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 motion for summary judgment by defendants Richard Damrow, Linda Slothower, and Martin Damrow (Fil. #190) and resistance by the plaintiff (Fil. #207). Jocelyn Walsh Golden represents the plaintiff, and Wayne Griffin represents the moving defendants. The motion was taken under advisement as submitted without oral arguments.

The motion will be denied.

The Chapter 7 bankruptcy trustee filed this adversary proceeding to recover alleged preferential and fraudulent transfers made to the moving defendants, who are the debtor's brothers and sister. In particular, the trustee alleges that the debtor transferred his interest in his mother's testamentary trust to his siblings within one year prior to the petition date under circumstances that caused the transfers to be preferential and fraudulent.

The trustee alleges that these transfers were made to insiders within one year before the petition date, while the debtor was insolvent, enabling the transferees to receive more than they otherwise would have, which makes the transfers avoidable under 11 U.S.C. § 547(b). The trustee also alleges the 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 further 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").

I. Summary Judgment Standard

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); see, e.g., Celotex Corp. v. Catrett, 477 U.S. 317, 322-23 (1986); Anderson v. Liberty Lobby, 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). A summary judgment motion should be interpreted by the court to dispose of factually unsupported claims and defenses. Tiffey v. Speck Enter., Ltd., 418 F. Supp. 2d 1120, 1123 (S.D. Iowa 2006).

II. Discussion

The debtor, Dennis, is one of four children. His mother, Velma, passed away in 1996; his father, Donald, is still living. Velma's will provided that if her husband survived her, certain real estate was to be given to the debtor and one of his brothers as co-trustees of the trust established in her will. Under the terms of the trust, the real estate is to be held in the trust during Donald's lifetime and he is to receive the income from it. Upon Donald's death, the real estate is to be distributed among the four children.

In the 2000-2001 time frame, the trust owed Adams Bank approximately $1 million, and a Damrow Farms family partnership composed of Donald, Dennis, and one of Velma & Donald's other sons owed Adams Bank approximately $720,000, for which the two sons were personally liable. Dennis was experiencing other financial problems at the time, as well. The Damrows and Adams Bank began negotiations to restructure the debt, and the bank required that Dennis resign as co-trustee of Velma's trust, assign his interest as a remainderman to his siblings, and withdraw from the Damrow Farms partnership.

Documents were prepared to accomplish these purposes in early March 2001. However, the form for Dennis's resignation as co-trustee and transfer of his interest in the trust was mistakenly prepared for and signed by his brother Martin, the other co-trustee. This was not discovered and corrected until April 2002, at which time a new form was signed by Dennis, stating that in accordance with Dennis's intent, it was to be effective as of March 5, 2001, when the related documents were signed.

The Damrows and Adams Bank eventually agreed to refinance the partnership and trust debt with the bank and relieve Dennis of liability on $364,802.49 of debt.

This bankruptcy case was filed in December 2002. Because of the April 2002 document transferring Dennis's interest in the trust, the bankruptcy trustee argues that an avoidable preference or fraudulent transfer occurred. The evidence supplied by the defendants credibly indicates that the family and the bank intended all of the transfers to have been made in March 2001. The trustee has offered no evidence to controvert this. Nevertheless, the remaining elements of the trustee's causes of action will be addressed in ruling on this motion.

A. Avoidable preferences under 11 U.S.C. § 547

Under § 547(b), a trustee or debtor-in-possession may avoid any transfer of an interest of the debtor in property:

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made —

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if--

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

A debt is antecedent for purposes of § 547(b)(2) if it is incurred prior to the debtor's alleged preferential transfer. Harrah's Tunica Corp. v. Meeks (In re Armstrong), 291 F.3d 517, 522 (8th Cir. 2002). Dennis's siblings have all testified via affidavit that he did not owe them money at any relevant time. However, a reduction in an insider-guarantor's financial liability to a third party is a measurable economic benefit for purposes of determining whether a preference has occurred. Lowrey v. Manufacturers Hanover Leasing Corp. (In re Robinson Bros. Drilling, Inc.), 6 F.3d 701, 703 (10th Cir. 1993), cert. denied, 510 U.S 1214 (1994); Travelers Ins. Co. v. Cambridge Meridian Group, Inc. (In re Erin Food Servs., Inc.), 980 F.2d 792, 797 (1st Cir. 1992). Some of the evidence indicates that the settlement with Adams Bank restructured the secured portion of the debt and, for the most part, forgave the unsecured portion of the debt. Apparently, the trust, Donald, and Martin became liable for the restructured debt, while Dennis remained liable only for the unsecured debt. The family considered their assumption of the secured debt to be more than adequate consideration for Dennis's relinquishment of his rights under the trust and withdrawal from the farm partnership. This raises a factual issue regarding whether the transfer was preferential.

