

Bankruptcy Law News




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Swing and a Miss: A Chapter 7 Trustee's Ability to Revoke a Debtor's Discharge Pursuant to § 727(a)(6)(A)

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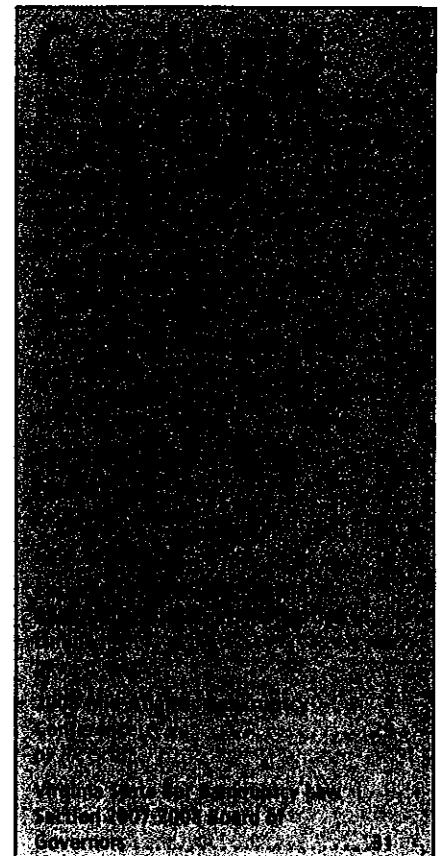
The recent economic downturn, especially of the housing market, has made the job of serving as a Chapter 7 Trustee more challenging. In the days of the real estate boom, selling real property for the benefit of the estate was almost as easy as listing the property and waiting for closing. While the number of Chapter 7 cases filed appears to again be on the rise after the post-BAPCPA lull, the potential assets available for administration by Chapter 7 Trustees in consumer cases tend now to be smaller and more difficult to find. The stagnant state of the real estate market has made real property with potential equity more likely to be abandoned than administered. In many cases Chapter 7 Trustees are being asked to abandon the estate's interest in property or sign consent to relief from stay orders even before the § 341 meeting. So what happens when the Chapter 7 Trustee's job is further complicated, or even hindered, by the actions of the debtor?

The Bankruptcy Code provides trustees, as "manager," a wide variety of pitchers to pull from the bullpen depending on the circumstances of the case.² There are the starters such as §§ 363 (use, sale or lease of property), 542 (turnover of property to the estate), and 554 (abandonment of property of the estate), which are used frequently and are therefore in the primary rotation and consideration of the trustee. There are the middle relievers, brought in when the starter needs help to push the case forward, such as §§ 547 (preferences), 548 (fraudulent transfers and obligations), 549 (postpetition transactions), and 550 (liability of transferee of avoided transfer). Only used when necessary, the set-up pitchers provide the trustee with options when a case proves to be a challenge, including §§ 505 (determination of tax liability), 506 (determination of secured status), and 706 (conversion). The true gem of the trustee's bullpen, however, is its closer, § 727 (discharge), specifically §

727(d) and the revocation of the discharge.³

Recently, however, the Fourth Circuit's April 3, 2008 decision in

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Smith v. Jordan (In re Jordan)⁴ threw⁵ doubt as to the veracity and ability of this closer with respect to the trustee's leverage to ensure debtors' cooperation. This article will examine the importance of § 727 to Chapter 7 Trustees and discuss what impact Jordan has and could have on consumer Chapter 7's.

The Lights-Out Closing Pitcher: Section 727(a)(6)(A) Revocation of Discharge for Refusal to Obey an Order of the Court

The vast majority of Chapter 7 debtors file their petition with the goal of seeking a discharge. The purpose of § 727(d)(3) is to make it possible for the debtor to obtain a discharge early in its case while at the same time protecting the estate and creditors by providing for the revocation of such discharge if the debtor later refuses to obey an order of the Court pursuant to § 727(a)(6)(A). The availability of the Trustee to seek denial of that discharge through the close of a debtor's case, combined with the debtor's inherent desire to obtain, has the same impact as a great closing pitcher – the threat is always there, but players hope that the score in the ninth inning precludes any need to call them from the bullpen.

