United States Bankruptcy Court
Northern District of Illinois
Eastern Division

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Bankruptcy Caption: In re Robert R. Williams

Bankruptcy No. 10 B 12193

Adversary Caption: Fifth Third Bank v. Williams

Adversary No. 10 A 1663

Date of Issuance: March 11, 2011

Judge: A. Benjamin Goldgar

Appearance of Counsel:

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UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF ILLINOIS
EASTERN DIVISION

In re:	)	Chapter 7
	)	
ROBERT R. WILLIAMS,	)	No. 10 B 12193
	)	
Debtors.	)	
	)	
	)	
FIFTH THIRD BANK,	)	
	)	
Plaintiff,	)	
	)	
v.	)	No. 10 A 1663
	)	
ROBERT R. WILLIAMS,	)	
	)	
Defendant.	)	Judge Goldgar

MEMORANDUM OPINION

This matter is before the court for ruling on the motion of debtor Robert R. Williams to dismiss Count I of plaintiff Fifth Third Bank's complaint for failure to state a claim. For the reasons that follow, Williams's motion will be granted, and Count I of the complaint will be dismissed with leave to amend.

1. Facts

On a motion to dismiss under Rule 12(b)(6), all well-pleaded allegations in the complaint are taken as true and all reasonable inferences drawn in favor of the non-movant. *Rujawitz v. Martin*, 561 F.3d 685, 688 (7th Cir. 2009). The court considers facts evident from exhibits attached to the complaint, *see* Fed. R. Civ. P. 10(c) (made applicable by Fed. R. Bankr. P. 7010); *Thompson v. Illinois Dep't of Prof'l Regulation*, 300 F.3d 750, 753 (7th Cir. 2002), as well as matters of which the court can take judicial notice, *Palay v. United States*, 349 F.3d 418, 425 n.5

(7th Cir. 2003); *but see Doss v. Clearwater Title Co.*, 551 F.3d 634, 639-40 (7th Cir. 2008) (calling "narrow" the circumstances under which judicial notice can be taken in connection with a motion to dismiss).

The complaint here alleges the following facts. Just Rite Home Services, Inc., is or was a retail nursery business in which Williams had an interest. Just Rite operated under the name "Castle Gardens" Between 2006 and 2008, Just Rite executed a series of notes in connection with two loans it received from Fifth Third Bank, one in the principal amount of $1.3 million, the other in the principal amount of $500,000. Williams executed a Guaranty Agreement under which he guaranteed payment of both loans.

In March 2010, Williams filed a chapter 7 bankruptcy case. In his Schedule A, Williams listed certain real property in Volo, Illinois ("the Volo Property"). According to Schedule A, the Volo Property is a "3-acre Homestead and Nursery Property" that serves as Williams's marital residence and is held in a tenancy by the entirety. The Statement of Financial Affairs Williams filed said that Williams and his wife established their residence on the Volo Property in November 2009. In his Schedule C, Williams claimed a $1.2 million exemption in the Volo Property.

Legal title to the Volo Property had been held solely in Williams's name until November 2, 2009, when Williams executed a deed in trust transferring the property to the "Williams Family Trust Number One" ("the Trust"). Williams later (just how much later is not alleged) amended the Trust provisions to provide that the "beneficial interests" in the Trust were held in a tenancy by the entirety.

Around the time Williams transferred the Volo Property to the Trust, he was in default on his obligations to the Bank and was negotiating a workout under which the Bank was seeking a

junior lien on the Volo Property. According to the complaint, the "primary purpose" of the Volo Property is commercial in nature, "not as a marital residence," because Castle Gardens has at all relevant times operated through corporations wholly owned by Williams or his wife.

The Bank's adversary complaint objects to Williams's discharge under section 727(a) of the Bankruptcy Code. The complaint originally had two counts but now has just one.[1/] The remaining count, Count I, is a claim under section 727(a)(2)(A) of the Code alleging that Williams's transfer of the Volo Property to the Trust – a "change in . . . residence" undertaken to claim an exemption on property in fact used for commercial purposes – was made with an "intent to hinder, delay, or defraud a creditor."

Williams now moves to dismiss Count I. He asserts that the Bank has not alleged sufficient facts to support a plausible inference that Williams intended to hinder, delay, or defraud the Bank. To do so, Williams argues, the Bank had to allege that Williams transferred the Volo Property into a tenancy by the entirety "with the sole intent to avoid the payment of debts existing at the time," the intent necessary to render the property subject to the execution of a judgment under Illinois law, *see* 735 ILCS 5/12-112 (2008), and the complaint makes no such allegations. In his reply, Williams asks for the first time that Count I be dismissed with prejudice.

