United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

Jeremy Hoffman, Plaintiff,
v. Paul H. Sabaska and Amy S. Sabaska, Defendants
(In re: Paul H. Sabaska and Amy S. Sabaska, Debtors)
Bankruptcy Case No. 08-11068-7
Adv. Case No. 08-106

United States Bankruptcy Court
W.D. Wisconsin, Eau Claire Division

February 6, 2009

Jay E. Heit, Herrick & Hart, S.C., Eau Claire, WI, for plaintiff
Lawrence J. Kaiser, Kaiser, Ltd.,Eau Claire, WI, for defendants

Thomas S. Utschig, United States Bankruptcy Judge

ORDER

The Court conducted the trial in this adversary proceeding on January 16, 2009. At the close of evidence, the plaintiff withdrew the portion of his complaint which alleged that his claim was nondischargeable under 11 U.S.C. § 523(a)(4). The remaining portion of the complaint alleged that the debtors' discharge should be denied under either 11 U.S.C. § 727(a)(2) or 727(a)(5). Based upon the record, the Court makes the following findings of fact and conclusions of law.

The debtor, Paul Sabaska, used to operate a trucking business called Midwest Motors, LLC. A number of years ago, Mr. Sabaska and the plaintiff, Jeremy Hoffman, entered into an agreement, apparently memorialized by a three-line document which was not presented at trial, under which Mr. Hoffman was to receive a 49% interest in Midwest Motors if he satisfactorily fulfilled certain conditions. The parties agree that Mr. Hoffman worked for Midwest Motors for several years, but never received the ownership interest. According to Mr. Hoffman, he fulfilled the conditions, and when Mr. Sabaska refused to honor the agreement, Mr. Hoffman filed suit in Chippewa County.

The lawsuit went to trial, and Mr. Hoffman was awarded judgment in the approximate amount of $200,000.00. In the wake of this judgment, Mr. Sabaska and his wife filed a chapter 13 case to attempt to reorganize. Mr. Hoffman objected to confirmation of their chapter 13 plan. The testimony at trial indicated that the debtors were unable to resolve various confirmation issues, including

federal tax problems associated with operation of the Midwest Motors business. The chapter 13 case was dismissed in August of 2007. In October of 2007, Mr. Hoffman garnished an account at Northwestern Bank and obtained $8,465.73.

At about the same time, Mr. Sabaska assigned the leases of four semi-tractors which had been used in the business of Midwest Motors to a new entity called A&P Express. This company is owned by his aunt, Amy Dixon. All of the vehicles were subject to a master vehicle lease which prohibited assignment of the lease without prior written consent of the lessor, Wallwork Financial Corporation. Notably, it was Mr. Sabaska, not Midwest Motors, who was the lessee of the vehicles. Mr. Sabaska acknowledges that he did not obtain the lessor's consent before he assigned the vehicle leases to A&P Express. The arrangement with his aunt provided that Mr. Sabaska would be paid 80% of the hauling jobs he completed using the vehicles now assigned to A&P Express. Essentially, this meant the end of Midwest Motors as an ongoing business, and Mr. Sabaska indicated he closed the company at this time.

The debtors then filed this chapter 7 case in March of 2008. During the pendency of the case, the lessor of the semi-tractors obtained relief from the automatic stay and reclaimed them. Meanwhile, Mr. Hoffman filed this adversary proceeding, contending that the debtors transferred assets with the intent to hinder, delay, or defraud creditors in violation of § 727(a)(2), or that they failed to satisfactorily explain a loss or diminution in assets in violation of § 727(a)(5). Under either scenario, he requests that the Court deny the debtors' discharge. His basic contention is that by assigning the leases to A&P Express and shutting down the operation of Midwest Motors, Mr. Sabaska embarked upon a scheme to hide or conceal assets from the reach of creditors. As the plaintiff, it is Mr. Hoffman's burden to prove the essential components of his claims.

As a preliminary matter, the Court finds no basis for denying the discharge of Amy Sabaska. Mrs. Sabaska was not a party to the underlying lawsuit, did not have an ownership interest in Midwest Motors, and did not work for the company in any way identified for the Court. There was no evidence that she played a part in the transfer of the vehicles, the termination of Midwest Motors' business operations, or her husband's employment arrangements with the new entity. Further, the plaintiff did not present any evidence of wrongful intent on her part. Consequently, the plaintiff has produced insufficient evidence to justify the denial of her discharge under § 727(a)(2). See Emerging Vision, Inc. v. Sundstrom (In re Sundstrom), 374 B.R. 663, 669 (Bankr. E.D. Wis. 2007). Since she was not involved in the alleged transfer, nor involved with the Midwest Motors business, the plaintiff has likewise failed to demonstrate that she once owned "substantial and identifiable assets" which are no longer available to creditors, and her discharge cannot be denied under § 727(a)(5).

