a loan in connection with the Georgia property (and presumably also received repayment of the loan at that time), but made no effort to use these funds to pay the judgments. In addition, savings and winnings from pool tournaments and sporting bets were used to finance trips to Roanoke, Virginia and Washington, D.C., rather than satisfy his financial obligations. Although it was

noted that debtor’s counsel had requested in a December 8, 1997 letter that plaintiffs’ counsel propose an amount which they would accept in satisfaction of their judgments, this request, which was coupled with a threat of bankruptcy, constituted a mere settlement offer at most rather than a good faith repayment effort.

Factors nine, eleven and twelve are that the debtor has transferred assets, has employed a deliberate and persistent pattern of evading a single major creditor, and has failed to make a candid and full disclosure. Clearly, the debtor’s transfers of real property in 1985 took place years before the judgments were obtained by the plaintiffs in 1996 and even before the guaranties, out of which the judgments arose, were signed in 1986 and 1988. Thus, it can not be said that the initial conveyances were designed to defraud the plaintiffs. Nonetheless, it is interesting to note that the transfers were made on April 1, 1985, less than thirty days after the debtor’s company, Action Mortgage, obligated itself on a $2 million promissory note to First Tennessee Bank on March 8, 1985. Furthermore, Nashville Sound, Central Development, and Economy Builders were all formed by the debtor and ownership thereof placed in the children’s names after the guaranties were signed and after Action Mortgage Co. defaulted on its loan to First

Tennessee Bank. On January 17, 1990, the debtor transferred to his children his interest in an April 18, 1989 promissory note in the face amount of $67,500 signed by a Larry D. and Carolyn M. LeSueur and any interest he had in the company United Investments Corporation for $10 consideration.

The court is firmly convinced after reviewing all of the evidence that while the initial 1985 transfers may not have been designed to defraud creditors, the debtor thereafter took advantage of the fact that the real properties had been placed in his children's names in order to protect his business enterprises from the reach of his creditors. This conclusion is based on the fact that notwithstanding actual title in the names of his children, who were only 19, 15, and 12 years of age at the time of the initial property transfers, the debtor treated the transferred properties as his own. The debtor represented in financial statements in 1986 and 1988 that he was the owner of the various parcels of realty transferred, and he continued to manage the properties and pay the property taxes. The debtor's statement that he did not offer the 25 acres as collateral to First Tennessee Bank in 1988, but said he would ask Bryan if he would do so is simply not credible considering the debtor had continued to manage the property, Bryan was 15 years old at the time, and there was no indication that Bryan

had assumed control over the property. Similarly, it was the debtor, rather than his children, who made the investment decisions in 1989 when a substantial amount of money was received for one parcel from the state of Tennessee.

This practice of placing ownership in the names of this children continued in the early 1990s when the three corporations, Central Development, Nashville Sound, and Economy Builders were created. These corporations were formed by the debtor and it was the debtor who operated these companies on a daily basis. The debtor explained in a 1995 deposition that his children did not have an active role in the businesses, "they're just stockholders," and that the businesses were set up this way by his accountant "on account of tax purposes." The debtor collected rent for Central Development from its tenants and even personally sued an insurance company which it refused to pay after one of Central Development's properties was vandalized. The debtor applied each year for Nashville Sound's liquor permit, and notified the Tennessee Alcoholic Beverage Commission in a March 211, [sic] 1995 letter that "[d]ue to the resignation of **my** manager and assistant manager, I Ted C. Smith am managing Nashville Sound, Inc." [emphasis supplied]. Similarly, the debtor's identity with Nashville Sound was so synonymous that in an order entered in a lawsuit against Nashville Sound, the

defendant was erroneously referred to as "Ted Smith, individually as the owner of Nashville Sound, Inc."

Although the debtor maintains that he was just managing these businesses for his children while they were away at college, this management began in 1985, covered periods of time in which his children were not in school, and apparently is still continuing. The debtor's daughter Melissa went to Kentucky to college and has continued to reside there, without any apparent active role in any of the corporations. Son Craig has been away at both college and law school, graduating this year from law school at the age of 34. While the debtor testified that his son Bryan has run the businesses for the last two years and since that time he has only helped in an advisory capacity, the evidence indicated that the debtor's involvement with the businesses has continued even after his bankruptcy filing on May 13, 1999. On May 25, 1999, the debtor paid the $105 permit fee and signed the permit for repair work on a building at 505 Orleans Street. The permit listed the debtor as both owner and contractor.

