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JUDGE: M. A. Mahoney

PARTIES: John Sherrell Jacobs, Colonial Bank, Joseph O. Verneuille, Jr.

CHAPTER: 7

ATTORNEYS: A. R. Maples, Jr., D. I. Littleton

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KEY WORDS:

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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In re

JOHN SHERRELL JACOBS,

Case No. 99-11751-MAM-7

Debtors.

COLONIAL BANK and
JOSEPH O. VERNEUILLE, JR., TRUSTEE,

Adv. No. 99-1234

Plaintiffs,

v.

JOHN SHERRELL JACOBS, et al.,

Defendants.

**ORDER DETERMINING DISCHARGE OF DEBTOR TO BE PROPER
AND CONVEYANCE TO TRUSTS TO BE VALID**

A. Richard Maples, Jr., Mobile, Alabama, Attorney for Trustee
Denise I. Littleton, Mobile, Alabama, Attorney for Debtor

This matter is before the Court on the complaint of the Trustee objecting to the granting of a discharge and seeking to invalidate the defendant trusts and conveyance of a condominium unit to the trusts. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and the Court has the authority to enter a final order. For the reasons indicated below, the Court determined that discharge of the Debtor is proper and the trusts and conveyance of the condominium unit to the trusts are valid.

FACTS

On October 22, 1987, Mr. Jacobs executed two revocable living trust agreements for the benefit of his two children and funded each trust with \$750. The income and principal was to be used to further the education of Mr. Jacobs' children. There was no evidence as to whether any other monies or assets were ever placed in these trusts. On August 17, 1994, Mr. Jacobs executed two irrevocable living trust agreements for the benefit of his two children and funded each trust with \$750. The income and principal of these trusts were also for the purpose of furthering the education of the beneficiaries. Again, there was no evidence of any other transfers of assets to these trusts. On August 28, 1997, Mr. Jacobs and his wife, Shirley H. Jacobs, obtained a judgment of divorce under which the properties located at 8064 Cambridge Way, Mobile, Alabama and 320 Cavalier, Dauphin Island, Alabama were to be sold. Mr. Jacobs had the right to occupy the Dauphin Island property pending the sale of that property. The divorce judgment also required Mr. Jacobs to be responsible for all expenses associated with the youngest child's continued enrollment at a private high school and for the tuition, fees, books and related expenses incurred for the oldest child's enrollment in college. On October 7, 1997, Mr. Jacobs again executed irrevocable living trust agreements for the benefit of his children which were substantially the same as the trusts executed in August 1994.¹ There was no evidence as to the existence of assets in the trusts or the origins of any assets which may have been placed in the trusts. On October 10, 1997, Mr. Jacobs, as trustee and grantee, acquired by

¹Only the daughter's trust agreement was offered in evidence, but the deed of the Cedar Bend property to the trust indicated there was a trust for each child.

warranty deed, Apartment Unit No. B, Building 8, Cedar Bend Court. There was no evidence as to the source of funds for this property which was deeded to the trusts.

Mr. Jacobs entered into a loan agreement with Colonial Bank on February 10, 1998. On the application for the loan, Mr. Jacobs stated that the loan was to be used for personal living expenses until he could sell his “ex-residence.” Mr. Jacobs listed his then present address as the Cedar Bend property and his previous address as the Cambridge property. Under assets on the application, Mr. Jacobs listed the Cedar Bend property which he valued at \$76,000. He also stated that the property was not subject to any debt. Mr. Jacobs listed the value of the Cambridge property at \$75,000, and indicated there was equity in the house and that it would be sold. He did not indicate the existence of any trusts holding any interest in any assets.

Mr. Sands was commercial lender and vice-president for Colonial Bank at the time Mr. Jacobs applied for the loan and had known Mr. Jacobs for several years. He loaned money to Mr. Jacobs on several occasions. Mr. Sands testified that in determining whether to loan Mr. Jacobs money, the Bank relied on the proceeds to come from the sale of the Cambridge residence. Mr. Sands stated that he was aware of the trust agreements and knew that the Cedar Bend property was involved in the trusts because he had entered into loan agreements concerning that property before with Mr. Jacobs and had to go through the trust paperwork. Mr. Sands testified further that the bank was not looking to the Cedar Bend property for payment and did not take a security interest in the Cedar Bend property.

Mr. Jacobs filed for relief pursuant to chapter 7 of the Bankruptcy Code on May 18, 1999. At the time of filing, the total amount due under the loan agreement including interest and attorney’s fees was \$12,526.79. This debt to Colonial Bank was listed on Mr. Jacob’s schedule F as an unsecured nonpriority claim. In his schedules and statement of affairs, Debtor showed

his address as 6449-B Cedar Bend Court, but listed no interests in real property on schedule A of his petition. Also, his expenses did not include a rent or mortgage payment. Under other transfers within a year before filing, Debtor listed the sale of his former marital homeplace (the Cambridge Way property) in December 1998 and indicated that the equity was paid to Mr. Jacobs' ex-wife for back child support and \$4,500 went to Debtor.