In order to succeed under § 727(a)(2), a creditor must prove, by a preponderance of the evidence, that the act in question occurred within the year prior to the petition date; that the debtor had the actual intent to hinder, delay, or defraud a creditor or an officer of the bankruptcy estate; and that the act consisted of transferring, removing, destroying, or concealing some portion of the debtor's property. Sundstrom, 374 B.R. at 668-69; see also In re Snyder, 152 F.3d 596 (7th Cir. 1998); In re Agnew, 818 F.2d 1284 (7th Cir. 1987). Proof of harm to creditors is not required to deny the debtor's discharge under this section. Snyder, 152 F.3d at 601; Peterson v. Scott (In re Scott), 172 F.3d 959, 968 (7th Cir. 1999). Further, if fraudulent intent can be shown, it may be irrelevant whether the transfer actually reduced the amount of assets available to the creditor. See Vermillion State Bank v. DeLong (In re DeLong), 323 B.R. 239, 248 (Bankr. W.D. Wis. 2005). However, as with all discharge exceptions, § 727(a)(2) must still be construed strictly against the objecting party and liberally in favor of the debtor. Neary v. Stamat (In re Stamat), 395 B.R. 59 (Bankr. N.D. Ill. 2008).

Essentially, then, there are two components of a § 727(a)(2) action: first, a transfer or concealment of property of the estate, and second, a subjective intent to hinder, delay, or defraud creditors. Structured Asset Servs., L.L.C. v. Self (In re Self), 325 B.R. 224 (Bankr. N.D. Ill. 2005). In this case, the plaintiff identifies the assignment of the truck leases as a "transfer" of estate assets. In Sundstrom, the debtor transferred her entire business operation to a new entity. According to the court, it was not clear whether the debtor actually "disposed of or parted with" the business's assets when she initially owned them as a sole proprietor and subsequently placed them in the name of a corporation that was wholly owned and controlled by her. Nonetheless, the court observed:

> [T]he transfer of ownership, even without diminution of assets available to a creditor, and certainly without loss of control by the debtor, appears to meet the expansive bankruptcy definition of "transfer."

374 B.R. at 669. While in this case the practical effect of the lease assignment is questionable since the debtor maintained control of the vehicles and even listed them on his bankruptcy schedules, the assignment must still be considered a "transfer" for purposes of § 727(a)(2).

As in Sundstrom, however, the real question is whether the plaintiff has demonstrated sufficient evidence of fraudulent intent. Admittedly, direct evidence of a debtor's intent is usually unavailable, and courts are required to infer intent from the circumstances surrounding the action in question. Synder, 152 F.3d at 601. Among the factors to be considered are the lack or adequacy of consideration; the relationships of the parties; the retention of possession, benefit, or use of the property; the financial condition of the debtor; the existence of a pattern of conduct; and the general chronology of the events in question. Village of

San Jose v. McWilliams, 284 F.3d 785, 791 (7th Cir. 2002). During the trial, the plaintiff contended that the debtor's actions prohibited him from attempting further garnishments of the debtor's bank accounts. However, the debtor indicated that the funds he received from A&P Express were deposited into the same accounts. In other words, the debtor's testimony indicated that he was attempting to salvage his trucking career as best he could, not that he was deliberately trying to conceal assets or income from the plaintiff or other creditors.

The plaintiff did not demonstrate that the debtor's financial condition was materially altered by the lease assignment, nor can the debtor's actions be characterized as a pattern of conduct designed to hinder or delay creditors. The vehicles were listed on his schedules, and the payments he received for his labor were deposited into accounts under his control. On his schedules, Mr. Sabaska listed his stock interest in Midwest Motors, valuing it at zero. According to his testimony and his answers to interrogatories, when Midwest Motors stopped operating it owned nothing more than miscellaneous office supplies, and the vehicles were owned or leased by Mr. Sabaska personally. Given the tax problems associated with his business operations (the schedules indicate that he owes approximately $120,000.00 in income and withholding taxes), it was not unreasonable for him to look for some other way to continue operating. The debtor's testimony indicated that he believed he retained a measure of responsibility for the semi-tractors, and he did not appear to think he was actually transferring anything of value away given the lease arrangement with Wallwork. He may have been wrong, but he does not appear to have had a wrongful intent.