[1/] The other count, Count II, alleged that Williams should be denied a discharge under section 727(a)(4)(A) of the Code for making a "false oath" on his bankruptcy schedules. That count was dismissed on December 3, 2010, for failure to state a claim. Although the dismissal order gave the Bank leave to amend Count II, no amended complaint was ever filed. Presumably, the Bank has chosen to abandon Count II and pursue only Count I.

2. Discussion

Williams's motion to dismiss will be granted, but not on the theory Williams advances. Count I fails to state a claim because the facts the Bank alleges do not raise a plausible inference that Williams transferred the Volo Property with the intent section 727(a)(2)(A) requires. Count I will be dismissed for this reason, and the Bank will be given leave to amend.

a. Standard for Dismissal Under Rule 12(b)(6)

Under Rule 12(b)(6), a complaint will be dismissed unless it clears "two easy-to-clear hurdles." *E.E.O.C. v. Concentra Health Servs., Inc.*, 496 F.3d 773, 776 (7th Cir. 2007).

First, the complaint must give the defendant fair notice of the claim. *See Pratt v. Tarr*, 464 F.3d 730, 733 (7th Cir. 2006). A complaint will be dismissed if it is "so sketchy" that it does not provide "the type of notice . . . to which the defendant is entitled under Rule 8." *Airborne Beepers & Video, Inc. v. A T & T Mobility LLC*, 499 F.3d 663, 667 (7th Cir. 2007). A complaint need not include "'detailed factual allegations,'" but "'a formulaic recitation of the elements of a cause of action'" will not suffice. *Ashcroft v. Iqbal*, 556 U.S. ___, ___, 129 S. Ct. 1937, 1949 (2009) (quoting *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 555 (2007)). At least some facts must support each element of the claim. *Id.* at ___, 129 S. Ct. at 1949-50.

Second, the complaint's allegations must plausibly suggest that the plaintiff has a right to relief, raising that right above a "'speculative level.'" *Concentra*, 496 F.3d at 776 (quoting *Twombly*, 550 U.S. at 555). Plausibility means the allegations must allow "the court to draw the reasonable inference that the defendant is liable for the misconduct alleged." *Iqbal*, 556 U.S. at ___, 129 S. Ct. at 1949. To establish plausibility, a plaintiff "must give enough details about the subject-matter of the case to present a story that holds together. In other words, the court will

ask itself *could* these things have happened, not *did* they happen." *Swanson v. Citibank, N.A.*, 614 F.3d 400, 404 (7th Cir. 2010).

Although mental state (such as an intent to hinder, delay, or defraud a creditor) is excepted from the more stringent pleading requirements of Rule 9(b), it is still subject to the requirements of Rule 8. *Iqbal*, 556 U.S. at ___, 129 S. Ct. at 1954. As such, a plaintiff must allege facts sufficient to raise a plausible inference of mental state; a plaintiff cannot allege intent merely as a conclusion. *See EMD Crop Bioscience, Inc. v. Becker Underwood, Inc.*, No. 10-cv-283-bbc, ___ F. Supp. 2d ___, ___, 2010 WL 4386674, at *13 (W.D. Wis. October 29, 2010); *Marwil v. Oncale (In re Life Fund 5.1 LLC)*, Nos. 09 B 32672, 10 A 42, 2010 WL 2650024, at *6 (Bankr. N.D. Ill. Jun 30, 2010).

b. The Section 727(a)(2)(A) Claim

Count I of the Bank's complaint fails to satisfy the second hurdle of Rule 12(b)(6), plausibility. Count I fails to state a claim because the Bank's allegations do not raise a plausible inference that Williams transferred the Volo Property into a tenancy by the entirety with "intent to hinder, delay, or defraud a creditor" as section 727(a)(2)(A) requires.

Section 727(a)(2)(A) of the Code denies a discharge to a debtor who,

> 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 . . . property of the debtor, within one year before the date of the filing of the petition.

11 U.S.C. § 727(a)(2)(A). This exception to discharge has two requirements: "an act (*i.e.*, a transfer or a concealment of property) and an improper intent (*i.e.*, a subjective intent to hinder, delay or defraud a creditor)." *In re Kontrick*, 295 F.3d 724, 736 (7th Cir. 2002), *aff'd*, 540 U.S.

