UNITED STATES BANKRUPTCY APPELLATE PANEL
FOR THE FIRST CIRCUIT

BAP No. MW 99-034

IN RE: ROBERT H. STURTEVANT,
IN RE: BARBARA J. STURTEVANT,
Debtors.

WASHINGTON SAVINGS BANK,
Appellant,

v.

ROBERT H. STURTEVANT AND
BARBARA J. STURTEVANT,
Appellees.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. Henry J. Boroff, U.S. Bankruptcy Judge)

Before
Votolato, Lamoutte, Vaughn, U.S. Bankruptcy Judges

Michael B. Feinman and Mark D. Johnson, for the Appellant.

Patrick J. Wood, for the Appellees.

July 10, 2000

Lamoutte, J.

Secured creditor Washington Savings Bank (WSB) appeals the bankruptcy court's denial of its complaint objecting to the discharge of Robert and Barbara Sturtevant. The issues before the panel are whether the bankruptcy court erred in finding the debtors' testimony "credible"; whether the bankruptcy court erred in the burden of proof it applied to the appellant creditor; and whether the bankruptcy court erred in failing to make proper findings of fact pursuant to Fed. R. Bankr. P. 7052.

Jurisdiction and Standard of Review

The bankruptcy court's findings of fact are reviewed under a clearly erroneous standard, while its legal conclusions are reviewed *de novo*. Jeffrey v. Desmond, 70 F.3d 183 (1st Cir. 1995); In re SPM Mfg. Corp., 984 F.2d 1305 (1st Cir. 1993). The question of whether the debtor had the necessary wrongful intent under § 727(a)(2)(a) is a question of fact which is reviewed on appeal under a clearly erroneous standard. 6 Lawrence P. King, et al., Collier on Bankruptcy ¶ 727.02[3][d] at 727-21, citing Commerce Bank & Trust Co. v. Burgess (In re Burgess), 955 F.2d 134 (1st Cir. 1992).

Background

On January 23, 1996, Barbara Sturtevant filed a voluntary petition under Chapter 13 of the Bankruptcy Code. Her case was voluntarily converted to Chapter 7 on February 13, 1998. On April 24, 1998, Robert Sturtevant filed a voluntary petition under Chapter 7 of the Code. Washington Savings Bank (WSB) is a secured creditor of both parties, its claim secured by a property located at 287 Pleasant Street in Lowell, Massachusetts (the "Pleasant Street property"). WSB obtained relief from the automatic stay in Barbara Sturtevant's case and foreclosed on the Pleasant Street property in August of 1997. WSB obtained judgement against Robert Sturtevant in October, 1997.

Debtors Barbara Sturtevant and Robert Sturtevant were married in 1973. They built a house in 1980 (hereinafter referred to as "the Glenellyn property)[1], where they lived while married, and where Barbara Sturtevant continued to reside after the debtors separated. In 1983 their child, Kaitlyn M. Sturtevant, was born. The debtors subsequently separated in 1990.

On December 13, 1993, the debtors created the KMS Realty Trust (named for their child), named themselves as trustees, and transferred various properties to the trust, including Glenellyn.[2] The beneficiary of the trust was Kaitlyn. The debtors state that the trust was created in light of their marital difficulties and out of concern for their daughter's future. The debtors initiated divorce proceedings in 1994 and reached a separation agreement; their divorce decree was entered in January, 1995. The separation agreement provided that Robert would pay the mortgage on the Glenellyn property (in lieu of child support) and entitled him to take the tax deduction thereon. However, he defaulted on this mortgage agreement in 1997 and foreclosure proceedings were initiated. In order to prevent foreclosure, the debtors sought to refinance the property.[3]

On January 27, 1998, the debtors, acting on behalf of the Trust, executed a deed transferring the Glenellyn Property to themselves, and then on that same date executed a mortgage and promissory note encumbering the property to the Lowell Cooperative Bank for $135,000. Thereafter, Robert Sturtevant transferred his interest to Barbara. Title to the property remains in the

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[1]During the course of their marriage, the debtors built several properties, including "Mission Place" in 1984, "Pleasant Street" in 1987, and "Ludlam Street" in 1987.

[2]The Ludlam Street property was being foreclosed and therefore was not transferred to the trust. The foreclosure deed was executed on December 14, 1993 and resulted in a deficiency obligation for the debtors.

