UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re

SAMUEL POZZANGHERA and
SHARON POZZANGHERA

Case No. 90-13670 K

Debtors

MICCICHE, INC.

Plaintiff

-vs-

AP 91-1122 K

SAMUEL POZZANGHERA and
SHARON POZZANGHERA

Defendants

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The Plaintiff's "Complaint Objecting to Discharge" of these joint Chapter 7 debtors alleges four "Grounds" for denial of discharge. The first "ground" consists of 8 paragraphs. One paragraph alleges prepetition diversion and sequestering of certain funds. Another paragraph alleges prepetition efforts to hinder plaintiff in the collection of a certain judgment. Another paragraph alleges preferential payments made with fraudulent intent. Two other paragraphs allege fraudulent transfer and misrepresentations regarding an alleged interest in a corporation. The last paragraph of the first "ground" alleges misrepresentation and concealment of an insurance claim, with regard to the bankrupt

estate.

The Second, Third and Fourth "Grounds" allege, for the most part, other theories for denial of discharge based upon the same or similar allegations of fact.

The debtors' Answer denied all material allegations and raised certain affirmative defenses.

The plaintiff has now filed a motion for "partial summary judgment ... on so much of Plaintiff's first cause of action as alleges that the Debtors' [sic] ... transferred, removed ... or concealed" the proceeds of the settlement of the insurance claim.

The only "facts" I am offered are these:

1. The cause of action (arising from an auto accident) was scheduled, without stated value.

2. In discovery the debtors admitted to having settled the insurance claim for $180,000.

3. By affidavit the Chapter 7 Trustee attests that at the meeting under 11 U.S.C. § 341 the debtors "did not advise" him that settlement was being negotiated or imminent, or that the sum sought was well in excess of $100,000; the debtors did not advise him that they had entered a settlement or offer to turn over any portion of the $180,000 settlement; he did not learn of the settlement until the creditor's attorney notified him of it approximately one year after the § 341 meeting.

4. The settlement proceeds were received by debtors' counsel February 12, 1991, 7 days after the § 341 meeting.

5. By affidavit the debtor's then-counsel attests that "the information concerning the automobile accident, which was referred to in the schedules, was given to trustee at the § 341 hearing and that copies of papers regarding the claim and information concerning same were immediately sent to the trustee after the § 341 hearing."

Thus the affidavits of the trustee and debtors' then counsel appear to be directly at odds as to a highly significant material fact. (I do not know what to make of the fact that both affidavits were executed after filing of the motion for summary judgment.)

Totally apart from that, the Court is troubled by the fact that the creditor has selected one of six operative allegations from one of four separate counts of a Complaint, and sought partial summary judgment thereon. I realize that plaintiff's present counsel is not the counsellor who filed the Complaint, but if current counsel believes that paragraph 10 of the Complaint should have been set forth as a separate action, let him seek leave to amend the Complaint, and then let us discuss the most effective means of proceeding with this case in the context of a renewed F.R.Civ.P.Rule 16 conference. The resolution of the present motion has consumed a considerable amount of the Court's time, and (I presume) of the parties' counsels' time. While it is true that a resolution of the present motion in favor of the creditor would result in denial of discharge, and could result in

a voluntary dismissal of the balance of the creditor's complaint, the same could be said of every material "count" in a 11 U.S.C. § 727 complaint. The sequence in which the Court's ruling is to be obtained as to matters of law or undisputed fact in a multicount complaint should be a matter of pretrial case-management and appropriate Rule 16 consultation and order.[1] In connection therewith, it is imperative to know whether the complaint is a four-count complaint or an eighteen-count complaint (There are eighteen numbered paragraphs in the Complaint. The present motion addresses paragraph 10 only.)

This is particularly troublesome here since both sides assert that the decisive issue as to this "sub-cause" is that of the exemptibility of the insurance proceeds. Both sides have totally missed the point.

The crux of the Complaint in the pertinent regard is that although the joint debtors disclosed on their schedules the existence of a personal injury cause of action in favor of one debtor-spouse arising out of an auto accident, it was not disclosed that her claim exceeded $100,000. It is further alleged by the creditor that at the time of the § 341 meeting, a $180,000 settlement with the appropriate insurance company was imminent but was not disclosed by the debtors and was in fact received a few

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[1]Cf. *Malcak v. Cooney* 93 FRD 830 (N.D. Ill. 1982) and see *Mendenhall v. Barber-Greene Co.* 531 F.Supp. 947 (N.D. Ill. 1981).

days later. And it is alleged that although the receipt of the settlement might have become known to the trustee eventually, the funds were not handed over to the trustee pending a resolution by the Court of its exemptibility, and moreover the debtors executed a general release on the claim without authority of the trustee or the Court.

What is presented by the Plaintiff are the questions of whether as a matter of law (1) the debtors knew about and should have offered further information about the personal injury cause at the § 341 meeting, and (2) should have offered to place the money at issue before the Court when it was received, upon penalty of denial of discharge under 11 U.S.C. § 727.

I cannot resolve the Plaintiff's motion without resolution of facts that have either not been established or that are genuinely disputed. What did the debtors know about the size of the settlement and when? What did the Trustee or creditors ask them and when? Etc.