443 (2004); *Keeney v. Smith (In re Keeney)*, 227 F.3d 679, 683 (6th Cir. 2000). As the statutory language suggests, the intent element is disjunctive: either an intent to defraud creditors or an intent to hinder or delay them is enough. *See Smiley v. First Nat'l Bank of Belleville (In re Smiley)*, 864 F.2d 562, 568 (7th Cir. 1989) (holding that the debtor "intended to hinder or delay his creditors, even if he had no intent to defraud them" and his discharge was therefore properly denied); *In re Adeeb*, 787 F.2d 1339, 1343 (9th Cir. 1986).[2/]

Actions under section 727(a)(2) are rarely straightforward, however, and "one of the more difficult issues in bankruptcy law is deciding when, if ever, intent to defraud creditors can be shown by the debtor's conversion of nonexempt assets to exempt assets." *Mathai v. Warren (In re Warren)*, 512 F.3d 1241, 1249 (10th Cir. 2008). That is because debtors are permitted the "'full use'" of available exemptions and "will not be penalized for ordering their affairs in such a manner as to take best advantage of the exemptions legally afforded to them." *In re Vangen*, 334 B.R. 241, 245 Bankr. W.D. Wis. 2005) (quoting *Smiley*, 864 F.2d at 567). The issue becomes "even more difficult" when "the debtor has attempted to utilize a statutory homestead exemption." *In re Jennings*, 533 F.3d 1333, 1338 (11th Cir. 2008).

The Bank's complaint here plainly alleges that Williams transferred the Volo Property to the Trust and placed the beneficial interests in a tenancy by the entirety within a year of his bankruptcy, rendering the property exempt. The question on Williams's motion to dismiss is

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[2/] Other authorities read the intent element differently, taking "intent to hinder, delay or defraud" creditors to mean simply intent to defraud. *See* 6 *Collier on Bankruptcy* ¶ 727.02[3][a] at 727-17 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010) (concluding that an "intent to defraud" alone is required but acknowledging that "a few courts have found that, under a literal reading of the language, an intent to hinder or delay creditors, even if not fraudulent, may be sufficient to warrant a denial of discharge").

whether the complaint alleges enough to infer that he made the transfer either with an intent to defraud or an intent to hinder or delay the Bank.

i. No Intent to Defraud

As Williams correctly argues, no intent to defraud can plausibly be inferred from the facts the Bank alleges.

Ordinarily, fraudulent intent for purposes of an action under section 727(a)(2)(A) may be inferred from the circumstances of a debtor's conduct. *In re Snyder*, 152 F.3d 596, 601 (7th Cir. 1998). Establishing intent circumstantially is more difficult, however, when a debtor's transfer of assets from a nonexempt to an exempt form is involved. A transfer of that kind standing alone raises no inference of fraudulent intent – even if the transfer occurs on the eve of bankruptcy. *Smiley*, 864 F.2d at 566. A last-minute change in the exempt status of assets supplies a basis for denying a debtor's discharge only if he "committed some act extrinsic to the conversion which hinders, delays, or defrauds." *Id.* These extrinsic signs of fraud include (1) that the debtor obtained credit in order to purchase exempt property; (2) that the conversion from non-exempt to exempt occurred after entry of a large judgment against the debtor; (3) that the debtor had engaged in a pattern of sharp dealing before bankruptcy; or (4) that the conversion rendered the debtor insolvent. *Id.* at 567; *see also In re Przybylski*, 340 B.R. 624, 629 (Bankr. E.D. Wis. 2006); *Vangen*, 334 B.R. at 245-46.

The Bank alleges none of these signs. The Bank does not allege that Williams purchased the Volo Property in the year before bankruptcy or that he obtained credit to do so. The Bank does not allege the entry of any judgment against Williams before he transferred the property. And the Bank does not allege that Williams's transfer of the Volo Property rendered him insolvent. The only pre-bankruptcy conduct on Williams's part the Bank does allege – that he

failed during his workout negotiations with the Bank to disclose his decision to place the Volo Property in a tenancy by the entirety – is not enough under *Smiley* to show fraud. *See Smiley*, 864 F.2d at 568 (noting that "a finding of fraud requires more than a failure to volunteer information").

