IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:	)	
	)	
DENNIS DAMROW,	)	
	)	CASE NO. BK02-43392
Debtor(s).	)	A03-4077
PHILIP KELLY, Chapter 7 Trustee,	)	
	)	
Plaintiff,	)	CH. 7
	)	
vs.	)	
	)	
DENNIS DAMROW; RICHARD DAMROW; LINDA SLOTHOWER; MARTIN DAMROW; SHERRY DAMROW; BARTON DAMROW; LYNSE SCHMIDT; LYNSE SCHMIDT & BARTON DAMROW as co-trustees of the LYNSE & BARTON DAMROW IRREVOCABLE TRUST,	)	
	)	
Defendants.	)	

ORDER

This matter is before the court on the plaintiff’s motion for summary judgment (Fil. #110) and objections by Sherry Damrow, Lynse Damrow Schmidt, and Barton Damrow (Fil. #141) and Sherry Damrow and Lynse Damrow Schmidt and Barton Damrow as co-trustees of the Lynse & Barton Damrow Irrevocable Trust (Fil. #143). Bruce Hart and Jeanelle Lust represent the plaintiff; P. Stephen Potter represents Sherry Damrow; and Kent Person represents Lynse Damrow Schmidt and Barton Damrow individually and as co-trustees. The motion was taken under advisement as submitted without oral arguments.

The Chapter 7 bankruptcy trustee filed this adversary proceeding to recover alleged preferential and fraudulent transfers made to the defendants. In particular, the trustee alleges that the debtor transferred money and personal property to his wife, children, and siblings. The motion for summary judgment is directed only to the transfers to the debtors’ wife and children. The debtor transferred various motor vehicles to the children, and most of the rest of his assets were awarded to his wife by way of a decree of dissolution of marriage. The trustee alleges that the marital dissolution was a sham, as the parties continued to live together as though married. In addition, the trustee alleges that the debtor contributed $75,000 from the sale of stock to the Lynse & Barton Damrow Irrevocable Trust, from which he then took loans.

The trustee alleges that these transfers were made with the intent of defrauding creditors, making the transfers avoidable by the trustee pursuant to 11 U.S.C. § 548(a)(1)(A). The trustee also alleges that the transfers are avoidable under § 548(a)(1)(B) because the debtor transferred his interest in property within one year prior to filing for bankruptcy, receiving less than reasonably equivalent value for the transfers, and he was insolvent at the time of the transfers. Finally, the trustee alleges that the transfers are avoidable under § 544 and the Nebraska Uniform Fraudulent Transfer Act ("NUFTA").

With regard to the transfers to Sherry Damrow, the debtor's wife, the trustee alleges the debtor transferred substantially all of his assets to Sherry and assumed the majority of the marital debt as part of the dissolution decree a mere four months before filing bankruptcy and a mere three months after an $8.6 million arbitration award was entered against him. Despite the divorce, the debtor continued to reside with Sherry and have the use and benefit of the personal property he transferred to her.

With regard to the transfers of personal property to the debtor's son and daughter, the trustee alleges that the debtor transferred the property with the intent to defraud creditors and that he transferred his interest in the property while he was insolvent but did not receive a reasonably equivalent value in exchange. Either of these prongs would render the transfers fraudulent under NUFTA.

Sherry Damrow denies any contemporaneous knowledge of the debtor's business dealings or financial problems. She maintains that the divorce was a legitimate method of attempting to protect herself from the financial ramifications of the debtor's activities and of moving on with her life. She indicates they resided separately for eight months after their divorce but subsequently lived together in a home she purchased. The debtor contributed toward rent and living expenses while residing there.

Barton Damrow and Lynse Damrow Schmidt did not respond to the trustee's motion.

<u>Summary Judgment Standard</u>

Summary judgment is appropriate only if the record, when viewed in the light most favorable to the non-moving party, shows there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law. Fed. R. Civ. P. 56(c) (made applicable to adversary proceedings in bankruptcy by Fed. R. Bankr. P. 7056); <u>see, e.g.,</u> <u>Celotex Corp. v. Catrett</u>, 477 U.S. 317, 322-23 (1986); <u>Anderson v. Liberty Lobby,</u>

Inc., 477 U.S. 242, 249-50 (1986); Morgan v. Rabun, 128 F.3d 694, 696 (8th Cir. 1997), cert. denied, 523 U.S. 1124 (1998); Get Away Club, Inc. v. Coleman, 969 F.2d 664, 666 (8th Cir. 1992); St. Paul Fire & Marine Ins. Co. v. FDIC, 968 F.2d 695, 699 (8th Cir. 1992).