B. Fraudulent transfers under 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)

This section of the Code deals with intentionally fraudulent transfers. 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 nearly all of these badges of fraud are present in connection with the transfers to the Damrow siblings. He refers to litigation against the debtor in the form of an arbitration proceeding in which $8.6 million was awarded to Carter Feeders, Inc., in May 2002. The trustee also refers to the debtor's admitted insolvency, as Dennis 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. Finally, the trustee points out the special relationship the transferees have with the debtor as his brothers and sister. A "special relationship" includes one based on family relationship, friendship, or a close association. In re May, 12 B.R. 618, 627 (N.D. Fla. 1980). There is no evidence that the debtor retained any beneficial interest in the property after the transfer.

The burden then shifts to the defendants to come forward with a preponderance of evidence to overcome th presumption of fraudulent intent and demonstrate a legitimate supervening purpose for the transfers.

> There is no bright line test for what constitutes a legitimate supervening purpose; the issue is simply whether the presumption of fraud has been adequately rebutted. See In re Bateman, 646 F.2d 1220, 1223 n.4 (8th Cir. 1981) ("The burden which shifts now upon a showing of reasonable grounds is not a burden of going forward with the evidence requiring the bankrupt to explain away natural inferences, but a burden of proving that he has not committed the objectionable acts with which he has been charged.") (quoting Shainman v. Shear's of Affton, Inc., 387 F.2d 33, 37 (8th Cir. 1967)).

Aptix Corp. v. Quickturn Design Sys., Inc., 148 Fed. Appx. 924, 2005 WL 1433137 at *4 (Fed. Cir. June 21, 2005).

Here, the defendants have provided evidence from the attorney who represented them in the dealings with the bank stating that the transfers of Dennis's interests in the trust and in the family partnership were made at Adams Bank's request, as it had lost faith in him and was unwilling to attempt a financial workout if he continued to be involved in the trust or the family partnership. If a transfer is made in the context of an attempted rehabilitation or financial workout, it may not be a fraudulent conveyance. Drake v. Peeples (In re Topgallant Group, Inc.), 1996 WL 33366594 at *16 (Bankr. S.D. Ga. Aug. 18, 1996) (intent to harm is the focus of fraudulent conveyance inquiry, and parties should not be punished if transfer is part of honest attempt at reorganization). The effort to continue in business constitutes a legitimate supervening purpose for the transfer. Max Sugarman Funeral Home, Inc. v. A.D.B. Investors, 926 F.2d 1248, 1254-55 (1st Cir. 1991) (citing In re Cushman Bakery, 526 F.2d 23, 33 (1st Cir. 1975)). The Topgallant court found the challenged payments and transfers from a foundering company into a new entity were an attempt by management to salvage the corporation and obtain additional financing to continue operating. The fact that efforts failed and the corporation ended up as a Chapter 7 debtor did not alter the original intent of the transactions and cause them to become fraudulent. The evidence here creates a factual issue which precludes entry of summary judgment.

2. 11 U.S.C. § 548(a)(1)(B)

This alternative prong of the fraudulent transfer statute deals with constructively fraudulent transfers. It 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 transfer was for reasonably equivalent value and 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).

As noted in the previous section, insolvency at the time of the transfers has been established.

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).

The satisfaction of an antecedent debt of the debtor may constitute "equivalent value," but the satisfaction of a third party's debt normally does not. Richards & Conover Steel, 267 B.R. at 613 (citing Bargfrede, 117 F.3d at 1080 (no reasonably equivalent value when husband pays a spouse's debt from his separate assets); Leonard v. Norman Vinitsky Residuary Trust (In re Jolly's, Inc.), 188 B.R. 832, 842 (Bankr. D. Minn. 1995) (transfers made solely for benefit of third party do not furnish reasonably equivalent value); and Biggs v. United States Nat'l Bank, 11 B.R. 524, 527 (D. Neb. 1980) (same)).

"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."

The focus is on what the debtor surrendered and what he received, regardless of any benefit flowing to a third party. Richards & Conover Steel, 267 B.R. at 614, n.4. "If the exchange preserves or enhances the debtor's net worth, then the transfer was not fraudulent even if a third party was the intended beneficiary of the transfer." Id. (citing Rubin v. Manufacturers Hanover Trust Co., 661 F.2d 979, 992 (2d Cir. 1981)).