Although the Bank's complaint fails to allege the kind of extrinsic facts *Smiley* requires, the Bank argues that other facts raise an inference of intent to defraud, facts showing that Williams's claim of exemption with respect to the Volo Property was a "sham." The claim of exemption was a sham, the Bank suggests, because Williams was not entitled to the exemption.

The Bank is mistaken. That a debtor is not actually entitled to the exemption claimed will not support an inference that in claiming the exemption he intended to hinder, delay, or defraud creditors. *Smiley* itself demonstrates as much. In *Smiley*, the bankruptcy court denied the debtor's claim of the Kansas homestead exemption because the debtor had not resided in Kansas long enough to claim it. But the denial of the exemption did not figure at all in the Seventh Circuit's analysis of the debtor's intent. *See Smiley*, 864 F.2d at 566-69.

Even if a debtor's lack of entitlement to the claimed exemption could give rise to an inference of intent to defraud, the Bank alleges no facts suggesting that Williams was not entitled to claim the exemption here. The Illinois Joint Tenancy Act ("the Act") provides in part:

> Whenever a . . . transfer of property, including a beneficial interest in a land trust, maintained or intended for maintenance as a homestead by both husband and wife together during coverture shall be made and the instrument of . . . transfer expressly declares that the devise or conveyance is made to tenants by the entirety, or if the beneficial interest in a land trust is to be held as tenants by the entirety, the estate created shall be deemed to be in tenancy by the entirety.

765 ILCS 1005/1c (2008). The Act creates two exceptions to the conclusive presumption that qualifying transfers of property create a tenancy by the entirety. First, a tenancy by the entirety

can "exist only if, and as long as, the tenants are and remain married to each other." *Id.* Second, a tenancy by the entirety will become a joint tenancy "upon the creation and maintenance by both spouses together of other property as a homestead." *Id.*

As far as the Bank's complaint alleges, the transfer of the Volo Property satisfied all the requirements of a tenancy by the entirety, and neither exception applies. The complaint does not allege that the Trust fails to provide that the beneficial interests are held in a tenancy by the entirety – quite the contrary, in fact. The complaint also does not allege that Williams and his wife are not married or that they do not treat the Volo Property as their homestead. The Bank alleges only that the "primary purpose" of the Volo Property is commercial because the property is the site of a retail nursery business. In making this allegation, the Bank appears to be asserting that property used partly as a homestead but primarily for commercial purposes cannot be held in a tenancy by the entirety under the Act. But the Bank cites no authority for this assertion, and there appears to be none.

Because the Bank alleges no extrinsic signs of fraud, the complaint contains insufficient facts to support a plausible inference that Williams transferred the Volo Property with an intent to defraud.

ii. No Intent to Hinder or Delay

It is equally impossible to draw an inference of intent to hinder or delay from the facts in the Bank's complaint.

Under *Smiley*, an intent to hinder or delay creditors may be inferred where the debtor has committed some act of deception – other than the mere conversion of nonexempt assets into exempt ones – that "would justify a finding that the debtor improperly intended to forestall creditors from realizing on their claims." *Cirilli v. Bronk (In re Bronk)*, Nos. 09-15224-7, 10-44,

2011 WL 61605, at *7 n.15 (Bankr. W.D. Wis. Jan, 7, 2011) (interpreting *Smiley*); *see also Smiley*, 864 F.2d at 567-68. In *Smiley*, the court found that the debtor's non-disclosure, coupled with his misrepresentations to creditors about the value of his assets, demonstrated an intent to hinder or delay creditors because the debtor had every incentive to forestall creditors from filing an involuntary petition against him until he could establish residency in a state with an unlimited homestead exemption. *Smiley*, 864 F.2d at 568.

The complaint here does not allege anything comparable to the facts in *Smiley*. The Bank nowhere asserts that Williams made any misrepresentations preventing it from realizing on its claim. The Bank alleges only that during negotiations of a possible workout Williams failed to disclose his intention to transfer the Volo Property into a tenancy by the entirety, rendering it exempt. This sort of non-disclosure is insufficient to show intent unless combined with affirmative misrepresentations or other fraudulent conduct. *Smiley*, 864 F.2d at 567-68. Without more, then, Williams's mere failure to tell the Bank about his pre-bankruptcy exemption planning raises no inference of an intent to hinder or delay creditors.[3/]