In ruling on a motion for summary judgment, the court must view the facts in the light most favorable to the party opposing the motion and give that party the benefit of all reasonable inferences to be drawn from the record. Widoe v. District No. 111 Otoe County Sch., 147 F.3d 726, 728 (8th Cir. 1998); Ghane v. West, 148 F.3d 979, 981 (8th Cir. 1998).

Discussion

A. 11 U.S.C. § 548(a)(1)

The Bankruptcy Code, in § 548, provides for avoidance of fraudulent transfers as follows:

> (a) (1) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily -
>
> (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
>
> (B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;
>
> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. § 548(a)(1).

1. 11 U.S.C. § 548(a)(1)(A)

Courts recognize that direct evidence of fraud by the debtor is difficult to produce, so the trustee may put on evidence of "badges of fraud." Kelly v. Armstrong, 206 F.3d 794, 798 (8th Cir. 2000). Those badges include but are not limited to: (1) actual or threatened litigation against the debtor; (2) a transfer of all or substantially all of the debtor's property; (3) insolvency on the part of the debtor; (4) a special relationship between the debtor and the transferee; and (5) retention of the property by the debtor after the transfer. Id. (quoting Kelly v. Armstrong, 141 F.3d 799, 802 (8th Cir. 1998)).

> If there is a confluence of the "badges of fraud," then the Trustee is entitled to a presumption of fraudulent intent. See [Kelly v. Armstrong, 141 F.3d 799, 802 (8th Cir. 1998)]. To overcome the presumption, a "'legitimate supervening purpose'" for the transfers must be shown by the bankrupt. Id. (quoting In re Acequia, Inc., 34 F.3d 800, 806 (9th Cir. 1994)).

206 F.3d at 798.

The trustee asserts that all of these badges of fraud are present in connection with the transfers to Sherry Damrow as part of the marital dissolution proceedings. I agree. At the time the decree of dissolution was entered in August 2002 dissolving the marriage and dividing the parties' assets and liabilities, an $8 million arbitration award had recently been entered against the debtor. Within the two years prior to the entry of the divorce decree, the debtor's house had been foreclosed upon, an involuntary bankruptcy had been filed against Damrow Cattle Company, and the debtor had informed the arbitrator that he could not afford to go forward with the arbitration proceeding. As part of the decree, the debtor agreed to transfer the majority of the parties' household goods to Sherry, along with approximately 18 claims or potential claims against various individuals and businesses connected with the financial dealings of Damrow Cattle Company and Carter Feeders. The debtor assumed a $1.8 million personal guarantee obligation and $28,000 in credit card debt. He also agreed to pay $4,000 per month in alimony, out of his $4,500 monthly income, although he has made only one alimony payment. In the approximately two-and-a-half years between the date of the divorce and the date of the debtor's incarceration in a federal penitentiary, he and Sherry lived together for all but eight or nine months, and he contributed a portion of his income for household expenses.

The conclusion to be drawn from the facts is that the debtor transferred substantially all of his assets to Sherry four months before his bankruptcy petition was filed, at a time when he faced significant financial problems in his business, yet he continued to enjoy a beneficial interest in the property while residing with his ex-wife. The trustee has therefore established a presumption of fraudulent intent on the part of the debtor. Sherry has not come forward with evidence sufficient to overcome that presumption and demonstrate a legitimate supervening purpose for the transfers. She states in her affidavit that she divorced the debtor because she wanted to move on with her life and to protect her assets from execution to pay debts incurred by the debtor. She further states that she believes the division of marital property to be fair recompense for the "investment" she had made in the marriage and the "compromise" to her lifestyle caused by the debtor's business deals. That does not explain her willingness to provide a home and some financial support for him for nearly two years after the divorce.

This finding should not be construed as an attack on the state court's entry of the decree of dissolution. The full faith and credit requirement of federal law compels federal courts to accord a state court judgment the same preclusive effect it would have in a state court proceeding. Nebraska preclusion principles therefore govern the extent to which the dissolution decree can be challenged.

The doctrine of "res judicata," or "claim preclusion," bars the relitigation of a matter that has been directly addressed or necessarily included in a former adjudication if: (1) the former judgment was rendered by a court of competent jurisdiction; (2) the former judgment was a final judgment; (3) the former judgment was on the merits; and (4) the same parties or their privies were involved in both actions. <u>Eicher v. Mid America Fin'l Inv. Corp.</u>, 702 N.W.2d 792, 809 (Neb. 2005).

