

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. MW 01-045

**IN RE AARON H. WATMAN,
Debtor.**

**LAWRENCE GROMAN,
Plaintiff-Appellant.**

v.

**AARON H. WATMAN,
Defendant-Appellee,**

**Appeal from the United States Bankruptcy Court
for the District of Massachusetts
[Hon. Joel B. Rosenthal, U.S. Bankruptcy Judge]**

Before

DE JESUS, VAUGHN and CARLO, U.S. Bankruptcy Judges.

Joseph S.U. Bodoff, Carolyn J. Genereux and Bodoff & Associates on brief for appellant.

Peter J. Haley, Leslie F. Su and Gordon Haley L.L.P. on brief for appellee.

December 28, 2001

Per Curiam

This proceeding is before the Panel for a second time. Previously, we reversed an order of the bankruptcy court granting the debtor's motion to dismiss an adversary proceeding objecting to discharge under 11 U.S.C. §§ 727(a)(2) and (a)(7) and remanded for a trial on the merits. After trial, the bankruptcy court entered judgment in favor of the debtor, which the plaintiff appeals. For the reasons set forth below, we affirm.

JURISDICTION AND STANDARD OF REVIEW

The Bankruptcy Appellate Panel has jurisdiction to review final decisions of the United States Bankruptcy Court pursuant to 28 U.S.C. § 158. See also Sanford Institution for Savings v. Gallo, 156 F.3d 71, 74 (1st Cir. 1998). "Findings of fact, whether based on oral or documentary evidence, shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses." Fed. R. Civ. P. 52(a), made applicable by Fed. R. Bankr. P. 7052; Fed. R. Bankr. P. 8013. The determination of a debtor's intent for purposes of 11 U.S.C. §§ 727(a)(2) and (a)(7) is a finding of fact. See In re Lang, 256 B.R. 539, 540 (BAP 1st Cir. 2000).

BACKGROUND

In summary, the debtor, Aaron H. Watman ("Watman"), filed a voluntary petition for relief under Chapter 7 on March 22, 1999. Lawrence Groman ("Groman") filed an adversary complaint against Watman objecting to discharge under 11 U.S.C. §§ 727(a)(2) and (a)(7). Groman's complaint alleged that prior to December 8, 1989, Groman was the sole owner of all of the stock in Children's Dental Associates of Lowell ("Children's Dental"). On or about December 8, 1989, Groman and Watman entered into a series of agreements to sell all of the stock to Watman. As subsequently modified the agreement required Watman to pay the sum of \$437,783.15. The parties agreed to a payment schedule and Watman and Children's Dental became jointly liable on the obligation. In August of 1997, Watman and Children's Dental defaulted on the obligation and Groman sued Watman and Children's Dental, obtaining a judgment on December 14, 1998, against them in the amount of \$437,918.00. Thereafter, Groman filed a complaint seeking the appointment of a receiver.

While the receivership was pending, Watman resigned from Children's Dental and began providing dental services in a separate dental practice that Watman established in his own name. Prior to resigning, Watman caused Children's Dental to pay one month of office rent, equipment leases, health insurance premiums and some employee salaries. The checks issued by Children's Dental to pay expenses amounted to approximately \$40,000. The checks were all

recorded in the books and records of Children's Dental and on its Statement of Financial Affairs.

Watman canceled Children's Dental's lease and began operating in the same space which Children's Dental had occupied, hiring all of Children's Dental's employees and using some of the equipment and other personal property of Children's Dental. One week after transferring the dental practice to his own name, Watman set up a corporation known as Lowell Dentistry for Children, P.C. ("Lowell Dentistry") and continued operating with the same patients, employees, equipment and other personal property. During the course of these events, on March 22, 1999, Watman filed a voluntary petition under Chapter 7 and on March 24, 1999, Children's Dental filed a voluntary petition for relief under Chapter 11.