[3/] A debtor's non-disclosure might support an inference of intent to hinder or delay creditors if the debtor had some underlying duty to disclose – for example, the duty to disclose in the Statement of Financial Affairs ("SOFA") certain transfers of property outside the ordinary course of business. *See Crews v. First Colony Life Insurance Co. (In re Barker)*, 168 B.R. 773, 780 (Bankr. M.D. Fla. 1994) (inferring intent to hinder or delay from a debtor's failure to disclose on his SOFA his transfer of nonexempt assets to exempt assets). But Williams's SOFA fully disclosed the transfer in question. The Bank has not claimed Williams had a duty to disclose the transfer during the workout negotiations, and it appears he had no such duty. *See Lewis v. Lead Industries Ass'n*, 342 Ill. App. 3d 95, 105, 793 N.E.2d 869, 876 (1st Dist. 2003) (holding that a mere passive concealment of pertinent facts during a business transaction does not constitute fraud absent "a special or fiduciary relationship . . . that would give rise to a duty to speak"); *Magna Bank of Madison County v. Jameson*, 237 Ill. App. 3d 614, 618, 604 N.E.2d 541, 544 (5th Dist. 1992) (finding no duty to speak "absent a fiduciary or other legal relationship between the parties").

Because the Bank has alleged no misrepresentations or other conduct on the part of Williams that forestalled creditors from realizing on their claims, the Bank has also failed to allege facts giving rise to a plausible inference of intent to hinder or delay a creditor. With no facts supporting either mental state necessary to state a claim under section 727(a)(2)(A), Count I must be dismissed.

iii. "Sole Intent" Irrelevant

Although it turns out not to matter, it may be worth noting that Williams's own argument for the dismissal of Count I – that the Bank had to allege Williams made the transfer with the "sole intent" to avoid payment of existing debts – is incorrect.

The argument is premised on Illinois state law, which requires a showing that property has been transferred into a tenancy by the entirety with the sole intent to avoid payment before creditors can reach the property to satisfy a judgment. *See* 735 ILCS 5/12-112 (2008). This intent requirement applies in bankruptcy at least to the extent that it governs a trustee's ability to avoid a transfer of property into a tenancy by the entirety under section 544(b) of the Code, *see Brown v. Stacy (In re Stacy)*, 227 B.R. 272, 274 (Bankr. N.D. Ill. 1998), because section 544(b) explicitly incorporates by reference applicable state law, *see* 11 U.S.C. § 544(b) (empowering the trustee to avoid any transfer of the debtor's property "that is voidable under applicable law").

Unlike section 544(b), however, section 727(a)(2)(A) does not incorporate state law. A debtor's right to a discharge is strictly a matter of federal law. *In re Johnson*, 880 F.2d 78, 79 (8th Cir. 1989); *In re Davidson*, 178 B.R. 544, 549-50 (S.D. Fla. 1995); *Murphey v. Crater (In re Crater)*, 286 B.R. 756, 763 n.9 (Bankr. D. Ariz. 2002). Whether the Bank can state a claim under section 727(a)(2)(A) therefore depends purely on federal law. The "sole intent"requirement under Illinois law is irrelevant.

c. Leave to Amend

Although Count I will be dismissed, the Bank will be given leave to amend its section 727(a)(2)(A) claim despite Williams's request (coming rather late in the game) to dismiss Count I with prejudice.

Rule 15(a)(2) permits a court to grant leave to amend a complaint and instructs that "the court should freely give leave when justice so requires." Fed. R. Civ. P. 15(a)(2) (made applicable by Fed. R. Bankr. P. 7015). Leave should not always be granted, of course, *see Park v. City of Chicago*, 297 F.3d 606, 612 (7th Cir. 2002), and leave can be denied for "repeated failure to cure deficiencies by amendments previously allowed." *Foman v. Davis*, 371 U.S. 178, 182 (1962); *see also* 6 Charles Alan Wright, Arthur R. Miller & Mary Kay Kane, *Federal Practice and Procedure* § 1487 at 743-46 (2010) (noting that a court may deny leave to amend if the plaintiff "has had multiple opportunities to state a claim but has failed to do so"). Here, however, there have been no "repeated failures." Count I represents the Bank's first attempt to state a claim. The Bank is entitled to another.

3. Conclusion

For the foregoing reasons, the motion of defendant Robert Williams to dismiss Count I of Fifth Third Bank's complaint is granted. Fifth Third Bank has 28 days to file an amended complaint. A separate scheduling order will be entered.

Dated: March 11, 2011

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A. Benjamin Goldgar
United States Bankruptcy Judge