[3]On January 9, 1998, Barbara Sturtevant filed a motion in her bankruptcy case for authority to refinance the Glenellyn Property.

name of Barbara Sturtevant. The debtors state that the transfer of the property out of the trust was necessary in order for the bank to agree to refinance the property.

After the Rule 2004 examination of the debtors, WSB filed adversary proceedings against each of the debtors on August 28, 1998, objecting to their discharge. These proceedings were consolidated and a hearing was held on April 16, 1999. At the trial the court found credible the debtors' testimony that they acted to protect the interests of their minor daughter. The court found that the debtors lacked the requisite intent to deny their discharge under § 727(a)(2)(A) and § 727(a)(4)(A). Accordingly, the bankruptcy court entered judgment in favor of the debtors on WSB's complaint objecting to discharge.

WSB argues that the debtors have made many misrepresentations regarding their finances during the course of these proceedings, including in their petitions, at their Rule 2004 examinations, and at the hearing on the objection to discharge. According to WSB, the court erred in finding the debtors' testimony credible, because it presented substantial documentary and testimonial evidence to contradict the debtors' testimony, which should have led the court to deny their discharge under §§727(a)(2)(A) and 721(a)(4)(A). WSB also argues that it proved by a preponderance of the evidence that the debtors intended to defraud their creditors by playing a "real estate shell game", and therefore the court must have applied a heavier burden of proof than provided by law. WSB states that once it met its burden of proof, the burden shifts to the debtors to prove that their oaths were not false, and they failed to do so. Finally, WSB argues that the bankruptcy court failed to make proper findings of fact pursuant to Fed. R. Bankr. P. 7052. It argues that the court's decision was based solely upon the credibility of the witnesses, and it failed to elaborate its findings.

Debtors argue that the court's findings are not clearly erroneous. According to debtors, the evidence presented supports the court's findings that they acted out of concern for their minor child and as a result of their marital discord, and not with intent to hinder, delay or defraud creditors.

Discussion

Sections 727(a)(2)(A) and 727(a)(4)(A)

Section 727(a)(2)(A) of the Bankruptcy Code provides an exception to discharge for a debtor who, "with intent to hinder, delay or defraud a creditor...has transferred, removed, destroyed, mutilated, or concealed...property of the debtor, within one year before the date of the filing of the petition." Section 727(a)(4)(A) provides an exception to discharge for a debtor who "knowingly and fraudulently, in or in connection with the case–made a false oath or account." WSB bases its objection to debtors' discharge on these provisions of the Code, arguing that the debtors transferred properties to the trusts intending to hinder and delay their creditors, and then failed to disclose certain assets in their schedules and testimonies within their cases.

These provisions denying discharge to a debtor are construed liberally in favor of the debtor and strictly against the creditor. 6 Lawrence P. King, et al., Collier on Bankruptcy ¶ 727.01[4] (15th ed. rev. 1999). In order to sustain an objection to discharge under § 727(a)(2), the objecting creditor must prove:

> (1) that the act complained of was done within one year before the date of the filing of the petition;
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> (2) that the act was done with actual intent to hinder, delay or defraud the creditor;
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> (3) that the act was that of the debtor; and
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> (4) that the act consisted of transferring, removing, destroying or concealing any of the debtor's property, or allowing it to be done.

Collier, ¶ 727.02[1] at 727-13. See also, In re Hayes, 229 B.R. 253, 259 (B.A.P. 1st Cir. 1999). With regard to the first requirement, if the act objected to occurred more than a year before the bankruptcy was filed, it still may be a basis for objection if it constitutes a "continuing concealment". Id. at 727.02[2][b]. The debtor's failure to disclose the transaction in the schedules may provide evidence of the concealment. Id. However, more than mere retention of possession is required to prove concealment; a showing that the debtor retained an interest in the transferred property is required. Id. Additionally, the creditor must show that the debtor's continued concealment intended to hinder, delay or defraud - not that the original transfer so intended. Id. The continuing concealment doctrine must not be used to short circuit the requirements of § 727(a)(2)(A); the creditor must prove that the requisite conduct, accompanied by the requisite intent, actually occurred within the year preceding bankruptcy. Hayes, 229 B.R. at 260.

