

FILED

at.....O'clock &.....min.....M

AUG 17 2000

BRENDA K. ARGOE, CLERK  
United States Bankruptcy Court  
Columbia, South Carolina (3)

UNITED STATES BANKRUPTCY COURT

DISTRICT OF SOUTH CAROLINA

In re:

Rodney G. Buchanan and Mary Kathleen  
Buchanan,

Debtors.

Kevin Campbell, Trustee

Plaintiff,

vs.

Mary Kathleen Buchanan

Defendant.

Case No. 99-09817-W  
Chapter 7

ENTERED

AUG 17 2000

V.L.D.

JUDGMENT

Adversary Proceeding No.  
00-80057-W

Based upon the Findings of Fact and Conclusions of Law as recited in the Order of this Court, the Court denies the Trustee's Notice of Application for Settlement and Compromise and further orders that Mary Kathleen Buchanan's discharge be entered and the above-captioned adversary action be closed.

  
UNITED STATES BANKRUPTCY JUDGE

Columbia, South Carolina  
August 17, 2000

**UNITED STATES BANKRUPTCY COURT  
DISTRICT OF SOUTH CAROLINA**

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Adversary Proceeding No.  
00-80057-W

**ORDER DENYING APPROVAL OF SETTLEMENT AND  
DISMISSING ADVERSARY PROCEEDING**

THIS MATTER comes before the Court upon Kevin Campbell's (the "Trustee") Notice of Application for Settlement and Compromise of this adversary proceeding ("Application for Settlement") filed with the Court on June 26, 2000. The United States Trustee ("UST") filed an Objection to Settlement and Compromise ("Objection") on July 7, 2000. A separate order is issued in connection with the Trustee's cause of action for turnover of property which was alleged in the Complaint. Pursuant to the following Findings of Fact and Conclusions of Law pursuant to Fed. R. Civ. P. 52, made applicable by Fed. R. Bankr. P. 7052,<sup>1</sup> the Court sustains in part the UST's Objection and denies the Trustee's Application for Settlement. The Trustee's remaining cause of action to revoke the discharge of Mary Kathleen Buchanan ("Defendant") is dismissed and the adversary proceeding is closed.

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<sup>1</sup> The Court notes that to the extent any of the following Findings of Fact constitute Conclusions of Law, they are adopted as such, and to the extent any Conclusions of Law constitute Findings of Fact, they are so adopted.

## FINDINGS OF FACT

1. Rodney G. Buchanan and Mary Kathleen Buchanan (hereinafter jointly the “Debtors”) filed a joint petition for relief under Chapter 7 of the Bankruptcy Code on November 12, 1999. Debtors were represented by counsel, A. Christopher Potts, Esquire.
2. Debtors’ schedules reflect non-priority unsecured debt of \$67,825.47.
3. The meeting of creditors pursuant to 11 U.S.C. § 341(a)<sup>2</sup> was scheduled for December 20, 1999. At that time, the Trustee examined Debtors concerning their financial affairs and concluded that their home and an automobile might be liquidated for the benefit of creditors. The Trustee also determined that Debtors would shortly become entitled to tax refunds which he considered property of the estate. At the meeting, the Trustee announced the abandonment of all other scheduled assets pursuant to SC LBR 6007-1(b) and noted for the record his position that any tax refund for tax year 1999 was property of the estate. He also requested that the Clerk of Court provide a notice to creditors to file proofs of claim or interest. By the July 10, 2000 claims bar date, six creditors filed unsecured non-priority claims totaling \$27,293.33.
4. Following the meeting of creditors, the Trustee, through counsel, corresponded with Debtors’ lawyer and restated his position that the tax refunds were property of the estate and should be delivered to him upon receipt by Debtors. He also requested some of Debtors’ books and records for examination along with any tax return information for the 1999 tax year and further asked that Debtors’ proposed tax return be delivered for review by an accountant prior to submission to the tax authorities.
5. Debtors turned over their books and records but not their tax information.

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<sup>2</sup> Further references to the Bankruptcy Code shall be by section number only.

6. Debtors' attorney, following the meeting of creditors and discovery of the Trustee's intention to liquidate property, counseled his clients concerning a conversion of their case to a Chapter 13 case. Debtors, who by that time had separated, were unable to agree on the conversion due to conflicting interests.

7. The deadline for objections to Debtors' discharge was February 18, 2000, but the Trustee filed no complaint seeking the denial of discharge.

8. The Trustee's review of Debtors' books and records led to questions concerning several large transfers and to subsequent communication, on February 25, 2000, with Debtors' counsel.

9. On February 29, 2000, Defendant telephoned the Trustee's office and stated that she and Mr. Buchanan were separated and that she was unfamiliar with the questioned transfers. In response to an inquiry about the tax refunds, Defendant stated that she had received and spent her tax refunds.