Under the doctrine of "collateral estoppel," or "issue preclusion," when an issue of ultimate fact has been determined by a final judgment, that issue cannot again be litigated between the same parties in a future lawsuit. <u>Id.</u> The four conditions that must exist for the doctrine of collateral estoppel to apply are: (1) the identical issue was decided in a prior action; (2) there was a judgment on the merits which was final; (3) the party against whom the doctrine is applied was a party or in privity with a party to the prior action; and (4) there was an opportunity to fully and fairly litigate the issue in the prior action. <u>Id.</u>

This court's examination of the dissolution decree for fraudulent conveyances is not precluded by either doctrine. While the decree is a final judgment rendered by a court of competent jurisdiction, it was not entered on the merits. The property settlement agreement was stipulated to by both parties, and constitutes a voluntary transfer of assets by the debtor. Although the stipulation was approved by the district court judge, there was no judicial determination that it was a proper allocation of the marital assets and liabilities.

Moreover, the trustee is an outsider to the marital dissolution proceeding; preclusion cannot be used to prevent a third party from challenging a judgment. While a bankruptcy trustee succeeds to a debtor's interest in assets of the bankruptcy estate, a trustee does not necessarily stand in privity with the debtor in all regards. Privity implies a relationship by succession or representation between the party to the second action and the party to the prior action in respect to the right adjudicated in the first action. Thomas Lakes Owners Ass'n v. Riley, 612 N.W.2d 529, 537 (Neb. Ct. App. 2000). "In its broadest sense, 'privity' is defined as mutual or successive relationships to the same right of property, or such an identification of interest of one person with another as to represent the same legal right." Id. (citing Gottsch v. Bank of Stapleton, 458 N.W.2d 443, 457 (Neb. 1990)). "For the purpose of issue preclusion, the mere fact that litigants in different cases are interested in the same question or desire to prove or disprove the same fact or set of facts is not a basis for privity between the litigants." Id.

Here, the trustee is not merely the successor-in-interest to the debtor; rather, he represents all the creditors of the debtor's bankruptcy estate. In no way could it be said that the legal rights of all the debtor's creditors were represented in the dissolution proceeding. Therefore, the lack of privity permits this court to independently review the dissolution decree and property settlement. See Corzin v. Fordu (In re Fordu), 201 F.3d 693 (6th Cir. 1999).

Furthermore, I am not finding in the trustee's favor regarding the $4,000 alimony payment made by the debtor. Alimony is an on-going court-ordered obligation of the debtor's; it is not a fraudulent transfer.

Finally, I do not accept the trustee's position that the divorce was a sham. My findings regarding the property allocation are based on the facts surrounding the timing and circumstances of the transfer, which lead to the conclusion that the transfer was made with fraudulent intent.

2. 11 U.S.C. § 548(a)(1)(B)

This alternative prong of the fraudulent transfer statute does not require a showing of intent. Rather, it requires the trustee to prove the debtor's insolvency at the time of, or as a result of, the transfer, and the debtor's receipt of less than a "reasonably equivalent value" in the exchange. Both are fact questions, with the trustee bearing the burden of proving the elements of § 548 and the transferees carrying the burden of proving that the debtor remained solvent after the transfer. See Dietz v. St. Edward's Catholic Church (In re Bargfrede), 117 F.3d 1078, 1080-81 (8th Cir. 1997).

In evaluating the issue of reasonably equivalent value, the Bankruptcy Appellate Panel of the Eighth Circuit has explained the necessary analysis:

> To succeed on a claim under 11 U.S.C. § 548(a)(1)(B)(i), the Chapter 7 Trustee must demonstrate, by a preponderance of the evidence, that payments a debtor made were not in exchange for reasonable equivalent value. Pummill v. Greensfelder, Hemker & Gale (In re Richards & Conover Steel, Co.), 267 B.R. 602, 612 (8th Cir. B.A.P. 2001). "This requires analysis of whether: (1) value was given; (2) it was given in exchange for the transfers; and (3) what was transferred was reasonably equivalent to what was received." Id. The payment of money is unquestionably the giving of "value." 11 U.S.C. § 548(d)(2)(A). When evaluating a transfer for reasonable equivalency of value as compared to a money payment, a court must examine the whole transaction and measure all the benefits – whether they be direct or indirect. Christians v. Crystal Evangelical Free Church (In re Young), 82 F.3d 1407, 1415 (8th Cir. 1996) (holding that the trustee could not recover tithes to a church under 11 U.S.C. § 548), vacated, 521 U.S. 1114, 117 S. Ct. 2502, 138 L. Ed. 2d 1007 (1997) (vacating for further consideration on the legitimacy of the Religious Freedom Restoration Act), reinstated, 141 F.3d 854 (8th Cir. 1998), cert. denied, 525 U.S. 811, 119 S. Ct. 43, 142 L. Ed. 2d 34 (1998). If the measure for reasonable equivalency is the value of an indirect benefit then that benefit must be tangible. Richards & Conover Steel, Co., 267 B.R. at 612-13.

