UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF MISSISSIPPI

IN RE: KENNETH W. McDANIEL and
PHYLLIS M. McDANIEL, DEBTORS — CASE NO. 03-15564

UNITED STATES TRUSTEE — PLAINTIFF

VERSUS — ADV. PROC. NO. 05-1004

KENNETH W. McDANIEL and
PHYLLIS M. McDANIEL — DEFENDANTS

OPINION

On consideration before the court is a complaint to revoke discharge filed by the United States Trustee for Region 5 (UST) against the defendants, Kenneth W. McDaniel and Phyllis M. McDaniel (defendants or debtors); an answer to said complaint having been filed by the debtors; and the court, having heard and considered same, hereby finds as follows, to-wit:

I.

The court has jurisdiction of the parties to and the subject matter of this proceeding pursuant to 28 U.S.C. §1334 and 28 U.S.C. §157. This is a core adversary proceeding as defined in 28 U.S.C. §157(b)(2)(A) and (J).

II.

In the pretrial order, entered earlier in this proceeding, the UST and the debtors stipulated to the following facts, to-wit:

a. Defendants filed for Chapter 7 relief on September 3, 2003.

b. Defendants were represented in their Chapter 7 Bankruptcy case by their attorney, Joe O. Sams, Jr.

c. Defendants and Joe O. Sams, Jr. shared an interest in a corporation/real estate at the time of the filing of their Chapter 7 case.

d. Defendants omitted an ownership interest in the corporation/real estate in their bankruptcy schedules and statement of financial affairs, and failed to attest to their ownership interest at their 341 meeting of creditors.

e. Joe O. Sams, Jr. filed a motion to reopen the Chapter 7 Bankruptcy case on June 21, 2004 on grounds that a conflict of interest had arisen between he, as counsel for the debtors, and the debtors which required him to withdraw as counsel for the debtors pursuant to the canons of ethics.

f. This bankruptcy case was reopened on June 30, 2004 upon motion of the debtors' attorney.

g. An order was entered on September 22, 2004 allowing Sams to withdraw as counsel for the debtors.

h. Joe O. Sams, Jr. disclosed to the Court the defendants' failure to list assets on or about October 4, 2004.

i. The U.S. Trustee moved to conduct a 2004 examination of the defendants on October 13, 2004.

j. This court entered an order allowing a 2004 examination of the defendants on October 14, 2004.

k. Defendants amended their bankruptcy schedules on October 28, 2004.

Since the debtors received their Chapter 7 discharge on January 9, 2004, the UST seeks to revoke said discharge pursuant to §727(d)(1) and (2) of the Bankruptcy Code which provide as follows, to-wit:

> (d) On request of the trustee, a creditor, or the United States trustee, and after notice and a hearing, the court shall revoke a discharge granted under subsection (a) of this section if--
>
> (1) such discharge was obtained through the fraud of the debtor, and the requesting party did not know of such fraud until after the granting of such discharge;

> (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;

III.

In the aforesaid stipulations, the debtors acknowledged that they initially failed to report the ownership of certain shares of stock in a corporation known as South Forty Farms, Inc., (South Forty Farms). The debtors owned fifty percent of the issued corporate stock, and the remaining fifty percent was owned by the debtors' bankruptcy counsel, Joe O. Sams, Jr., (Sams).

South Forty Farms was organized to own approximately 130 acres of real property located on Highway 45 South, in Lowndes County, Mississippi. The said property was acquired in 1997 from Otis and Patricia Richardson, who financed $73,000.00 of the total purchase price.

At a later date, the debtors and Sams each acquired from the corporation 2 ½ acre home sites which were located on the 130 acres. The debtors borrowed money from Fairbanks Mortgage Company (Fairbanks) and secured the loan with a deed of trust encumbering their 2 ½ acres, as well as, a mobile home that they also acquired. They subsequently defaulted on this indebtedness and Fairbanks foreclosed its deed of trust in March, 2003.

In January, 2003, South Forty Farms sold approximately sixty acres of the property to Wes Jones and satisfied the indebtedness owed to the Richardsons. At the time of this transaction, because of unexplained legal difficulties, Sams had transferred his shares of stock in South Forty Farms to the debtors to be held in trust for him. (See Attorney Richard Spann's letter to the court, dated October 4, 2004.) Despite this transfer, the debtors always considered Sams to be a joint owner of the corporate real estate interest. (See affidavit of ownership dated January 16, 2003.)

Other than handling their bankruptcy filing, over the years, Sams performed other general legal services for the debtors. Sporadically, Phyllis McDaniel worked for Sams in his law office performing secretarial and filing duties. She, however, had nothing to do with the preparation or typing of the bankruptcy petition and schedules that Sams filed for her and her husband.

After Sams had the debtors' bankruptcy case reopened and following his withdrawal from their representation, a dispute arose as to the advice that he had given the debtors regarding the disclosure of their interest in South Forty Farms in their bankruptcy schedules. The debtors testified that Sams told them on more than one occasion that they did not have to disclose their ownership interest in the corporation. Sams, of course, denied that he made these statements.

Sams testified that the subject of bankruptcy had been discussed with the debtors much earlier than their actual filing date. Sams indicated that he told the debtors to "get rid" of the land, as well as, several horses that they owned before they filed bankruptcy. He stated that at the time of the bankruptcy filing that he thought that the debtors had divested themselves of the ownership of these properties.

Although the debtors failed to disclose that they had disposed of assets in their original schedules, they acknowledged in their testimony that they had sold certain horses and cattle in March, 2003, approximately six months before their filing date. After their case was reopened, they amended their schedules to reflect these sales. Because the consideration received appeared to be reasonable, albeit nominal, the court attaches little significance to these transfers insofar as the current adversary proceeding is concerned. The sales did not appear to be fraudulent in any way, and the trustee has expressed no interest in attempting to recover any of the livestock sold.

The debtors also did not disclose in their schedules that they had a prepetition cause of

action against Fairbanks which, as noted earlier, had foreclosed its deed of trust which encumbered the debtors' residence and 2 ½ acre home site. The testimony, however, revealed that the debtors were actually unaware of this cause of action until after they had received their discharge. As potential class action plaintiffs in a suit against Fairbanks, they were contacted and signed a contract of employment with the Colom Law Firm of Columbus, Mississippi, in March, 2004, which was approximately two months after the date of their discharge. When the debtors amended their schedules, they disclosed this cause of action. The Chapter 7 trustee was able to recover approximately $25,000.00 in net proceeds for the benefit of the bankruptcy estate. Insofar as the estate's creditors are concerned, there was no economic detriment caused by this untimely disclosure.

Although the debtors obviously failed to disclose these matters, the primary issue that causes concern for the court is the non-disclosure of their interest in South Forty Farms. The debtors own fifty percent of a corporation that, in turn, owns approximately sixty-five acres of unencumbered real property fronting on Highway 45 South in Lowndes County, Mississippi. A sale of the debtors' interest in this property is currently being negotiated by the Chapter 7 trustee. The debtors' portion of the proceeds from this contemplated sale, coupled with the proceeds received from the Fairbanks class action litigation, will satisfy a major portion of the claims that have been filed in this bankruptcy case. Despite this somewhat successful result, should the debtors' discharge still be revoked because they failed to disclose their ownership in South Forty Farms?

The debtors both say that they relied on the advice of their attorney, who allegedly told

them that they did not have to disclose the ownership of a corporate asset. The attorney is certainly not blameless. He was a co-owner of the corporate shares with the debtors. He obviously knew they owned this stock in January, 2003, only nine months before the bankruptcy petition was filed, because this was the occasion when South Forty Farms sold sixty acres of the property and satisfied the Richardson indebtedness. As bankruptcy counsel, Sams had a fundamental obligation to his clients and to the court to exercise due diligence and thus make inquiry before the petition was filed so that he could accurately disclose the assets owned by the debtors. Sams failed to do so. Why? The court can only speculate, but the fact that he had transferred his own shares in trust to the debtors, coupled with the likely concern that his shares might get ensnarled with the debtors' shares in the administration of their bankruptcy case, certainly is a possibility. For whatever reason, the debtors' bankruptcy petition should never have been filed without this very basic disclosure.

Can the debtors preserve their discharge by asserting that they relied on the advice of Sams? Presume, for a moment, for the same reason noted in the paragraph immediately preceding, that Sams advised the debtors not to disclose their ownership in South Forty Farms. The Fifth Circuit Court of Appeals has made it clear that a debtor is not entitled to a discharge where that debtor makes statements, under oath, with reckless indifference to the truth. Subsequent amendments to the schedules cannot serve as an excuse. In re Sholdra, 249 F.3d 380, 382 (5th Cir. 2001) (citing Mazer v. United States, 298 F.2d 579, 582 (7th Cir. 1962).) See also, Swicegood v. Ginn, 924 F.2d 230, 232 (11th Cir. 1991).

Insofar as reliance on the advice of counsel is concerned, In re Gartner, 326 B.R. 357 (Bankr. S.D. Tex., 2005), provides the following insight:

> A debtor can defend against claims brought under section 727(a)(4) by asserting reliance on attorney advice. However, this defense is only available where the debtor's reliance was reasonable and in good faith. In re Dreyer, 127 B.R. 587, 597 (Bankr. N.D. Tex. 1991) (citing In re Weber, 99 B.R. 1001, 1018 (Bankr. D. Utah 1989)). The reasonableness of the debtor's reliance is undermined where the debtor has admitted under oath to having read and signed the Schedules and Statement of Financial Affairs that are challenged in the adversary proceeding. Dreyer, 127 B.R. at 597. Evidence of the debtor's intent to omit information from the bankruptcy petition undermines the debtor's assertion of good faith Id. at 598.

326 B.R. at p. 374.

Both debtors acknowledged that they read and signed their bankruptcy petition and schedules after they were prepared by Sams. Kenneth McDaniel candidly testified that he questioned Sams' advice about not disclosing the interest in South Forty Farms. He then stated, however, that Sams was his lawyer and that he did what his lawyer told him to do.

The requirements of the bankruptcy schedules and the Statement of Financial Affairs are clear and unambiguous. On Schedule B. Personal Property, paragraph 12, the debtors are required to list their ownership in "Stock and interests in incorporated and unincorporated businesses." The debtors indicated that they owned "none." On the Statement of Financial Affairs, paragraph 10, entitled "Other Transfers," the debtors are required to disclose all property transferred either absolutely or as security within one year immediately preceding the commencement of the bankruptcy case. Again, the debtors indicated "none."

Considering the testimony of all the witnesses, the court is of the opinion that the debtors knew full well that their interest in South Forty Farms should have been disclosed. Even if Sams had given them the advice not to disclose, and he may well have, the court does not believe that

their reliance on such advice was reasonable and in good faith. The court cannot excuse their glaring omission. The complaint filed by the UST, asserting a violation of §727(d) of the Bankruptcy Code, is well taken, and it must be sustained. The debtors' discharge will be revoked by a separate order entered contemporaneously herewith. Fortunately, the Chapter 7 trustee already has and will continue to recover assets that will satisfy a substantial portion of the claims that have been filed in this bankruptcy case. As a result, the economic impact to the debtors, as well as, to their creditors will be significantly minimized.

The quality of Sams' representation in this case was deplorable. The court cannot say with certainty that Sams advised the debtors not to disclose their ownership interest in South Forty Farms. That would certainly be the greater sin insofar as this court is concerned. However, it is clear that Sams committed the lesser sin of failing to exercise due diligence or any diligence in filing the bankruptcy petition and schedules. Obviously, Sams knew that the debtors owned an interest in South Forty Farms and were holding corporate shares in trust for him within months of the bankruptcy filing date. There is simply no excuse for his allowing the debtors' petition and schedules to be filed as they were.

This the 23rd day of January, 2007.

/s/ David W. Houston, III
DAVID W. HOUSTON, III
UNITED STATES BANKRUPTCY JUDGE