Similarly, on October 12, 1999, five months after his bankruptcy case was commenced, the debtor again was the applicant for Nashville Sound for a liquor permit from the Tennessee Alcoholic Beverage Commission, stating in the

application that he was employed by Economy builders from 1990-1999, even though his bankruptcy schedules did not reference any such employment. The debtor downplayed the reference to Economy Builders in the application, stating that it was a dormant corporation. Yet, on July 22, 1999, again after his bankruptcy filing, the debtor filed with the Tennessee Secretary of State the annual report for Economy Builders, Inc. in which he indicated that he was the president and his wife the secretary of the corporation. In connection therewith, the debtor signed a warranty deed on behalf of Economy Builders on February 29, 2000, transferring the corporation's interest in a lot in Washington County, Tennessee to some third parties. This same property had been quitclaimed the day before to Economy Builders by Melissa Smith, the debtor's daughter, and the debtor signed the affidavit of value.

It is simply all too convenient for the debtor that while his own financial circumstances has declined such that all of his assets have been depleted, the businesses owned by the debtor's children, which he formed and managed, have prospered. According to the 1993-1998 income tax returns for Nashville Sound, the corporation has assets of $400,000 and gross sales have ranged from $978,950 to $703,449. The 1994 tax return for Economy Builders, the only one submitted into evidence, listed

assets of $414,437 and gross receipts of $356,778. Although no financial information was submitted with respect to Central Development, it appears from the testimony of the debtor, both at trial and in his depositions, that Central Development owns or has owned several pieces of real estate, including part of a shopping center, some rental houses, a lot in Murfreesboro, and some Bristol Highway property. The debtor, on the other hand, has reported no income since 1992 other than a minimal amount of interest income, a small amount of capital gain, and the $10,000 from Apple Homes Corporation in 1997.

In light of the success of his children's businesses attributable to the debtor's management, the lack of sufficient income to meet his expenses appears to have been a matter of choice by the debtor. In a September 16, 1993 deposition, the debtor testified that he received anywhere from $300 to $500 a week from Central Development, yet his 1993 tax return reported no such income. In an April 4, 1995 deposition, the debtor stated that he received a salary from his children's businesses, yet neither his 1994 nor his 1995 tax return reflects any such salary or income. At trial, the debtor stated that he had not received a salary during some years because the corporations did not always have sufficient funds with which to pay him, but he also testified that he did not pay himself more because he

didn’t need much to live on, his wife made a good living.

One admitted benefit which the debtor receives from his children’s corporations is the use of a 1990 Infiniti automobile, although there was no indication that the debtor reported its personal use as income in his tax returns notwithstanding his contention that he no longer works for the corporations. Furthermore, there was some confusion as to who actually owns the vehicle, which was indicative of the debtor’s treatment of the various corporations as simply his businesses. In his 1997 deposition, the debtor stated that he believed the vehicle was in the name of Nashville Sound, but at trial he testified that he thought that Economy Builders was the owner, although it also could be in the name of Factory Housing, an unidentified business. In a late-filed exhibit to the 1997 deposition, debtor’s attorney advised that it could not be determined what entity paid for the Infiniti, but that it was owned by Factory Housing Outlet, and the last insurance premium on the automobile had been paid by son Bryan. The 1994 tax return for Economy Builders lists the Infiniti as one of its assets and states that it is used for business 100%.

The fact that the debtor has run his children’s businesses on a full-time basis admittedly until 1998, yet received no income therefrom since 1992, leads the court to believe that

because of the debtor’s obligation to First Tennessee Bank and then to the plaintiffs, he has either intentionally pauperized himself by not drawing income or he has failed to disclose the income which he did receive. The debtor’s testimony in his 1993 deposition that he made from $300 to $500 a week from Central Development and his testimony in his 1995 deposition that he received a salary from his children’s corporations, yet none was reported on his tax returns, suggest the latter. Further evidence of the debtor’s efforts to impoverish himself during this time period was his incurrence of the obligation to First American Bank in 1994 in order to buy son Craig a condominium in Nashville. This loan was taken out when the plaintiffs’ lawsuit against the debtor was pending and at a time when Craig has numerous assets, i.e., the corporations, and the debtor allegedly had none.

In *Zick*, the Sixth Circuit Court of Appeals upheld the bankruptcy court’s dismissal of the chapter 7 case which had been based on: (1) the debtor’s manipulations reducing his creditors to one; (2) the debtor’s failure to make significant lifestyle adjustments or efforts to repay; (3) the fact that the petition was filed in response to a creditor obtaining a mediation award; and (4) the unfairness of the debtor’s use of chapter 7 under the facts of the case. *Id.* at 1128. In the

present case, the debtor's obligations to the plaintiffs represent 91% of his debt. The debtor has made no efforts to repay these obligations and in fact believes "in his heart" that he does not owe them. The debtor has for several years engaged in a pattern of maintaining his business interests in the names of his children, purposely pauperizing himself in the process to avoid his obligations to his creditors. His contentions at trial to the contrary were simply not credible. Based upon all of the foregoing, the court concludes that this chapter 7 case was not filed in good faith. Accordingly, an order will be entered contemporaneously with the filing of this memorandum opinion dismissing the chapter 7 case of the debtor.

FILED: September 1, 2000

BY THE COURT

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY COURT