Groman alleged that Watman's actions constituted a transfer, removal, destruction, mutilation or concealment of assets with the intent to hinder, delay or defraud Groman within the meaning of 11 U.S.C. § 727(a)(2) and warranted a denial of his discharge. Groman also alleged that Children's Dental was an insider of Watman and Watman's actions constituted a transfer, removal, destruction, mutilation or concealment of assets of an insider in Children's Dental's bankruptcy case, warranting the denial of Watman's discharge pursuant to 11 U.S.C. § 727(a)(7).

DISCUSSION

The Bankruptcy Code provides that:

(a) The Court shall grant the debtor a discharge, unless-- (2) the debtor, with intent to hinder, delay, or defraud a creditor . . . has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed-- (A) 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 section includes four elements: (1) the debtor must transfer, remove, destroy, mutilate or conceal, (2) property of the debtor, (3) within one year of the bankruptcy filing, (4) with the intent to hinder, delay, or defraud a creditor. In re Hayes, 229 B.R. 253, 259 (BAP 1st Cir. 1999) (citations omitted). The Bankruptcy Code also forbids a debtor from committing an act prohibited by 11 U.S.C. § 727(a) (2) in connection with the bankruptcy case of an insider. Section 727(a) (7) of the Bankruptcy Code, 11 U.S.C. § 727(a) (7), provides as follows:

(a) The Court shall grant the debtor a discharge, unless-- (7) the debtor has committed any act specified in paragraph (2), (3), (4), (5), or (6) of this subsection, on or within one year before the date of the filing of the petition, or during the case, in connection with another case, under this title or under the Bankruptcy Act, concerning an insider; . . .

In cases in which the debtor is an individual, an insider includes a "corporation of which the debtor is a director, officer, or person in control." 11 U.S.C. § 101(31) (A) (iv).

Watman was the sole officer and shareholder and wholly owned and controlled Children's Dental. Children's Dental thus qualifies as an insider of Watman for purposes of 11 U.S.C. § 727(a) (7).

Accordingly, Watman would be denied a discharge if he committed any of the acts prohibited by § 727 with respect to Children's Dental's case.

The parties dispute whether a transfer occurred and whether Watman had the intent to hinder, delay, or defraud Groman. While the bankruptcy court suggested that it did not believe that a transfer had occurred, the court made findings which essentially stated that even if a transfer did occur, Watman still lacked the requisite intent to hinder, delay or defraud, in order to be denied a discharge. (Tr., pp. 195-97). For the purpose of this opinion, we will assume that the payments by Children's Dental, the diversion of patients, employees, location, etc., collectively constituted a transfer within the meaning of 11 U.S.C. §§ 727(a)(2) and (a)(7).

The real issue is whether Watman intended to hinder, delay or defraud Groman. After trial, the bankruptcy court found that Watman was advised by his counsel that it was necessary for him to resign as an employee of Children's Dental prior to the commencement of the bankruptcy proceeding of Children's Dental (Tr., pp. 194-95, adopting section III, paragraphs 1 through 4 of the contested matters for the defendant contained in the second pre-trial stipulation). The court found that Watman reviewed his course of action and at no time received advice that he could not act in the manner in which he acted. Id. The court found that

Watman conducted himself with the advice of counsel and believed that he was acting within the law. Id. The court finally concluded that Watman had no intent to hinder, delay or defraud his creditors or the creditors of Children's Dental. Id. The Court found that reliance on the advice of counsel in such a close case, negated some of the inferences of intent. (Tr., p. 197).

More specifically, as to intent, the court accepted the testimony of Watman that he had discussed the direction of Children's Dental with counsel, including a plan "hopefully" for Children's Dental to stay in business (Tr., p. 195, adopting defendant's proposed findings of fact included within the opposition and response to plaintiff's proposed findings of fact). Watman testified that he believed that this action was consistent with the interests of Children's Dental. Id. Watman resigned from Children's Dental on the advice of counsel. Id. Further, based on the advice of counsel, Watman believed that the formation of Lowell Dentistry was consistent with the reorganization of Children's Dental. Id.