Section 727(a)(2) provides that the action complained of must have been done with intent to hinder, delay or defraud a creditor. Absent specific intent to hinder, delay or defraud creditors, a discharge should not be denied. Collier, ¶ 727.02[3][a] at 727-17. The objecting creditor must prove that the debtor acted with actual intent to hinder, delay or defraud. In re Sterman, 244 B.R. 499 (D. Mass. 1999). For example, a transfer in good faith is not one made with actual intent, and constructive intent is insufficient to bar discharge. Collier, ¶ 727.02[3][a] at 727-17. Since actual intent will rarely be proven by direct evidence, a finding of actual intent may be based upon circumstantial evidence, or may be inferred from a course of conduct. Collier, ¶ 727.02[3][b] at 727-18; Sterman at 4. Circumstances indicating fraud may include:

> – the lack or inadequacy of consideration;
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> – the family, friendship or close associate relationship between the parties;
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> – the retention of possession, benefit or use of the property in

question;

– the financial condition of the party sought to be charged both before and after the transaction in question;

– the existence or cumulative effect of a 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; and

– the general chronology of the events and transactions under inquiry.

Id., citing In re Kaiser, 722 F.2d 1574 (2nd Cir. 1983). These so-called "badges of fraud" support a finding of actual intent, especially where there is no adequate rebuttal or explanation. Sterman at 4. Determinations of fraudulent intent depend largely upon an assessment of the credibility and demeanor of the debtor. Id.

In order to justify denial of discharge, the transfer must be an actual transfer of valuable property belonging to the debtor which reduced the assets available to the creditors and which was made with fraudulent intent. Collier, ¶ 727.02[5] at 727-25. A transfer is a disposition of an interest in property, and any transfer of an interest in property is a transfer, including a transfer of possession, custody, or control, even if there is no transfer of title. Id. at 727-26. Transfer includes the creation of security interests by consensual transaction, such as the execution of mortgages and deeds of trust. Id.

Pursuant to § 727(a)(4)(a) of the Code, a debtor may be denied a discharge if he knowingly and fraudulently, in or in connection with the case, made a false oath or account. It applies to sworn as well as unsworn declarations. Collier, ¶ 727.04[1][a] at 727-38. The analysis of what constitutes intent to defraud under § 727(a)(2) is applicable to § 727(a)(4); however, under § 727(a)(2) the debtor must intend to defraud a creditor or officer of the estate in order for his discharge to be barred, while under § 727(a)(4) there is no such limit on the object of debtor's fraudulent intent. Id. at 727-

39. The plaintiff bears the burden of proof on the elements necessary to sustain the charge of false oath; however, the requisite intent may be inferred from the facts. Id.

The false oath alleged under § 727(a)(4) must be material; that is, it must relate to the debtor's business transactions or the discovery of assets, business dealings, or the existence or disposition of debtor's property. Id. at ¶ 727.04[1][b]; Sterman at 11. The omission may be material if it adversely affects the creditor's ability to discover other assets or to fully investigate the debtor's pre-bankruptcy dealings and financial condition. Id. at 727-40. A false oath sufficient to deny discharge under § 727(a)(4) may be a false statement or omission in the debtor's schedules, or a false statement at an examination during the course of the proceedings. Id. at ¶ 727.04[1][c]. However, if an item was omitted from the schedules by mistake or upon honest advice of counsel, the declaration is not wilfully false. Id. at ¶ 727.04[2].

The bankruptcy court analyzed three cases decided by the First Circuit Court of Appeals which are relevant to the issues herein. In Boroff v. Tully (In re Tully), 818 F.2d 106 (1st Cir. 1987), the court affirmed the bankruptcy court's denial of discharge to a chapter 7 debtor who was found to have intentionally omitted assets from his schedules. The court noted that § 727(a)(4)(A) invokes competing considerations. Id. at 110. "On the one hand, bankruptcy is an essentially equitable remedy," so "the statutory right to a discharge should ordinarily be construed liberally in favor of the debtor." Id. "On the other hand, the very purpose of certain sections of the law, like 11 U.S.C. § 727(a)(4)(A), is to make certain that those who seek the shelter of the bankruptcy code do not play fast and loose with their assets or with the reality of their affairs." Id. The court found that there was ample evidence on the record to support a conclusion by the bankruptcy judge that the debtor exhibited "reckless indifference to the truth", which is "the functional equivalent of fraud for purposes of § 727(a)(4)(A)." Id. at 112.