Meeks v. Don Howard Charitable Remainder Trust (In re S. Health Care of Ark., Inc.), 309 B.R. 314, 319 (B.A.P. 8th Cir. 2004).

"Value", for purposes of § 548, is defined in § 548(d)(2)(A) as "property, or satisfaction or securing of a present or antecedent debt of the debtor, but does not include an unperformed promise to furnish support to the debtor or to a relative of the debtor."

Here, the debtor transferred virtually all of his assets to Sherry as part of the divorce settlement. According to the joint property statement, Sherry received personal property worth $8,940, while the debtor received personal property worth $665. In addition, he transferred to her his rights to pursue claims against persons and entities involved in the Carter Feeders financial transactions. The debtor does not know the value of those claims, but opined at his deposition that the claims against the Carter Feeders principals were worth in excess of $700,000. Sherry will presumably incur costs to liquidate those claims, but she nevertheless stands to realize a potentially significant net gain. In addition to the transfer of assets, the debtor also assumed a significant amount of debt. He took responsibility for $28,000 of credit card debt, compared to the $2,500 in credit card debt assigned to Sherry, and he assumed a $1.8 million liability to Adams Bank. There is no evidence that the debtor received any value or tangible benefit in exchange for the property transfers.

"Insolvent" is defined in the Bankruptcy Code as a financial condition such that the sum of the debtor's debts is greater than all of the debtor's property at a fair valuation, exclusive of (i) property transferred, concealed, or removed with intent to hinder, delay or defraud the debtor's creditors; and (ii) property that may be exempted from property of the estate under section 522 of this title. 11 U.S.C. § 101(32)(A).

The debtor testified in his deposition that in early 2001, Damrow Cattle Company was in an involuntary Chapter 7 bankruptcy case, his other business entities had no assets, his house had been foreclosed upon, and his assets consisted of the $700,000-plus claim against Carter Feeders. In May of 2001, he informed the arbitration association that he did not have the financial resources to continue with the arbitration proceeding he had instituted against the Carter Feeders shareholders. In May of 2002, an arbitration award of $8.6 million was entered against him. At about the same time, he borrowed money from the Lynse & Barton Damrow Trust to settle a bank claim and to pay attorneys' fees. Three months later, the decree of marital dissolution was entered. There is no evidence to controvert the conclusion that the transfers to Sherry Damrow occurred while the debtor was insolvent. Even if he was not insolvent at the time of the transfers, they clearly rendered him insolvent.

B. 11 U.S.C. § 544 and NUFTA

The Bankruptcy Code provides the trustee with authority to "avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim[.]" 11 U.S.C. §

544(b)(1). “Applicable law” in this instance is the Nebraska Uniform Fraudulent Transfer Act. The advantage for the trustee, standing in the shoes of an unsecured claim holder, is a four-year look-back period.

In an action seeking to set aside a fraudulent transfer, the burden of proof is on a creditor (trustee in a bankruptcy case) to prove, by clear and convincing evidence, that fraud existed in a questioned transaction. Eli's, Inc. v. Lemen, 591 N.W.2d 543, 555 (Neb. 1999) (citing Dillon Tire, Inc. v. Fifer, 589 N.W.2d 137 (Neb. 1999)). Clear and convincing evidence is "that amount of evidence which produces in the trier of fact a firm belief or conviction about the existence of a fact to be proved." Id. at 555-56 (quoting Dillon Tire, 589 N.W.2d at 142).

A transfer by a debtor is fraudulent as to present and future creditors if the debtor made the transfer:

1. with actual intent to hinder, delay, or defraud any creditor, or
2. without receiving a reasonably equivalent value in exchange for the transfer, and the debtor:
   (i) was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation; or
   (ii) intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

Neb. Rev. Stat. § 36-705(a).

Like 11 U.S.C. § 548(a), the state fraudulent transfer statutes encompass alternative prongs of liability – either proof of actual intent to hinder, delay, or defraud creditors, or proof of a transfer for less than reasonably equivalent value made while the debtor was insolvent or which caused the debtor to become insolvent. Neb. Rev. Stat. § 36-706(a).