LAW

The Trustee² filed this three count complaint (A) to object to the granting of a discharge to the debtor, Mr. Jacobs, on the grounds set forth in 11 U.S.C. § 727(a)(2) (Count I); (B) to determine the debt to Colonial Bank to be nondischargeable under § 523(a)(2)(B) (Count II); and (C) to invalidate the defendant trusts and conveyance of a condominium unit to the trusts pursuant to the Alabama Fraudulent Transfer Act, Ala. Code § 8-9A-1 (1975) (Count III). Each count will be discussed below in turn.

The burden of proof is on the Trustee in this case and he must prove his case by a preponderance of the evidence. *Grogan v. Garner*, 498 U.S. 279, 111 S. Ct. 654, 112 L. Ed. 2d 758 (1991). *Grogan* held that proof of fraud for purposes of determining debt dischargeability pursuant to 11 U.S.C. § 523(a)(2) only required a preponderance of the evidence. Although *Grogan* was a dischargeability case under 11 U.S.C. § 523, its reasoning has been utilized to find that only a preponderance is necessary in all bankruptcy matters, including fraud situations. *In re*

²The complaint was originally filed by Colonial Bank against Mr. Jacobs. The Bank and Jacobs settled their disputes and the Court approved a compromise of the Bank's complaint on August 24, 2000. On May 10, 2000, the Trustee was added as a plaintiff in this case. The compromise between Jacobs and the Bank did not include the Trustee's claims. Therefore, this trial was between the Trustee and the defendants only.

Scott, 172 F.3d 959 (7th Cir. 1999); *In re Adams*, 31 F.3d 389 (6th Cir. 1994); *Matter of Allison*, 960 F.2d 481, 485 (5th Cir. 1992).

A.

Count I

The fundamental importance of discharge and fresh start in the bankruptcy process dictates that exceptions to discharge be strictly or narrowly construed. *In re Hunter*, 780 F.2d 1577, 1579 (11th Cir. 1986). However, courts loath rewarding a debtor who attempts to take advantage of the bankruptcy process to avoid the consequences of his misdeeds; only the honest, unfortunate debtor is generally afforded relief from his obligations. *TranSouth Financial Corp. of Florida v. Johnson*, 931 F.2d 1505, 1508 (11th Cir. 1991).

Under § 727 (a), the court shall grant a discharge unless:

(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; or

(B) property of the estate, after the date of the filing of the petition;

The Trustee claims that Mr. Jacobs, although the true owner of the Cedar Bend property concealed his ownership with intent to hinder, delay or defraud, his creditors. If Jacobs did not own the property at the time of filing, then there was no concealment. There is no question that legal title to the property was in the children's trusts. The transfer to the trusts occurred in 1997, more than a year before Jacob's bankruptcy, so that transfer is not actionable unless the transfer was fraudulent and the fraud continued to mask the real situation--that Jacobs owned the property. The Court will discuss the issues in part C below.

B.

Count II

The Debtor and Colonial Bank compromised the dischargeability complaint as to the Bank's debt. The Trustee was not pursuing this claim because it has no value to the other creditors. The Trustee did not argue that he had a right to pursue this claim. In fact case law would indicate the Trustee has no standing to bring the personal claim of a creditor where no other claimant or creditor has an interest in the cause. *See Caplin v. Marine Midland Grace Trust Co. of New York*, 406 U.S. 416, 92 S. Ct. 1678, 32 L. Ed. 2d 195 (1972).

C.

Count III

The Trustee contends that the creation of the trusts and transfers to the trusts were fraudulent pursuant to the Alabama Fraudulent Transfer Act, Ala. Code § 8-9A-1 (1975). Two types of fraudulent transfers, actual and constructive, are within the scope of the Alabama Fraudulent Transfer Act. *See McPherson Oil Co., Inc. v. Massey*, 643 So.2d 595 (Ala.1994). An actual fraudulent transfer is one made by a debtor who transfers assets "whether the creditor's claim arose before or after the transfer was made, with actual intent to hinder, delay, or defraud any creditor of the debtor." Ala. Code § 8-9A-4(a) (1975). A constructive fraudulent transfer occurs when a debtor transfers assets to another without receiving reasonably equivalent value, and the debtor was, or became, insolvent at the time of the transfer. Ala. Code § 8-9A-5(a) (1975); *McPherson Oil, supra*. Constructive fraud is applicable only as to a creditor whose claim arose before the transfer was made. Ala. Code § 8-9A-5(a) (1975). The debt to Colonial Bank arose after the transfer was made and thus, constructive fraud would not apply. However, the Trustee steps into the shoes of any creditor with an unsecured claim against the debtor as of

the petition date and can assert state law causes of action on their behalf. *In re Sethi*, 250 B.R. 831, 840 (Bankr. E.D.N.Y. 2000); *In re Mortgageamerica Corp.*, 714 F.2d 1266, 1272 (5th Cir. 1983). Thus, if any of the unsecured claims arose prior to the transfer then constructive fraud could apply.