In Commerce Bank & Trust Co. v. Burgess (In re Burgess), 955 F.2d 134 (1st Cir. 1992), abrogated on other grounds by Field v. Mans, 516 U.S. 59 (1995), the court affirmed the bankruptcy court's dismissal of an action objecting to discharge and the dischargeability of a debt. It rejected the Bank's claim that the bankruptcy court committed reversible error by granting the debtor a discharge notwithstanding the fact that he made several allegedly false statements in violation of § 727(a)(4)(A), noting that the Bank pointed to no real and substantial evidence that the debtor's misstatements were made with fraudulent intent and failed to produce evidence that the alleged misstatements were material. Id. at 137. The Court further found that the Bank failed to show clear error in the bankruptcy court's finding that the transfers were not made with intent to hinder, delay or defraud creditors and thus were insufficient to bar discharge under § 727(a)(2)(A).

The bankruptcy court herein reconciled the decisions in Tully and Burgess, noting that the omissions in Tully were found to be material, while those in Burgess were not. It further noted that the bankruptcy court in Tully had found an intent to deceive, while in Burgess the bankruptcy court did not find such intent. The bankruptcy court then turned its analysis to the case of Palmacci v. Umpierrez, 121 F.3d 781 (1st Cir. 1997). In that case, a creditor objected to the dischargeability of his debt because he claimed it was the product of false representations by the debtor. The bankruptcy court's finding that the debt was dischargeable was affirmed by the court of appeals, which noted that "[d]eference to the bankruptcy court's factual findings is particularly appropriate on the intent issue '[b]ecause a determination concerning fraudulent intent depends largely upon an assessment of the credibility and demeanor of the debtor.'" Id. at 785, citing Burgess, 955 F.2d at 137. The court of appeals upheld the bankruptcy court's conclusion that the evidence presented did not infer fraudulent intent, noting "[i]t is the province of the trial court to determine this issue: the court may choose to infer intent, or not to draw that inference, based on all the evidence." Id. at 790.

Applying the analysis of these cases to the facts before it, the bankruptcy court found that the debtors acted with the intent to effectuate the agreement they had reached with regard to providing for their minor child, in light of their marital difficulties. The bankruptcy court found that they did not act with intent to hinder, delay or defraud their creditors, and therefore should not be denied discharge under § 727(a)(2)(A). The bankruptcy court also noted that while there were certain omissions from the debtors' schedules which should have been updated, they were not sufficient to constitute an exception to discharge under § 727(a)(4)(A).

This panel has reviewed the transcript of the hearing, and concludes that the bankruptcy court's findings are not clearly erroneous, but rather are supported by the evidence. For example, the debtors testified that their intent in creating the trust was to avoid Barbara having to deal with Robert's prospective new wife in the event something should happen to him and so that she could take care of herself and Kaitlyn in the future. (Tr. at 13, 21- 22, 49, 83). Furthermore, they testified that although the Ludlam Street property was being foreclosed at the time the trust was created, the transfer of the other properties to the trust was not done in order to avoid obligations. (Tr. at 21). Rather, they understood that they were still obligated on the mortgage notes of the properties transferred to the trust, and believed that because of the real estate situation at the time, the bank would not collect on the defaulted mortgages. (Tr. at 21, 53, 55). This testimony constitutes an adequate basis for the bankruptcy court's findings and conclusions.

Burden of proof

Under § 727(a) of the Bankruptcy Code, the burden of persuasion rests with the party opposing the debtor's discharge, and the objecting party must prove each element of its objection to a discharge by a preponderance of the evidence. Fed. R. Bankr. P. 4005; In re Sterman, 244 B.R. 499, (D. Mass. 1999), citing In re Burgess, 955 F.2d at 136; cf. Grogan v. Garner, 498 U.S. 279, 286-87 (1991).