The Court considered that prior to his default, Watman had made payments to Groman for many years. The Court found that Watman joined Children's Dental in April 1988 and that at the end of the first year, Watman agreed to purchase 50 percent of the practice, paying Groman monthly for ten years (Tr., p. 195, adopting proposed findings of fact contained within the plaintiff's

post-trial brief). In 1992, Watman agreed to purchase the other 50 percent and the payment period was extended an additional ten years. Id. Watman made the monthly payments until September 1997, at which time Watman said that he was having difficulties making the payments. Id.

With respect to the payments made by Watman from the accounts of Children's Dental prior to the bankruptcy filing, the court accepted that they were fully and accurately set forth in the books and records of Children's Dental. Id. These payments were the current bills and obligations of Children's Dental as of March 18, 1999 and made at the direction of counsel. Id. Moreover, when the petition was filed, Children's Dental had cash on hand in its checking account of \$5,944 and \$26,478 in a money market account. Id. These funds were turned over to the trustee. Id. These facts contradict Groman's allegations that Watman was trying to enrich himself at the expense of Children's Dental's creditors. Id. The court found that "the two bankruptcy cases were filed practically simultaneously with the alleged transfers, and that was done with full disclosure." (Tr., p. 195).

The court further found that Watman did not take actions to transfer title of the office furnishings or equipment to himself or to Lowell Dentistry. Id. The computer belonging to Children's Dental was used to collect Children's Dental's receivables and then stored in the basement and remains available to the trustee. Id.

None of the patients had a contractual agreement with Children's Dental and the patient records remained in the control of the patients. Id.¹

While the parties do not dispute the individual findings of fact, they dispute whether they collectively constitute intent to hinder, delay or defraud. "A finding of fact is clearly erroneous when the reviewing court is left with the abiding and firm conviction that a mistake has been committed." Anderson v. City of Bessemer City, 470 U.S. 564, 573 (1985). We conclude that the bankruptcy court had ample evidence from which to find that Watman did not intend to hinder, delay or defraud Groman.

Watman made the transfers with the advice of counsel. Generally, a debtor, who acts in reliance on the advice of counsel, lacks actual intent to hinder or delay a creditor, as long as the debtor's reliance on the attorney's advice was in good faith. In re Adeeb, 787 F.2d 1339 (9th Cir. 1986). Where the debtor's reliance on the advice of counsel is reasonable, the advice negates an inference of fraudulent intent. In re Siddell, 191 B.R. 544 (Bankr. N.D.N.Y. 1996).

Prior to the bankruptcy petitions, Watman made payments to Groman for nine years. After defaulting on his obligation to

¹While another Court may have found, based upon the same record, that despite the patients' control of their records, the dental practice had an independent going concern value, we cannot say that the Bankruptcy Court's contrary determination in the instant case rises to the level of clear error.

Groman and even after the bankruptcy petitions were filed, Watman testified that he was hopeful that he could resolve his differences with Groman. Watman caused Children's Dental to make payment of current expenses prior to beginning to practice in his name, but Watman reasonably believed that these actions were not inconsistent with Children's Dental's interests. Watman fully disclosed the transfers. At the time of filing the bankruptcy petitions, Children's Dental had cash on hand of \$5,944, \$26,478 in a money market account, plus receivables of approximately \$69,000. Watman did not take title to any of Children's Dental's equipment and the equipment that was not leased, remains available to the Chapter 7 trustee for distribution.

CONCLUSION

The bankruptcy court did not commit clear error in finding that the debtor did not act with the intent to hinder, delay or defraud Groman within the meaning of 11 U.S.C. §§ 727(a)(2) and (a)(7). Accordingly, we **AFFIRM** the judgment of the bankruptcy court.