

CONSUMER BANKRUPTCY

Can Debtor Lose Discharge for Inability to Pay Trustee?

By Craig D. Robins

Here is a scenario that is not at all uncommon in typical Chapter 7 consumer cases. The trustee learns that the debtor has a non-exempt asset and demands that the debtor turn it over. Perhaps it is a tax refund, funds in a bank account, some kind of investment or entitlement to money.

However, the debtor ultimately does not do so because he or she spent the money. The frustrated trustee then brings a turnover proceeding and obtains an order directing the debtor to turn over the non-exempt asset. When the debtor does not do so, the trustee threatens to bring an adversary proceeding seeking to prevent the debtor from getting a discharge (or revoking the discharge if the debtor already received one). When the debtor still does not pay, crying poverty that the funds are no longer available, the trustee makes good on his threat and brings the adversary proceeding. Sounds like the trustee should win, but does he?

This was the situation in a recent case out of Oklahoma (*Manchester v. Eaves (In re Eaves)*, Case No. 18-13008, Adv. No. 19-01059 (Bankr. W.D.OK. October 31, 2019)). After the debtor's mother died, the debtor had to move in to take care of her father, as well as several other family members. In order to pay for everyone's medical, care-giving and funeral expenses, the debtor withdrew \$40,000 from her retirement account. Several weeks later, when she filed for Chapter 7 relief, she still had \$12,000, which was not exempt, and she neglected to list this asset in her petition. She received a discharge.

Several months later, the trustee found out

about the non-exempt funds and filed a motion for turnover, which the court granted. However, despite the order directing the turnover, the debtor did not turn over the funds. The debtor asserted that since the bankruptcy was filed, she suffered from additional financial difficulties and illness, arguing that she was unable to turn over the funds because she had depleted them for her and her family's expenses, and there just was nothing left to turn over.

The trustee, who was not too happy with that response, filed an adversary proceeding seeking to revoke the debtor's discharge pursuant to Bankruptcy Code §§ 727(a)(6) and (d)(3), and also seeking a money judgment against the debtor. He then brought a motion for summary judgment within the adversary proceeding, arguing that there were no disputed facts. His main contention was that the debtor disobeyed the court order directing turnover of the funds.

In responding to the motion for summary judgment, the debtor argued that she did not intend to refuse to turn over monies to the trustee, but the funds were simply unavailable because she used them for necessary expenses. The debtor further stated that she did not intend to defraud the trustee.

Judge Sarah A. Hall first noted the relevant provisions of § 727, which provide that the court shall grant the debtor a discharge, unless the debtor has refused to obey any lawful order of the court, and that on request of the trustee, the court shall revoke a discharge if the debtor committed such an offense.

Citing a case decided by our own Chief Judge Carla E. Craig (*Adar 980 Realty LLC v. Sofer*, 519 B.R. 28, Bankr. E.D.N.Y. 2014), the Oklahoma judge stated that Section

727(a)(6) requires a plaintiff to establish that (i) the court issued an order and (ii) the debtor refused to obey such order. Thus, refusal to obey an order for turnover generally provides a basis for the denial or revocation of discharge.

However, the judge went on to qualify that principle by stating that the mere failure to obey a court order is not enough; there must be some degree of willfulness or volition by the debtor. For this reason, inability to comply with the terms of an order can negate a claim under § 727(a)(6).

Thus, the court held that such non-compliance must have been willful and with the intent to disobey the order. A technical violation of a court order, the judge stated, is insufficient under Section 727(a)(6).

The judge further remarked that although disobedience to an order must be intentional or willful, the lack of intent or willfulness is raised by defense. Judge Hall noted that the sole issue in dispute was whether the debtor "refused" to obey the turnover order. Since the debtor averred that she did not have the intent to violate any court order, the judge determined that this was a material question of fact, precluding the court from granting the motion for summary judgment. The judge did grant the trustee the money judgment.

Practical tips. It is an unfortunate but a common occurrence that debtors know that they will need to turn over certain non-exempt assets (especially tax refunds), but nevertheless end up depleting them, much to the consternation of the trustee and their own attorney. No one wants to get into a battle with the trustee over such issues, but it is good to



CRAIG D. ROBINS

know that despite threats from the trustee that the debtor will not get a discharge, that may not be the case.

Prudent attorneys should caution their clients that they should not spend non-exempt assets when they receive them, lest they be responsible for thousands of dollars of additional legal fees that they will eventually be required to pay,

both to their own counsel as well as the trustee.

In the event the trustee does bring an adversary proceeding threatening discharge, the debtor should argue that he or she did not intend to violate any turnover order, and that not turning over the asset was based on an inability to do so and not due to willfulness or volition. It would also help to amplify this with some compassionate reasons as to why the debtor was unable to pay. Finally, be mindful that at the end of the day, the trustee wants to collect this bankruptcy estate asset, so be pragmatic and work towards some kind of payment arrangement that would accomplish a resolution.

Note: Craig D. Robins, a regular columnist, is a Long Island bankruptcy lawyer who has represented thousands of consumer and business clients during the past 33 years. He has offices in Melville, Coram and Valley Stream and can be reached by calling (516) 496-0800 or at CraigR@CraigRobinsLaw.com. Please visit his Bankruptcy Website: www.BankruptcyCanHelp.com and his Bankruptcy Blog: www.LongIslandBankruptcyBlog.com.