Here, the affidavit of the attorney who represented Martin Damrow in connection with the settlement with Adams Bank indicates that, at the time, Martin had a negative net worth and Donald and Dennis had few or no unencumbered assets. Counsel indicates that the bank required Dennis to relinquish his interests in the trust and the family partnership as a condition of restructuring the debt. Martin, Donald, and the trust negotiated to retain much of the trust's real estate and certain personal property, for which they would pay slightly more than fair market value. The remainder of the amount owed to the bank was essentially unsecured and was, for the most part, written off, although the bank retained its rights to attempt to collect from Dennis. According to the affidavit, the parties believed their transactions in connection with the debt restructure were adequate consideration for the transfers of Dennis's interests:

> 12. . . . The parties were also of the belief that the assumption and payment by the Trust and other family members of the secured balance, as herein defined, to the Bank was more tha[n] adequate consideration to Dennis for his withdrawal from the Partnership, his resignation as co-trustee of the Trust and the transfer of his interest in the Trust to his siblings. The parties were further of the opinion and belief that any resulting value to the Trust would occur only as a result of the pay down of the indebtedness owed by the Trust to the Bank after the negotiation of the debt restructure. That pay down would be accomplished primarily as a result of the future labor and efforts of Martin Damrow.
>
> 13. The assumption and payment of the Bank debt described above as the secured debt by the Trust, the Partnership, Donald and [Martin] for the benefit of themselves and Dennis was the consideration for the transfer by Dennis of his interest in the Trust, his resignation as Co-Trustee and his withdrawal from the Partnership.

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It appears that about $440,000 of trust and partnership debt was written off when the loans were restructured and a new note for $1,385,000 was signed by Martin and Donald individually and on behalf of the trust and the partnership.

It is difficult to ascertain whether Dennis received reasonably equivalent value for his transfer to the defendants, but at a minimum, a question of fact exists. The trust and the farm partnership had few, if any, unencumbered assets and had little, if any, positive net worth. Dennis transferred assets with little monetary value in exchange for a reduction of liability of more than $1.5 million. Martin, Donald, and the trust were able to restructure debt, sell or turn over assets, and lessen their liability by $440,000. Dennis's interests in the trust and in the farm partnership presumably had intangible value, but no evidence of that is before the court. As noted in the Richards & Conover Steel case above, a transfer that preserves or enhances the debtor's net worth is not fraudulent.

C. 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).

"Value" is defined in the fraudulent transfer statute as follows:

> (a) Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied, but value does not include an unperformed promise made otherwise than in the ordinary course of the promisor's business to furnish support to the debtor or another person.
>
> (b) For the purposes of subdivision (a)(2) of section 36-705 and section 36-706, a person gives a reasonably equivalent value if the person acquires an interest of the debtor in an asset pursuant to a regularly conducted, noncollusive foreclosure sale or execution of a power of sale for the acquisition or disposition of the interest of the debtor upon default under a mortgage, deed of trust, or security agreement.
>
> (c) A transfer is made for present value if the exchange between the debtor and the transferee is intended by them to be contemporaneous and is in fact substantially contemporaneous.

Neb. Rev. Stat. §36-704.

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). Martin, Richard and Linda are all considered insiders for purposes of NUFTA.

Here, the transfers were to insiders; there is no evidence that Dennis retained possession or control of the property after the transfers; the transfers do not appear to have been disclosed in Dennis's bankruptcy documents; Dennis was involved in the Carter Feeders arbitration and litigation with the bank at the time of the transfers; the transfers were not of a substantial portion of Dennis's assets; Dennis did not abscond, or remove or conceal assets; as noted in the previous section, there is a question of fact as to whether Dennis received a reasonably equivalent value for the transfers; Dennis was insolvent at the time of the transfers; there is no evidence that a substantial debt was incurred around the time of the transfers; and Dennis did not transfer business assets to a lienor.

This "mixed bag" of badges of fraud creates material factual issues which cannot be determined on a motion for summary judgment.

III. Conclusion

Genuine issues of material fact exist on various elements of the avoidable preference and fraudulent transfer causes of action, including the existence of an antecedent debt owed by the debtor, whether the debt restructure is a legitimate supervening purpose for the transfer, and whether the debtor received reasonably equivalent value for the transfers.

IT IS ORDERED: The motion for summary judgment by defendants Richard Damrow, Linda Slothower, and Martin Damrow (Fil. #190) is denied.

DATED: June 6, 2006

BY THE COURT:

/s/ Timothy J. Mahoney
Chief Judge

Notice given by the Court to:
*Wayne Griffin
Jocelyn Walsh Golden
U.S. Trustee

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