10. At the hearing on the Trustee's Application for Settlement, Defendant admitted that she knew the Trustee claimed entitlement to the tax refunds but stated she spent it based, to some degree, upon her expectation that her case was going to be converted to a Chapter 13 case according to her counsel's advice.

11. On March 1, 2000, the Trustee's counsel wrote Debtors' lawyer and related the telephone conversation with Defendant. The letter also demanded that arrangements be made to turnover the amount of the tax refunds.

12. Shortly thereafter, Defendant provided the Trustee with copies of her 1999 tax returns, indicating that she had been entitled to tax refunds of \$440.00 from the South Carolina Department of Revenue and \$3,510.00 from the Internal Revenue Service.

13. Defendant expressed an inability to pay the funds to the estate; therefore, the Trustee

initiated this action for turnover of the funds and revocation of Defendant's discharge pursuant to § 727(d)(2)<sup>3</sup>. Service was effected on March 27, 2000.

14. Debtors' counsel attempted to negotiate a settlement of the Trustee's Complaint but, faced with irreconcilable differences in the positions of his clients, ultimately sought and received permission to withdraw as counsel in the case. The time for answering the Complaint has passed, although counsel for the Trustee considered the parties to be operating under an informal extension of time to responsively plead.<sup>4</sup>

15. The Trustee and Defendant, proceeding without counsel, agreed to resolve the adversary action. As specified in the Application for Settlement, Defendant agreed to pay the estate \$3,950, the amount equal to her combined 1999 tax refunds, as well as the additional sum of \$1,100, representing the attorney's fees and costs incurred by the Trustee in pursuing the adversary action. According to the settlement, these amounts were to be paid over time, with interest on the unpaid balance at eight (8%) percent *per annum*, but the total amount was due no later than the date of Defendant's receipt of her year 2000 tax refund or April 15, 2001. The parties' settlement further provided that Defendant was to consent to an order revoking her

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<sup>3</sup> Section 727(d)(2) provides:

On request of the Trustee . . . and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if - (2) the debtor acquired property that is property of the estate, or became entitled to acquire property that would be property of the estate, and knowingly and fraudulently failed to report the acquisition of or entitlement to such property, or to deliver or surrender such property to the trustee . . . .

<sup>4</sup> The local rules of this Court limit the ability of parties to grant extensions of time to respond to pleadings to one additional period that may not exceed in length the original time for response. SC LBR 9006-1(b).

discharge and that the Trustee would hold the order and file it only if Defendant failed to pay the agreed consideration.

16. The UST filed his Objection on July 7, 2000, arguing that the settlement was not in the best interest of the estate and that the settlement impaired the integrity of the judicial process.

### CONCLUSIONS OF LAW

In his Complaint, the Trustee sought the turnover of property of the estate pursuant to §542 and revocation of Defendant's discharge pursuant §727(d)(2). The claims against Defendant appear primarily aimed at recovering the tax refunds for the benefit of the bankruptcy estate.

Fed. R. Bankr. P.7041 provides for dismissal of a complaint objecting to a debtor's discharge "only on order of the court containing terms and conditions which the court deems proper." According to the rule, notice of the proposed dismissal must be given "to the trustee, the United States trustee and such other persons as the court may direct." The Court is to "consider such dismissals, and settlements on a case by case basis, under the circumstances and conditions before the Court." Note Buyers, Inc. v. Cooler (In re Cooler), C/A 98-02856-W, Adv. Proc. 98-80162-W (Bankr. D. S.C., 6/1/1999), aff'd sub nom. McDow v. Note Buyers, Inc., C/A 2:99-2531-18 (D. S.C., 3/24/2000). "[A]n approach that requires the court to determine if the settlement is fair and equitable, and also requires the court to consider the best interests of the estate is the proper framework of analysis. The court also retains the authority to impose such terms and conditions on the settlement as it deems proper." McDow v. Note Buyers, Inc., C/A 2:99-2531-18 (D. S.C., 3/24/2000). The burden usually falls on the proponent of a settlement to prove that such settlement is in the best interest of the estate. In re Frye, 216 B.R. 166 (Bankr. E.D.Va. 1997).

Bankruptcy courts have come to different conclusions concerning the propriety of settling a discharge action. Some courts have adopted a *per se* rule that discharge actions can not be settled while others permit the settlement under varying terms. This Court has previously rejected a *per se* rule that a § 727 action brought by a creditor cannot be settled or dismissed unless the settlement proceeds are paid to the Chapter 7 trustee for distribution to all creditors. See, e.g., Note Buyers, Inc. v. Cooler (In re Cooler), C/A 98-02856-W, Adv. Proc. 98-80162-W (Bankr. D. S.C., 6/1/1999), aff'd sub nom. McDow v. Note Buyers, Inc., C/A 2:99-2531-18 (D. S.C., 3/24/2000). In considering settlements of a §727 action, a court must balance the sometimes competing considerations of favoring compromise and promoting settlement with protecting the integrity of the bankruptcy system and achieving the best interests of the estate.