A debtor's discharge can only be revoked when the debtor has refused to obey a lawful order of the court. The term "refused" is not defined in the Bankruptcy Code. The majority of courts, including the Fourth Circuit, require a showing of a willful or intentional act, not merely the showing of mistake, inadvertence, or mistake. See Jordan, 2008 U.S. App. LEXIS at *8-9 (adopting the analysis of the Bankruptcy Court in Marcus v. Jefferies, 356 B.R. 661 (Bankr. E.D. Va. 2006)(St. John, J.)). A minority of courts have found that actions under § 727(a)(6)(A) should be treated as civil contempt proceedings which do not require a showing of willfulness or intent. See e.g. Hunter v. Magack (In re Magack), 247 B.R. 406, 409-410 (Bankr. N.D. Ohio 1999). Thus, a Trustee seeking a revocation of a discharge must establish that the debtor willfully and intentionally refused to obey the court's order by some degree of volition or willfulness on the part of the debtor. Marcus v. Jefferies, 356 B.R. at 667 (quoting District Court opinion in Jordan, 356 B.R. 656, 660 (E.D. Va. 2006) *rev'd on other grounds by Jordan*).

While proving a debtor willfully or intentionally refused to obey an order by a preponderance of the

evidence could create an issue of evidence, courts have held that a Trustee can meet his or her evidentiary burden by showing that the debtor received the order in question and failed to comply with its terms. See Marcus v. Jefferies, 356 B.R. at 667 (citing cases). Upon such a showing, the burden of proof then shifts to the debtor to provide an explanation for his or her noncompliance by proving that the noncompliance with the order resulted from inadvertence, mistake, or impossibility, rather from an intentional or willful act. *Id.*

*When a Strike is Not a Strike: **Smith v. Jordan***

In January 2005, Ms. Jordan filed a Chapter 7 petition in the Eastern District of Virginia, Norfolk Division (Case No. 05-70093). The court's standard Administrative Order to Debtor was entered in Ms. Jordan's case. Ms. Jordan was ordered, *inter alia*, to not sell, transfer, remove, destroy, mutilate or conceal any of her property, and to obey all orders of the United States Bankruptcy Court. The order also provided that her responsibility for following these directives did not cease even after a discharge was granted. The § 341 meeting was held in February 2005. On June 24, 2005 the Trustee requested the Clerk of Court issue an asset notice and Ms. Jordan received her discharge at the same time. One week later, on July 1, 2005, without knowledge or consent of the Chapter 7 Trustee or the court, Ms. Jordan refinanced her property, resulting in a new deed of trust for \$231,000 and a cash payment to the debtor of approximately \$15,000 cash. In November 2005, the Trustee received a private offer to purchase the property for \$227,000 and filed a motion for court approval of the sale. It was only then that the Trustee discovered the curve-ball of the new deed of trust in excess of the amount of the offer to purchase and he withdrew his motion to sell. The Trustee subsequently filed a complaint to revoke Ms. Jones' discharge pursuant to 727(a)(6)(A).

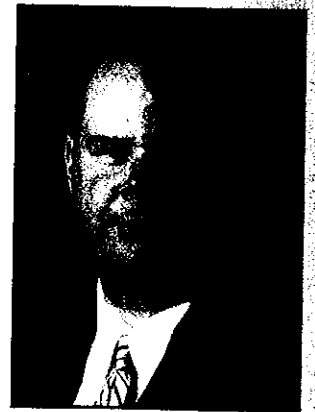
At the trial on the Trustee's complaint, the debtor testified that she believed that upon her discharge the Trustee no longer had any rights to her home and she could deal with her property as she desired. She also argued that no provision of the Administrative Order prohibited her from refinancing her property. The Bankruptcy Court revoked Ms. Jordan's discharge finding that she "unequivocally failed to obey" the Administrative Order by taking

the equity out of the property and that her actions were "tantamount to a refusal" to obey the Administrative Order. Smith v. Jordan (In re Jordan), 356 B.R. 651, 655-56 (Bankr. E.D. Va. 2006). In affirming the revocation of Ms. Jordan's discharge, the District Court adopted and applied the majority approach discussed above and held that "the fact that the debtor received the Administrative Order and simply ignored or acted contrary to its directives is sufficient . . . to constitute a refusal to obey the order." Jordan v. Smith (In re Jordan), 356 B.R. 656, 659-661 (E.D. Va. 2006).

In its Smith v. Jordan option, the Fourth Circuit affirmed the District Court's adoption of the majority approach, which requires a refusal to comply with an order be willful and intentional to revoke a debtor's discharge pursuant to § 727(a)(6)(A). The majority then noted that the Administrative Order in Ms. Jordan's case did not specifically prohibit the "refinancing" of property, only "selling, transferring, removing, destroying, mutilating or concealing" property. 2008 U.S. App. LEXIS at *10. The court found that while refinancing property may technically be a transfer of property, such distinction "would not be apparent to the typical debtor" and that the duty to clarify such a restriction lies with the "business-savvy" drafters of the order rather than a layperson such as Ms. Jordan. Id. at *10-11. Therefore, the majority held that based upon the record in the case, Ms. Jordan's failure to comply with the Administrative Order was not willful, thus not a

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Message from the Editor



As many section members look to summer vacation season, sports fans in the group will appreciate Elizabeth Gunn's (DuretteBradshaw PLC) article on the Chapter 7 Trustee's options to seek revocation of a debtor's discharge – unless you happen to be a Yankees fan. This issue of the News also features an excellent update by Martha Hulley, Tara Elgie and Chris Perkins (LeClairRyan) on the popular topic of deepening insolvency, with a local flavor highlighting a recent Virginia decision on the theory. We are also re-publishing Ira Wolpert's article on expert testimony in bankruptcy cases, originally published in the Fall 2007 newsletter. The endnotes that accompanied Mr. Wolpert's article were omitted from the Fall issue due to a printing error; we apologize to Mr. Wolpert for this omission.