Similarly, the debtors' cross motion asks that I rule, as a matter of law, that the debtors' silence regarding the impending settlement would not violate § 727 because their belief that the proceeds are exempt was at least reasonable, if not indeed well-founded in law. Implicitly contained in this argument is the view that since 11 U.S.C. § 727(a)(2) punishes certain postpetition activities in connection only with "property of the estate," that subsection has no application to exempt property -- "property of

the debtor." While this might be so under some circumstances, it is not so in the case at Bar, when the undisputed facts are viewed in the light most favorable to the creditor. This becomes clear upon examining pertinent case law, statutes and rules.

In the case of *In re Kasishke*, 40 B.R. 712 (Bkrtcy. N.D. TX 1984) the debtors sold their residence (which had been claimed exempt) less than 30 days after the § 341 meeting despite oral notice from the trustee of his belief that only he could sell property of the estate, and oral notice from a creditor that it intended to object to the claim of the exemption.

The Court held the debtors in contempt for effecting a sale of property that was, at the time, "property of the estate," but the Court was "not persuaded that the actions of the debtor in proceeding with the sale over the oral objections of the trustee merit [the] drastic relief" of denying discharge under 11 U.S.C. §727(a)(2)(B).

In the case of *In re Vann*, 113 B.R. 704 (Bkrtcy. D. Colo. 1990), the debtor scheduled as an asset an interest in a "Deferred Compensation Plan" and claimed it, in essence, as totally exempt but did not indicate the Plan's value (over $280,000). After objections to the exemption were filed, he amended the claim of exemption as to value and claimed its exempt value to be "as applicable." Two months after the filing of the petition he withdrew more than $122,000 from the Plan. He did not notify the trustee of this until a month later. The trustee brought the

debtor before the Court on papers seeking a temporary restraining order. By the time that matter came before the Court, the debtor had dissipated all but $25,000 of the withdrawal. Despite knowledge of the trustee's objections to the claim of exemption, the debtor "consistently dealt with the funds as though these objections did not exist," and ultimately withdrew even the 25% of the fund which the Court eventually found to be "clearly non-exempt." The Court concluded that because of the debtor's conduct, the debtor's claim of exemption as to the 75% of the fund that would otherwise have been declared exempt, would be denied. (Apparently, § 727 relief was not sought by the trustee.)[2]

Indeed Bankruptcy Rule 4003(b) together with 11 U.S.C. §522(l) make it clear that until at least 30 days after the § 341 meeting, "property of the estate" may not become "property of the debtor" merely by virtue of a claim of exemption.

Thus, in this case the claim of exemption does not place wrongful conduct with regard to the insurance proceeds outside the scope of 11 U.S.C. § 727(a)(2)(B), even if I were ultimately to conclude that the proceeds are exempt.

Under § 727, therefore, actual intent to defraud the estate might result in denial of discharge even though the assets

[2]See also *In re Cleveland* (Bkrtcy. E.D. VA. May 15, 1985) (LEXIS, Bkrtcy. library, Cases file). That case further contains an excellent and thorough discussion of the "intent" element of a § 727 cause of action.

involved would otherwise be declared exempt. Conversely, an intent to defraud the estate cannot be inferred from a debtor's mistaken understanding of exemption law, if such understanding was reasonable and was relied upon in good faith; there must be "convincing evidence of extrinsic fraud,"[3] and whatever facts have been presented in the current papers that might otherwise constitute such evidence are vigorously disputed.

The exemptibility of the proceeds, thus, is not at issue in this Adversary Proceeding. What is at issue is knowledge, belief and intent.

Not an iota of evidence has been offered by either side in these regards.[4] (The Trustee's affidavit states that the debtors did not on February 5 tell him anything about the impending settlement, but it does not aver that he asked them anything about it despite the fact that it was scheduled.)

The Motion and Cross Motion for Summary Judgment are denied. The debtors' Motion to Compel is denied until there is compliance with Local Rule 29, commanding a certificate of efforts to resolve a discovery dispute.

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[3]*In re Adlman*, 541 F.2d 999, (2nd Cir. 1976).

[4]The Plaintiff offers exhibits in its motion papers to demonstrate that the debtors' entitlement to the proceeds had been "placed in issue" prior to February 5. Such exhibits are not yet credible evidence for Rule 56 purposes, for they had not been stipulated-to as evidence of fact.

The debtors ask also for partial summary judgment on their Second Affirmative Defense. This in essence seeks a reopening of the judgment taken against them in State Court by the plaintiff in the present case. That motion is denied on the basis of *Kelleran v. Andrijevic*, 825 F.2d 692 (2d Cir. 1987).

Because this is a § 727 Complaint truly sounding in § 727, it may not be settled without possible violation of 18 U.S.C. § 152. An adjourned pre-trial conference will be conducted in Bankruptcy Court, in Rochester, New York, on March 27, 1992 at 3:00 p.m.

Dated: Buffalo, New York
March 10, 1992

/S/ MICHAEL J. KAPLAN
U.S.B.J.