Determining whether a settlement is fair and equitable requires the Court to consider the following factors: “the probability of success in the litigation; (2) the collectability of a resulting judgment; (3) the complexity, expense, inconvenience, and delay attendant to continued litigation; and (4) the interest of creditors.” McDow v. Note Buyers, Inc., C/A 2:99-2531-18 (D. S.C., 3/24/2000). For the reasons stated below, the Court declines to approve the settlement of the §727 action in this case.

Initially, the direct linkage of an action to deny or revoke a discharge with an action seeking the payment of money to the trustee in settlement of another cause of action is disfavored by the Court. When a trustee, as the fiduciary for all the creditors, elects to bring such an action, he should intend to pursue the action to its conclusion at trial. It is implicit that a trustee should not undertake such a serious action against a debtor unless he has sufficient cause and a strong case to present to the Court. Of course, both the bankruptcy system and creditors benefit from the denial of a discharge to the unscrupulous debtor. Yet, because the unfortunate

but honest debtor should receive a discharge; the trustee, just as any other party, should not initiate or pursue a weak but colorable objection to discharge to secure the settlement of another cause of action. The proper balance between the debtor's fresh start and the creditor's right to recovery from non-exempt assets is best preserved if the threat of loss of discharge is not used merely as a means to augment the estate.

Secondly, based upon the pleadings, proffers of counsel, and statements of Defendant, the Trustee would not prevail in this §727 action. The decision of the Court to revoke Defendant's discharge<sup>5</sup> is dependent on proof of her fraudulent intent in failing to deliver the tax refunds to the Trustee. In this case, while Defendant knew that she had a duty to turn the tax refunds over to the Trustee but failed to do so, her conduct is mitigated by the fact that she and her husband separated at or near the time of these events. The separation gave rise to a conflict in the interests of the joint Debtors which caused their attorney to subsequently withdraw from representing either. Defendant discussed with counsel the option of filing a Chapter 13 case and proffered testimony that she believed she could repay her creditors over time without losing her home, automobile, and tax refunds. Her plans were not carried out once her now estranged husband<sup>6</sup> refused to join in a motion to convert, at which time she determined that she could not afford plan payments without his assistance. Finally, she has agreed to pay to the Trustee all of

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<sup>5</sup> The last day to object to Defendant's discharge has passed; however, the Clerk of the Court had not processed the order of discharge at the time this adversary action was filed and did not thereafter do so. Since the last day to object to discharge had passed, the Trustee properly sought to revoke rather than deny Defendant's discharge.

<sup>6</sup> The timing of Defendant's marital discord and separation is not clear from the record before the Court. Debtor's counsel, in filing a joint petition for relief as permitted by § 302(a), should carefully consider the actual and potential adverse interests of the spouses, whether separated or not. See Rule 1.7 of SCACR 407.

the funds that are due.

A debtor enjoys a presumption in favor of the discharge of indebtedness in a Chapter 7 bankruptcy case. The Bankruptcy Code favors the discharge of a debtor's debts, and the bankruptcy laws should generally be construed liberally in favor of granting the discharge. In re Weldon, 184 B.R. 710, 712 (Bankr. D.S.C. 1995). The burden of proof is on the party objecting to discharge. See Grogan v. Garner, 498 U.S. 279 (1991); Farouki v. Emirates Bank International, Ltd., 14 F.3d 244 (4<sup>th</sup> Cir. 1994). The general application of § 727 requires a determination of whether a debtor intended to defraud creditors. Zanderman, Inc. v. Sandoval (In re Sandoval), 1998 WL 497475 (4<sup>th</sup> Cir. Aug. 10, 1998), which may be shown by circumstantial evidence or by inferences drawn from a course of conduct. In re Weldon, 184 B.R. at 710.

#### CONCLUSION

Based upon the facts and proffers before the Court, the trustee has not met his burden of proving that Defendant fraudulently failed to turnover the tax refunds to the estate. It is therefore,

**ORDERED** that the Trustee's Notice of Application for Settlement and Compromise is denied.

**IT IS FURTHER ORDERED** that Defendant's discharge shall be entered and this adversary action closed.

**AND IT IS SO ORDERED.**

Columbia, South Carolina

August 17, 2000.

  
UNITED STATES BANKRUPTCY JUDGE