1.

Actual Fraud

As to actual fraud, the primary issue is the intent of the debtor. The trial court considers several factors in determining whether the debtor possessed the requisite intent, including to whom the transfer was made, the amount of assets transferred, and the financial condition of the debtor before and after the transfer. Ala. Code § 8-9A-4(b) (1975); *McPherson Oil, supra*.

Under Ala. Code § 8-9A-4(b), eleven badges of fraud are listed as factors to consider in analyzing a transfer.

- (1) The transfer was to an insider;
- (2) The debtor retained possession or control of the property transferred after the transfer;
- (3) The transfer was . . . concealed;
- (4) Before the transfer was made the debtor had been sued or threatened with suit;
- (5) The transfer was of substantially all the debtor's assets;
- (6) The debtor absconded;
- (7) The debtor removed or concealed assets;
- (8) The value of the consideration received by the debtor was [not] reasonably equivalent to the value of the asset transferred;
- (9) The debtor was insolvent or became insolvent shortly after the transfer was made;
- (10) The transfer occurred shortly before or shortly after a substantial debt was incurred;
- and
- (11) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Jacob's actions fulfill many of these factors as shown by the facts stated above. However, the factors showing intent do the trustee no good in this case.

The very basic issue not proven by a preponderance of evidence in this case is whether a “transfer” occurred at all. Did Jacobs provide the funds to purchase the Cedar Bend property or did the money come from funds already in the children's trusts? Because a “transfer” is not shown, there are not enough concrete facts from which the intent to hinder, delay, or defraud could be inferred. The facts show that some of the badges of fraud were present if the Dauphin Island home sale proceeds of Jacobs were used to fund the Cedar Bend purchase. Property was transferred to Jacobs’ children’s trusts and he used the property as his own residence at no cost except upkeep. The transfer was not hidden. The transfer occurred four months before he incurred his major bankruptcy debt to Colonial Bank. The crucial holes in the case are the source of the money for the Cedar Bend purchase, the state of Jacobs’ finances at the time of the transfer (if his money was used), which set of trusts was used, and the assets held by the trusts.

The Trustee speculates (as does the Court) that the source of funds for Cedar Bend was the sale of Jacobs’ Dauphin Island property, but this is not proven by a preponderance of the evidence. The Court concludes it cannot assume this fact. Therefore, the Trustee has not sustained his burden of proof as to actual fraud. The Trustee has not sustained his burden of proof as to a transfer by Jacobs which would prevent his discharge.

2.

Constructive Fraud

As noted above a transfer constitutes constructive fraud when a debtor transfers assets to another without receiving reasonably equivalent value, and the debtor was, or became, insolvent at the time of the transfer. Ala. Code § 8-9A-5(a) (1975); *McPherson Oil, supra*. This type of fraud is applicable only as to a creditor whose claim arose before the transfer was made. Ala. Code § 8-9A-5(a) (1975). If there is a creditor whose claim arose before the transfer was

made, the Trustee can assert a constructive fraud claim on their behalf. However, it is not clear from the schedules that any of the claims arose before October 10, 1997, nor was any evidence offered supporting that fact. Even if there is a claim that arose before the transfer, the Trustee has not met his burden of proof as to the other elements of constructive fraud.

The elements of constructive fraud are the same as the eighth and ninth “badges of fraud” listed above. The Trustee must show by a preponderance of the evidence that equivalent value was not given and that debtor was or became insolvent at the time of the transfer. As discussed above, the trusts were created and the Cedar Bend property was transferred to the trusts for the benefit of his children’s education. There was an antecedent debt that was being satisfied by the transfer of property to the trusts. Again it is unclear where the money to buy the Cedar Bend property arose and which trusts hold the Cedar Bend property, but it is clear that the Trustee has not met his burden of proving the element by a preponderance of the evidence.

THEREFORE, IT IS ORDERED AND ADJUDGED:

1. Count I of Trustee’s complaint objecting to the granting of a discharge to John Sherrell Jacobs is DENIED.
2. Count III of Trustee’s complaint to invalidate the defendant trusts and conveyance to the trusts as Fraudulent Transfers is DENIED.

Dated: February 13, 2001

MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE