IN THE UNITED STATES DISTRICT COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

IN RE: RICHARD A. DILORETO	:	**CIVIL ACTION**
	:	
	:	**NO. 04-CV-1326**
	:	
	:	

MEMORANDUM AND ORDER

Kauffman, J. **October 13, 2006**

Richard A. DiLoreto ("Debtor") appeals a final order of the United States Bankruptcy Court for the Eastern District of Pennsylvania denying his discharge pursuant to 11 U.S.C. §§ 727(a)(2), (3), and (4). In a Memorandum and Order dated February 17, 2004, the Honorable Bruce I. Fox entered judgment against Debtor in an adversary proceeding initiated by the Superintendent of Insurance of the State of New York (the "Superintendent") which sought to prevent Debtor from obtaining a Chapter 7 discharge. For the reasons which follow, the decision of the Bankruptcy Court will be affirmed.[1]

I. Factual and Procedural History

This Court will adopt the Bankruptcy Court's thorough and exhaustive findings of fact.[2] Given the lengthy factual background, the Court will refer only to those facts relevant to the disposition of this appeal.

Debtor, a Pennsylvania resident, filed a petition for relief under Chapter 7 of the

[1] This Court has jurisdiction pursuant to 28 U.S.C. § 158(a).

[2] The Court must accept the Bankruptcy Court's factual determinations unless "clearly erroneous." In re Morrissey, 717 F.2d 100, 104 (3d Cir. 1983); Universal Minerals, Inc. v. C.A. Hughes & Co., 669 F.2d 98, 102-03 (3d Cir. 1981). Debtor has failed to produce evidence sufficient to establish that the Bankruptcy Court's findings of fact are clearly erroneous.

Bankruptcy Code, 11 U.S.C. §§ 101-1330, on November 12, 1998. R. at 517. A Schedule of Assets and Liabilities and a Statement of Financial Affairs accompanied his petition. On March 12, 1999, the Superintendent, as Liquidator of the Nassau Insurance Company, filed a complaint alleging that Debtor should be denied bankruptcy discharge under 11 U.S.C. §727. Trial was held on May 16-17, 2002. On February 17, 2004, the Bankruptcy Court granted the Superintendent's objections to Debtor's discharge.

The issues presented arise from Debtor's ownership, operation, and involvement in a number of intricately-related companies. Of these, the most relevant are Nassau Insurance Company ("Nassau"), Ardra Insurance Co. ("Ardra") and Tiber Holding Co. ("Tiber"). Nassau, a casualty and property insurance company, was in the business of selling medallion taxi policies. Nassau was owned by Venice Holding Company, whose shares were wholly owned by Debtor. Bankr. Op. at 21. Nassau became insolvent, and on June 22, 1984, a liquidation order was entered. Id.

In order to minimize the cost of reinsurance premiums paid by Nassau, Debtor formed Ardra, a Bermuda-based reinsurance company. At the time of its formation in 1976, Ardra was wholly owned by Debtor's wife, Jeanne. In November 1979, her shares were transferred to SWM, Inc. ("SWM"), a Delaware corporation also wholly owned by her. Id. at 22. The only entity Ardra reinsures is Nassau. Id. Although from 1977 through 1984 Nassau paid Ardra $11,660,496 in reinsurance premiums, Ardra paid Nassau only $3,933,653.76. The $7 million difference has not been accounted for or explained by Debtor. Id. at 23.

On January 1, 1982, SWM merged into Tiber, and Ardra became Tiber's subsidiary. Id. at 23. Debtor, the president of Tiber, intermittently served as chairman and CEO of Tiber, and his wife and daughter were shareholders. Id. at 23-24. Tiber remained the parent and sole shareholder of Ardra until December 3, 1990, when Tiber sold all its outstanding shares to Corporate Holding Corporation ("CHC"), a Delaware corporation wholly owned by Debtor. Id. at 24. On June 1, 1998, five months prior to the bankruptcy filing, Debtor caused CHC to transfer its shareholder interest in Ardra to P.T.C. Finance ("P.T.C."). Id. at 25.[3]

II. Opinion of the Bankruptcy Court

The Bankruptcy Court found that Debtor had embarked upon a complex plan over many years to control his personal assets and the assets of various entities through family members and other different entities. Debtor retained complete control of these assets, using them for his personal benefit while they were ostensibly beyond the reach of creditors. See Bankr. Op. at 97.[4] When courts in New York began to enter judgments against Debtor for activities related to these offshore corporations, he sought protection by a Chapter 7 filing. The Bankruptcy Court found that: (1) the financial statements offered by Debtor in support of his bankruptcy petition were inaccurate and misleading; (2) Debtor improperly transferred and concealed property belonging

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[3] In April 1985, the Superintendent brought an action against Ardra, Debtor, and his wife, in the Supreme Court of New York, alleging that the DiLoretos breached their fiduciary duty to Nassau by channeling Nassau funds to Ardra and then misappropriating the funds. Bankr. Op. at 25-26. The jury found that Debtor was the equitable owner of both Tiber and Ardra, and thus their alter ego. Id. On April 8, 2003, a four-judge panel of the Appellate Division of the Supreme Court of New York affirmed the alter-ego judgment, finding that Debtor controlled Ardra and "deprived it of the funds needed to meet its reinsurance obligations." Id. at 27.

[4] For example, assets of Ardra were used to pay the DiLoretos' country club dues. Bankr. Op. at 43. In March 2000, despite a court order admonishing Mrs. DiLoreto that Ardra must not pay any of her legal expenses, Ardra reimbursed her for legal payments she made on her own behalf. Id. Between 1995 and 1997, Debtor signed a number of promissory notes on behalf of INS Claims Services Inc. payable to CHC. He was the sole director, officer and employee of both companies. Id. at 24, 43.

both to him and to his alter ego corporations within a one year period of his bankruptcy filing; (3) Debtor failed to maintain or produce adequate records by which his financial condition could be ascertained; and (4) Debtor knowingly made a false statement under oath by signing and confirming incomplete bankruptcy schedules. In light of these material misrepresentations and omissions, the Bankruptcy Court concluded that Debtor was not entitled to a discharge. See id. at 47-48.

On appeal, Debtor raises the following issues:

(1) Whether the Bankruptcy Court properly concluded that certain corporations, trusts and their assets were the property of Debtor, and whether in making this determination the Bankruptcy Court properly applied federal law rather than Pennsylvania law.

(2) Whether the Bankruptcy Court properly denied Debtor's discharge under Sections 727(a)(2), (3) and (4) of the Bankruptcy Code.

III. Standard of Review

"On an appeal the district court or bankruptcy appellate panel may affirm, modify, or reverse a bankruptcy judge's judgment, order, or decree or remand with instructions for further proceedings." Fed. R. Bankr. P. 8013. The Court must accept the Bankruptcy Court's factual determinations unless clearly erroneous, see Fed. R. Bankr. P. 8013, but its review of issues of pure law, or mixed questions of law and fact, is plenary. See Jones v. Chemetron Corp., 212 F.3d 199, 204-05 (3d Cir. 2000).

IV. Discussion

Debtor contends that the Bankruptcy Court committed reversible error by failing to conduct a veil-piercing analysis under Pennsylvania law, and that had the Bankruptcy Court used Pennsylvania law, there would have been no basis to pierce the veil of the various corporate and trust entities. See Appellate Brief at 23.

A. The Veil-Piercing Analysis under Pennsylvania State Law

The premise underlying Debtor's argument that the Bankruptcy Court's use of federal law to determine Debtor's alter ego status constituted reversible error is that Pennsylvania law imposes a more exacting standard than federal law. See Appellee's Brief at 31-32; Appellate Brief, at 24-25. Debtor's interpretation does not withstand scrutiny because the result would be the same either under federal or Pennsylvania law.

"It has long been the law of Pennsylvania that the legal fiction of a separate corporate identity may be disregarded whenever justice and public policy so demand." Elias H. Stein and Leon W. Silverman and Samuel Rappaport Inv. v. Samuel Rappaport, 11 Phila. Co. Rptr. 594, 604 (Pa. Com. Pl. 1985). Under Pennsylvania law, courts apply a "totality of the circumstances" test when determining whether to pierce the corporate veil and impose alter ego liability. Plastipak Packaging, Inc. v. DePasquale, 2003 WL 22120971, at *1 (3d Cir. Sep. 12, 2003) (applying Pennsylvania law). Pennsylvania generally recognizes that the corporate veil may be pierced "whenever necessary to avoid injustice." Id. (citing First Realvest, Inc. v. Avery Builders, Inc., 600 A.2d 601, 604 (Pa. Super. 1991), and Rinck v. Rinck, 526 A.2d 1221, 1223 (Pa. Super. 1987)). See also Hudson United Bank v. Pena, 2005 WL 736603, at *7 (E.D. Pa. March 30, 2005) ("Pennsylvania courts will not hesitate to treat as identical the corporation and the individuals owning all its stock and assets whenever justice and public policy demand"). The "legal fiction of a separate corporate entity was designed to serve convenience and justice, and will be disregarded whenever justice or public policy demand and when the rights of innocent parties are not prejudiced nor the theory of the corporate entity rendered useless." Ashley v. Ashley, 393 A.2d 637, 641 (Pa. 1978) (internal citations omitted).[5]

In comparison, courts applying the federal law of alter ego or veil-piercing have been concerned with the following questions: "(i) was there such unity of interest and lack of respect given to the separate identity of the corporation by its shareholders that the personalities and assets of the corporation and the individual are indistinct, and (ii) would adherence to the corporate fiction sanction a fraud, promote injustice, or lead to an invasion of legal obligation." NLRB v. Greater Kansas City Roofing, 2 F.3d 1047, 1052 (10th Cir. 1993). In addition to policy considerations, federal courts take into account what the Bankruptcy Court has characterized as "traditional state law factors," including gross undercapitalization, "failure to observe corporate formalities, non-payment of dividends, the insolvency of the debtor corporation at the time, siphoning of funds of the corporation by the dominant stockholder... absence of corporate records, and the fact that the corporation is merely a facade for the operations of the dominant stockholder..." United States v. Pisani, 646 F.2d 83, 88 (3d Cir. 1981), quoted in Bankr. Op. at 16.

Applying the "totality of the circumstances" approach of Pennsylvania to the facts at bar, the outcome would be the same. The Bankruptcy Court found that Debtor retained control and

[5] A number of factors are typically considered as part of the veil piercing analysis. They include: "[t]he failure to observe corporate formalities; non-payment of dividends; insolvency of debtor corporation; siphoning the funds from the corporation by dominant shareholders; non-functioning of other officers and directors; absence of corporate records; whether the corporation is a mere facade for the operations of a common shareholder or shareholders; and gross undercapitalization." Plastipak, 2003 WL 22120971, at *1 (internal citations omitted).

dominion of the corporations and trusts in question, even when they were nominally titled in the names of others; that he directed that assets of those companies be transferred for his personal benefit or the benefit of his family members; and that he actively concealed his assets by setting up "an intricate structure consisting of numerous business entities and two trusts that were all interconnected and under his control." Bankr. Op. at 46, 59. The Bankruptcy Court further found that:

> Despite transferring assets and ostensible ownership, and despite the care with which he took to prevent subsequently-acquired assets from being titled in his name, [Debtor] maintained control over these assets by retaining control over the entire corporate structure. This control allowed him to use corporate assets to satisfy personal obligations of himself and his family to prevent creditors of himself, Nassau and Ardra from recovering any sums due, and represented his attempt to circumvent the financial consequences of the plaintiff's seizure of Nassau.

Id. Debtor's transfers of Ardra to various holding companies that he controlled and his eventual transfer of Ardra to an offshore entity constituted a continuing concealment of property because, at all relevant times, he maintained control over that entity. Further, Debtor concealed an equitable interest in Ardra because he had personal debts paid by the company even when he allegedly had no ownership or control of it. Debtor attempted to conceal his interest in a series of offshore companies by establishing trusts which owned shares of those entities either directly or indirectly, and transferred or concealed this alter ego property with the intent to defraud his creditors.

Having reviewed the relevant veil-piercing principles under both federal and Pennsylvania state law, the Court is satisfied that the application of state law to the alter ego analysis would not have changed the result reached by the Bankruptcy Court relying on federal law. Accordingly, the Bankruptcy Court's determination of Debtor's alter ego status will be affirmed.

B. The Bankruptcy Court's Discharge Analysis Under 11 U.S.C. § 727(a)

11 U.S.C. § 727(a)(2)(A) provides that a debtor shall be denied a discharge where he

> with intent to hinder, delay or defraud a creditor or an officer of the estate charged with the custody of property under this title, has transferred, removed, destroyed, mutilated or concealed, or has permitted to be transferred, removed, destroyed, mutilated or concealed –
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> (A) property of the debtor, within one year before the date of the filing of the petition;
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> or
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> (B) property of the estate, after the date of the filing of the petition.

Thus, in order to meet his burden of persuasion, the Superintendent was required to prove by a preponderance of the evidence that Debtor (1) transferred or concealed property, (2) belonging to him, (3) within one year of the bankruptcy filing or after the petition was filed, and (4) with intent to hinder, delay or defraud a creditor. See In re Dawley, 312 B.R. 765, 782 (Bkrtcy. E.D. Pa. 2004); In re Bernard, 96 F.3d 1279, 1281 (9th Cir. 1996).

Having properly resolved to pierce the corporate veil of the entities controlled by the Debtor, the second element in the aforementioned test, requiring that the property in question belong to the debtor, was satisfied. The Bankruptcy Court further inquired whether Debtor transferred or concealed the property within one year of the bankruptcy filing, and whether he had done so with intent to hinder, delay or defraud a creditor. Bankr. Op. at 51, 68. With respect to the transfer element, the Bankruptcy Court identified a series of instances in which Debtor transferred property, both before and after the bankruptcy filing. Id. at 52-57. For instance, throughout the 1980's, Debtor engaged in multiple asset transfers to and from companies of which he was the sole owner. Id. at 52. In 1997-1998, Debtor made a number of cash payments to Regis Insurance Company in amounts ranging from $25,000 to $80,000. Id. at 53. Debtor identified these payments as "repayment of advance" from Regis, or "reimbursements of salary advances that were secured by rights of setoff and recoupment." On June 1, 1998 – well within one year of the bankruptcy filing – CHC transferred its shareholder interest in Ardra to P.T.C. At all relevant times, Debtor was CHC's sole director, officer, and employee. Id. at 61. Debtor contended that these were transfers of corporate and not personal assets, and therefore were not subject to Section 727(a)(2)(A). Appellate Brief at 30-31. However, the Bankruptcy Court, having engaged in a veil-piercing analysis, correctly concluded that the "various entities founded by [Debtor] should not be recognized as separate legal entities." Bankr. Op. at 54.

Furthermore, acknowledging that many of the questionable transfers occurred well before the filing of the bankruptcy petition, the Bankruptcy Court invoked the "continuous concealment doctrine," which provides that a "concealment will be found to exist during the year before bankruptcy even if the initial act of concealment took place before this one-year period as long as the debtor allowed the property to remain concealed into the critical year." Rosen v. Bezner, 996 F.2d 1527, 1531 (3d Cir. 1993); see also In re Womble, 289 B.R. 836, 845 (N.D. Tex. 2003). Pursuant to this doctrine, the Bankruptcy Court concluded that Debtor concealed property either by "retaining a beneficial interest" or "maintaining control over assets and interests" in the various companies. The Bankruptcy Court observed that:

> The evidence presented reveals that, in the early 1980s, the debtor began to transfer title to his personal and business assets to family members and corporations which remained subject to his control. Thereafter, aided by attorneys and other professionals, he set up an

> intricate structure consisting of numerous business entities and two trusts that were all interconnected and under his control. Despite transferring assets and ostensible ownership ... [Debtor] maintained control over these assets by retaining control over the entire corporate structure. This control allowed him to use corporate assets to satisfy personal obligations of himself and his family, to prevent creditors of himself, Nassau and Ardra from recovering any sums due, and represented his attempt to circumvent the financial consequences of the plaintiff's authorized seizure of Nassau.

Bankr. Op. at 59. The Bankruptcy Court further noted that Ardra "paid personal expenses of the DiLoreto family throughout the 1980s and 1990s." Id. at 63. These payments included country club fees, credit card bills, and contributions to the family's charitable organization. Finally, the Bankruptcy Court found that Debtor attempted to conceal his interest in a number of offshore companies by setting up trusts that would own shares of those entities. Id. at 64. Because this concealment continued into the one-year period preceding the bankruptcy filing, the Bankruptcy Court correctly concluded that the elements of the continuing concealment doctrine had been met. Id. at 67.

The remaining prong of the discharge test requires the Superintendent to prove that the Debtor acted "with intent to hinder, delay or defraud" creditors. Such intent "may be based on inferences drawn from a course of conduct." In re Zimmerman, 320 B.R. 800, 806 (Bkrtcy. M.D. Pa. 2005). "In deciding whether the requisite intent has been shown, a bankruptcy court may look to all the surrounding facts and circumstances." Id.; see also In re Hollingsworth, 224 B.R. 822, 829-30 (M.D. Fla. 1998). As the Bankruptcy Court correctly noted, Debtor's gratuitous transfers to his relatives create a rebuttable presumption of fraud. See Bankr. Op. at 70-71. The Bankruptcy Court found that the "frequent changes made to the corporate structure" and management of the Debtor's businesses, and the multiple transfers of property that had no apparent business purpose are indicative of fraudulent intent. Id. at 73-74.[6]

Additional bases for the denial of discharge stemmed from the provisions of 11 U.S.C. § 727(a)(3) and §727(a)(4). In order to state a claim under 11 U.S.C. § 727(a)(3), the Superintendent was required to prove that (1) Debtor concealed or failed to maintain and preserve adequate records, and (2) the failure made it impossible to ascertain his financial condition and material business transactions. Meridian Bank v. Alten, 958 F.2d 1226, 1233 (3d Cir. 1992). The purpose of § 727(a)(3) is "to give creditors and the bankruptcy court complete and accurate information concerning the status of the debtor's affairs and to test the completeness of the disclosure requisite to a discharge..." In re Larrieu, 230 B.R. 256, 269 (Bkrtcy. E.D. Pa. 1999). The Bankruptcy Court found that Debtor failed to maintain adequate records from which his financial condition could be ascertained. Bankr. Op. at 87. The principle challenge mounted by the Debtor is that the entities that were found to be his alter-egos were "bona fide separate legal entities," and therefore the absence of these companies' records is irrelevant to the discharge analysis. Appellate Brief at 43. Having concluded, however, that the Bankruptcy Court was correct to disregard the corporate form of these entities, Debtor's argument that the incomplete records are not those of an individual debtor collapses. Accordingly, the Court agrees with the Bankruptcy Court's determination that Debtor's failure to maintain and preserve adequate records, among other reasons, merited denial of discharge.

Section 727(a)(4) creates an affirmative duty on the part of the debtor to fully disclose all

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[6] Of particular concern was the history of the Debtor's offshore insurance business. The Bankruptcy Court noted that "within a ten-year period, the assets and liabilities held by this succession of entities were held by three different corporations, incorporated in two different countries, under five different names. In reality, however, these were all the same company with the same apparent purpose, holding the same assets and debts." Bankr. Op. at 74.

assets and liabilities and to answer all questions with "utmost candor." Scimeca v. Umanoff, 169 B.R. 536, 544 (D.N.J. 1993). A debtor is not entitled to a discharge when he "knowingly and fraudulently, in or in connection with the case – (A) made a false oath or account." 11 U.S.C. § 727(a)(4). False oaths sufficient to justify the denial of discharge include a false statement or omission in the debtor's schedules or a false statement at an examination during the course of the proceedings. In re Katz, 203 B.R. 227, 233 (Bkrtcy. E.D. Pa. 1996). The Bankruptcy Court found that Debtor knowingly made a false statement under oath, with fraudulent intent, that related materially to the bankruptcy case. See Bankr. Op. at 94-97. Debtor failed to disclose on his bankruptcy schedules his beneficial interest in companies like Ardra, Tiber, Sondam and Nara, and then testified falsely that the records he submitted were complete.

Debtor argues in response that since the jury verdict in the Ardra litigation, holding that he was the alter ego of the companies in question, was not rendered until a year and a half after the petition and the schedules had been filed, he could not have made any of the misstatements *knowingly*. Appellate Brief at 49-50. However, as the Superintendent points out, a debtor's duty of candor to his creditors and to the courts is not triggered by the adjudication of his alter ego status. Rather, the Debtor has "affirmative duties ... to disclose the existence of all assets and his ownership interests in property and to answer all questions fully and honestly for the benefit of his creditors and other parties with an interest in the proper administration of the debtor's bankruptcy case who are entitled to a truthful statement of the debtor's financial condition." In re Freedman, 1994 WL 455030, at *3 (Bkrtcy. E.D. Pa. Aug. 19, 1994) (citations omitted). If a "debtor is uncertain as to whether certain assets are legally required to be included in his petition, it is his duty to disclose the assets so that the question may be resolved." In re Ingle, 70 B.R.

979, 983 (Bkrtcy. E.D.N.C. 1987).

In addition, as the Bankruptcy Court notes, reckless indifference to the truth is sufficient to deny Debtor a discharge if the subject matter of the omission is material to the administration of the bankruptcy. See In re Burnley, 1999 WL 717215, at *3 (Bkrtcy. E.D. Pa. 1999). "The subject of a false oath is material if it bears a relationship to the bankrupt's business transactions or estate, or concerns the discovery of assets, business deals, or the existence and disposition of his property." Id. at *4 (citing In re Steiker, 380 F.2d 765, 768 (3d Cir. 1967)). Having reasonably found that the omission of a series of corporate interests held by Debtor was material and undermined the effort to investigate his financial condition, the Bankruptcy Court correctly concluded that Debtor's reckless indifference to the truth was sufficient to deny him discharge.

Finally, with respect to the requirement that the false statement be made fraudulently, it is well-recognized that "fraudulent intent can be gleaned from circumstantial evidence or by inferences drawn from a course of conduct established by the evidence." Chusid v. First Union Nat. Bank, 1998 WL 42292, at *7 (E.D. Pa. Jan. 21, 1998) (internal citations omitted). The Bankruptcy Court made a permissible inference of fraudulent intent from the pattern of concealment engaged in by Debtor over many years. A discharge in bankruptcy is a privilege, not a right, and it is the fundamental premise of bankruptcy law that relief is limited to the honest debtor. In re Grosse, 1997 WL 668059, at *3 (Bkrtcy. E.D. Pa. Oct. 15, 1997).

V. Conclusion

In denying Debtor discharge, the Bankruptcy Court properly disregarded the corporate form of the entities in question and correctly concluded that Debtor concealed property within one year of his bankruptcy filing through continuing concealment of assets and acted with the intent to “hinder, delay, or defraud” creditors. Accordingly, the Bankruptcy Court’s decision is affirmed. An appropriate Order follows.

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	:	**NO. 04-CV-1326**
	:	

ORDER

AND NOW, this 13th day of October, 2006, for the reasons stated in the accompanying Memorandum, it is **ORDERED** that the decision of the Bankruptcy Court is **AFFIRMED**.

BY THE COURT:

/s/ Bruce W. Kauffman
BRUCE W. KAUFFMAN, J.