The Nebraska fraudulent transfer statute lists 11 “badges of fraud” that may be considered when determining actual intent under § 36-705(a)(1). Those factors are:

1. whether the transfer was to an insider;
2. whether the debtor retained possession or control of the property transferred after the transfer;
3. whether the transfer was disclosed or concealed;
4. whether before the transfer was made, the debtor had been sued or threatened with suit;
5. whether the transfer was of substantially all the

debtor’s assets;

6. whether the debtor absconded;
7. whether the debtor removed or concealed assets;
8. whether the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred;
9. whether the debtor was insolvent or became insolvent shortly after the transfer was made;
10. whether the transfer occurred shortly before or shortly after a substantial debt was incurred; and
11. whether the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Neb. Rev. Stat. § 36-705(b).

An insider under NUFTA includes a relative of the debtor, § 36-702(7)(i)(A), and a relative is defined as a spouse or an individual related by consanguinity within the third degree as determined by common law. § 36-702(11). Sherry, Lynse, and Barton are all considered insiders for purposes of NUFTA.

As discussed above, the debtor retained use of much of the property transferred to Sherry in the divorce; the transfer was made after a large monetary award was entered against him; the transfer was of substantially all his assets; the debtor did not receive reasonably equivalent value for the assets transferred; and the debtor was insolvent when the transfer was made or became insolvent as a result of the transfer. Therefore, I find that the transfer to Sherry Damrow was fraudulent.

The trustee also challenges the transfer of motor vehicles and trust funds to the debtor’s children Lynse and Barton. The debtor and Sherry transferred a 1997 Chevrolet pickup truck to Barton and a 1996 Jeep Grand Cherokee to Lynse in January 2000, almost three years before he filed bankruptcy. The stated reason for doing so is that the children were no longer minors, they were either in or soon to start college, and their parents did not want to be liable for the vehicles they were driving. Sherry and/or Dennis paid for the insurance on both vehicles. In the spring of 2001, Lynse gave possession of the Jeep to Sherry but retained the title. In the summer of 2002, Lynse collected insurance proceeds on the Jeep and delivered them to Sherry to use for the down payment on a house. Sherry subsequently sold the Jeep and kept the proceeds. Barton received and spent the insurance proceeds he collected for damage to the pickup in the summer of 2002. He continues to drive the vehicle. The trustee also questions the transfer of a 1993 Chevrolet truck to Barton, although he indicates he did not receive an ownership interest in that vehicle.

In addition, the debtor received $75,000 from the sale of Carter Feeders stock on November 2001. He deposited that money in Lynse & Barton’s trust. He testified that the money was intended to provide them with a college education, because the money they invested in Damrow Cattle Company for college had been lost. In May 2002, he borrowed $32,000 from the trust but has not repaid it nor has he listed the debt in his bankruptcy schedules. The remainder of the funds appear to have been used by Lynse and Barton primarily for school and personal expenses, including rent while they were in college and living with the debtor.

The badges of fraud are not as pronounced in connection with the vehicle transfers or the trust fund deposit. The record does not reflect that the debtor was insolvent at the time of the vehicle transfers, that the transfers were made in the face of a lawsuit or the incurrence of a substantial debt, that the debtor retained possession or control of the property, or that the transfers involved substantially all of the debtor’s assets. The debtor has provided reasonable explanations for the vehicle and trust transfers, which are sufficient to create a material factual issue and survive the motion for summary judgment.

IT IS ORDERED: The plaintiff’s motion for summary judgment (Fil. #110) is granted as it regards the transfers to Sherry Damrow and denied as it regards the transfers to Lynse Damrow Schmidt and Barton Damrow. The trustee should submit a proposed judgment for the court’s consideration itemizing the value of the various personal property transferred to Sherry Damrow. Because the appropriate remedy for the fraudulent transfer of the causes of action, which would belong to the trustee as property of the bankruptcy estate had they not been transferred, is entry of a judgment declaring the transfer fraudulent and therefore void, I will not enter a judgment for the value of those causes of action. The judgment entered as a result of this order will not be a final judgment under Federal Rule of Bankruptcy Procedure 7054 because it does not adjudicate all claims as to all parties.

DATED: December 20, 2005

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

*Bruce Hart P. Stephen Potter
*Jeanelle Lust Kent Person U.S. Trustee
Dennis Damrow

Movant (*) is responsible for giving notice of this order to all other parties not listed above if required by rule or statute.