WSB argues that the bankruptcy court erred in weighing the evidence that it received. According to WSB, it presented ample documentary and testimonial evidence to contradict the debtors' testimony. WSB believes that it proved by a preponderance of the evidence that the debtors intended to defraud their creditors, and that since the bankruptcy court found for the debtors it must have applied a heavier burden of proof to it than that provided by law. However, WSB has not indicated any specific examples of documentary evidence which it submitted or testimonial evidence which it elicited which demonstrate error on the part of the bankruptcy judge, and there is no basis for the Panel to conclude that it was error for the bankruptcy judge to find that the debtors lacked the requisite intent to deny their discharge under §§727(a)(2) and (4). As noted by the First Circuit in Burgess, "[t]he Bank's exclusive reliance on its conclusory assertion that the [debtor's] testimony should not have been believed falls far short of a showing of clear error in the bankruptcy court's finding that these transfers were not made with 'intent to hinder, delay or defraud.'" 955 F.2d at 138.

Fed. R. Civ. P. 7052

Finally, WSB argues that the bankruptcy court failed to make proper findings of fact pursuant to Fed. R. Bankr. P. 7052. That rule makes Fed. R. Civ. P. 52 applicable to adversary proceedings in bankruptcy, and provides "[i]n all actions tried upon the facts without a jury or with an advisory jury, the court shall find the facts specially and state separately it's conclusion of law thereon, and judgment shall be entered pursuant to Rule 58." The rule further provides that "[f]indings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." Finally, the rule provides "[i]t will be sufficient if the findings of fact and conclusions of law are stated orally and recorded in open court following the close of the evidence...."

Findings of fact and conclusions of law may be incorporated into an opinion by the court, or may be rendered orally if recorded in open court following the close of the evidence. Collier, ¶ 7052.02 at 7052-5. In order to enable the appellate court to determine the basis for the lower court's decision, the findings must be more than conclusory. Id. In fact, the purpose of findings of fact is threefold: to help the trial judge's process of adjudication; for purposes of res judicata and collateral estoppel; and to aid the appellate court on review. Id.

A finding of fact is clearly erroneous, although supported by evidence, "when the reviewing court, after carefully examining all the evidence, is 'left with the definite and firm conviction that a mistake has been committed.'" Palmacci v. Umpierrez, 121 F.3d 781, 785 (1st Cir. 1997). Further, "[d]eference to the bankruptcy court's factual findings is particularly appropriate on the intent issue '[b]ecause a determination concerning fraudulent intent depends largely upon an assessment of the credibility and demeanor of the debtor.'" Id.

At the conclusion of the hearing, the bankruptcy court made findings of fact pursuant to R. 7052. Specifically, the court found:

> 1) the debtors transferred their properties into the KMS Real Estate Trust in 1993 in order to protect their child and avoid "an unwelcome probate turn of events" should Robert remarry. (Tr. at 131).
>
> 2) there was no intent to conceal the transfer of the properties to the trust from creditors. (Tr. at 131).
>
> 3) the debtors' actions, from the creation of the trust in 1993

throughout the course of their petitions, are not consistent with an intent to defraud or perjure, but rather demonstrate “significant confusion” over how to legally effectuate the agreement they reached in 1993. (Tr. at 132).

4) the omissions from Robert Sturtevant’s schedules are relevant, but are not sufficient to constitute an exception to discharge under §727 (a)(4), as that type of omission and misstatement was rejected by the First Circuit in Commerce Bank & Trust Co. v. Burgess (In re Burgess).

5) Barbara Sturtevant’s failure to update her schedules is serious but does not constitute a false oath under § 727(a)(4). (Tr. at 134).

6) there were no material omissions or misstatements, no concealment sufficient to deny discharge to the debtors. (Tr. at 134).

It is the conclusion of the Panel that the bankruptcy judge focused on the debtors’ intent to hinder, delay or defraud creditors, - an essential element to bar discharge under §§727(a)(2) and (a)(4), evaluated the evidence, and concluded that said evidence did not show the intent required by §§727(a)(2) & (4). Accordingly, we rule that the bankruptcy court’s findings were made in accordance with Rule 7052, and that the requirements of that rule have been fulfilled.

Conclusion

Upon review of the record before it, the panel finds that the bankruptcy court’s ruling was not clearly erroneous, and that the findings made at the hearing on WSB’s motion are sufficient to support it’s conclusion. Accordingly, the bankruptcy court‘s denial of WSB’s complaint denying the debtors their discharge is affirmed.

SO ORDERED.