This issue also features the usual recurring content: Jim Schroll's (Bean, Kinney & Korman) "Notes from the Section Chair," a Clerk's Corner update from Bill Redden from the Eastern District, and a series of interesting case updates from Mark Leffler (The Boleman Firm, P.C.) and his reporting team.

Finally, please note the announcement regarding this October's Mid-Atlantic Bankruptcy Conference in Charlottesville.

If you have an article or topic you think would be appropriate for the Law News, please contact me at any time at richard.scott@leclairryan.com.

Ric Scott

particular, to educate individuals and families about options available for dealing with consumer debt. The program was excellent and one we hope to repeat.

As previously mentioned in this space, the Advanced Consumer Program, conceived and organized by past chair of our section, Richard Maxwell, will be consolidated, beginning this fall, with the business-bankruptcy focused Mid-Atlantic Bankruptcy Seminar held each year in Charlottesville in September. The intention is to create a premier event for both business and consumer practitioners. We will be supplementing this seminar with a basic bankruptcy program for those just entering the field. At this point it would appear that the basic seminar would be held in March of next year.

My term as chair of the bankruptcy section will come to an end this month when I turn over the reins to Robert Copeland at our annual meeting in Virginia Beach. This past year has been an immensely rewarding experience as has been my entire six year term on the board of governors. Thanks to all of my fellow board members for your support and diligent efforts this past year on behalf of the bankruptcy bar.

James R. Schroll
2007-2008 Chair

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refusal. *Id.* at *11. In his dissent, Judge Michael found that Ms. Jordan did not meet her burden to explain her noncompliance with the Administrative Order after the Trustee established that she received the order in question and failed to comply with its terms. *Id.* at * 14. The dissent argued that although the majority accurately set forth the law with respect to § 727(a)(6)(A), it erroneously concluded that Ms. Jordan did not act willfully and refuse to obey the Administrative Order *Id.* *17.

Instant Replay?: The Effects of *Jordan*

The first effect of the *Jordan* opinion was seen within a few weeks of the entry of the Fourth Circuit's opinion. In April 2008, the Clerk of the United States Bankruptcy Court for the Eastern District of Virginia added one word to the second full paragraph of its Administrative Order – "refinance." The Administrative Order now orders that Chapter 7 debtors in the Eastern District not sell, *refinance*, transfer, remove, destroy, mutilate, or conceal any of their property. It appears that the new Administrative Order will only apply to cases prospectively and that the Clerk is not re-filing the order in open cases for a retroactive application.

The more intriguing question will be the impact of the decision in future § 727(a)(6)(A) cases, especially given the application of the law by the majori-

ty in *Jordan*. Does the *Jordan* opinion open the way for an "ignorant layperson" defense to complaints which allege actions that are not specifically enumerated in the Administrative Order? Did the *Jordan* decision hinge, in part, on the education and sophistication of the Debtor (which is never specifically set out in the opinions)? For example, had Ms. Jordan been an investment banker or loan officer, would the Court have still considered her a "layperson" incapable of reading between the lines to understand that refinancing her property was the same as transferring the property? Do Trustees now have the onus of proving that not only did the debtor receive the order in question and fail to comply with its terms, but also that the debtor understood such order and/or acted with specific intent to violate such order? The only thing that can be stated with certainty is that while the Fourth Circuit adopted the majority approach in evaluating a complaint under § 727(a)(6)(A), the majority left the door open for legal arguments and interpretation as to its application. ♦

1. Elizabeth L. Gunn is an associate with DuretteBradshaw PLC in Richmond, Virginia and a lifelong Boston Red Sox fan. She can be reached at 804-775-6900 or egunn@durettebradshaw.com.
2. With summer just around the corner, the baseball analogy could not be avoided.
3. A request pursuant to § 727(d) may be filed by the trustee, a creditor, or the United States trustee. The law herein, while specifically focused on the Chapter 7 Trustee, is equally applicable to any action filed under § 727(d).
4. 2008 U.S. App. LEXIS 7062 (Case No. 06-2154).
5. Pun intended.