Indeed, he seems to have regarded the transfer as little more than a way to continue making money as a truck driver while simultaneously divesting himself of some of the challenges associated with managing the business. Or, to put it another way, he tried to work for someone else rather than continue what appears to have been at best a struggling enterprise. The evidence at trial does not support an inference that the debtor deliberately attempted to conceal the vehicles, their value, or his income from creditors or the bankruptcy estate. When considering the general chronology of events, the Court concludes that the plaintiff has failed to demonstrate that the debtor possessed the subjective wrongful intent necessary to deny his discharge under § 727(a)(2).

The plaintiff next complains that the debtor has failed to satisfactorily explain a substantial loss of assets, and that his discharge should be denied under § 727(a)(5). Under this section, the debtor's discharge may be denied if the debtor has failed to satisfactorily explain any loss of assets or a deficiency of assets to meet the debtor's liability. This section is one of several code provisions designed to relieve creditors of the "full burden" of reconstructing a debtor's financial history and condition. Instead, the burden is on the debtor to fully disclose his financial condition, and the failure to do will lead to the denial of his discharge. Cohen v. Olbur (In re Olbur), 314 B.R. 732 (Bankr. N.D. Ill. 2004). Full financial disclosure is

a “condition precedent” to the granting of a discharge, see Goldberg v. Lawrence (In re Lawrence), 227 B.R. 907, 916 (Bankr. S.D. Fla. 1998), and the success of the bankruptcy system hinges upon each debtor’s veracity and willingness to make full disclosure. Tillery v. Hughes (In re Hughes), 184 B.R. 902, 909 (Bankr. E.D. La. 1995).

An action under § 727(a)(5) occurs in two stages. First, the creditor must demonstrate that the debtor at one time owned substantial and identifiable assets that are no longer available to his creditors. Stamat, 395 B.R. at 76. If this showing is made, the burden then shifts to the debtor to offer a “satisfactory explanation” for the loss or unavailability of those assets. Id. In this case, the only assets identified by the plaintiff are the leased vehicles. The debtor acknowledges his assignment of the vehicles to A&P Express. During his testimony, he indicated that the lessor had recovered the vehicles after the bankruptcy filing. Regardless, the plaintiff did not offer any evidence to show that these vehicles had any value to the estate, and the debtor’s testimony supports the conclusion that even if the leases were treated as disguised security interests, there would be little, if any, equity available to the estate.

Consequently, the Court is compelled to conclude that the plaintiff has not met the burden of demonstrating that the debtor had any significant assets. The plaintiff pointed to the fact that the debtor’s tax returns indicated gross receipts in 2006 of over $2 million, but as the debtor noted, gross receipts are not net income. Indeed, the same tax return reflects 2006 net profits of about $168,000 after deduction of various expenses, including payments to drivers (on terms similar to those currently received by the debtor from A&P Express). The debtor’s 2005 tax returns also reflect a business loss of $134,000, which was offset by the sale of some assets. Taken together, the debtor’s tax returns reflect that his business was struggling to generate a profit after the payment of all expenses, not that he had substantial assets. The semi-tractors appear to have been the only tangible asset of any value left when the debtor terminated operation of Midwest Motors, and the plaintiff has not identified anything else which could have been available to creditors.

Even if the debtor did have substantial assets which are no longer available to creditors, the debtor’s explanations as to the disposition of the vehicles and the Midwest Motors business are credible and, indeed, without contravention. His assignment of the trucks to A&P Express did not alter his actual possession of them, and he acknowledged that fact, even going so far as to list them on his bankruptcy schedules. The subsequent repossession or surrender of the vehicles may be unfortunate, but it is undoubtedly a “satisfactory” explanation of what happened to them. The Midwest Motors business ceased operations due to ongoing problems and had no significant assets when Mr. Sabaska opted to pursue another avenue of employment. The inquiry under § 727(a)(5) is not as to the wisdom of the debtor’s disposition of the assets but instead upon the

"completeness and truth of the debtor's explanation." Clean Cut Tree Serv. v. Costello (In re Costello), 299 B.R. 882, 901 (Bankr. N.D. Ill. 2003). Here, the Court finds the debtor's explanation to be complete and truthful.

Accordingly,

IT IS ORDERED that the plaintiff's claims under §§ 727(a)(2) and (a)(5) are denied, and the case is dismissed. The parties shall bear their own costs.