

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)
)
ROBERT D. AND SANDRA SMITH,) CASE NO. BK93-80682
)
DEBTOR) CH. 7

MEMORANDUM

Hearing was held on August 21, 1996, on Objection to Claim of Farm Credit Bank of Wichita (Claim #5).. Appearances: Christine Law for Farm Credit Bank Wichita, Albert Burnes for debtors, Susan Williams for Leland Porter, Phil Kelly as trustee. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(B).

Background

The debtors in this case, Robert D. and Sandra E. Smith originally filed a petition for Chapter 12 bankruptcy on April 23, 1993. In an order dated December 22, 1994, the case was converted to a Chapter 7 for fraud in connection with the case. Some of the fraudulent activity identified in the memorandum concerned the Joyce E. Smith Trust (the trust), which is the subject of the instant motions.

With regard to the trust, the following findings were made in the previous order:

On November 26, 1986, the Joyce E. Smith Trust was created (the Trust) by and on behalf of Joyce E. Smith . . . Joyce E. Smith, who is the mother of Robert Smith, is a resident of Denver, Colorado and has owned various rental units in Denver and Englewood, Colorado over the years. While managing the rental units, she actively participated in real estate deals and is not unsophisticated in real estate matters.

The Trust is irrevocable and provides that Joyce E. Smith and Sandra Smith are the trustees of the Trust. It also states that Robert and Sandra Smith are the beneficiaries under the Trust. The corpus of the Trust originally consisted of two pieces of property located in Sedgwick County, Colorado (Sedgwick County Properties). The Sedgwick County Properties were purchased by Joyce Smith on March 25, 1986 . . . and conveyed to the Trust on December 23, 1988 . . .

Joyce Smith has a right to receive \$100.00 of income per month under the Trust, but she has so far declined to receive the monthly payment. The Trust document states that the trustees shall pay over to the

beneficiaries “so much of the income and so much of the principal of this Trust as the Trustees deem necessary or advisable to provide for the care, comfort and support of ROBERT D. SMITH and SANDRA E. SMITH” . . . The trustees are also authorized to pay for the funeral, burial, and probate expenses of the debtors in the event of their deaths. Finally, the trustees may terminate the Trust at any time and assign all interests in the Trust to the debtors.

Even though it is not in the written Trust document, the debtors are permitted, pursuant to an oral lease agreement, to farm all of the Trust property and keep all of the income from the farming operation. In addition to operating the farm, the debtors also maintain a residence on the Sedgwick County properties.

There is substantial evidence that the Trust was created at the direction of Robert and not Joyce Smith. The debtors’ Nebraska attorney (not their bankruptcy attorney) created the Trust for Joyce Smith. She live in Colorado and Colorado is the location of the trust corpus. Joyce Smith stated that she was advised to create the trust on the advice of the debtors’ attorney, who also advised Joyce to make Sandra a trustee in the Trust instead of Robert. The Trust was created a few months after the foreclosure action was filed by [Leland] Porter, and the Sedgwick County property was conveyed to the Trust while the deficiency action was pending in state court . . .

The most compelling evidence that Robert orchestrated the creation of the Trust to permit the debtors to acquire assets without accounting to Porter, is the original Contract to purchase the Trust property entered into on March 26, 1986 between Joyce Smith and the seller . . . On the last page of the contract, the debtors personally guaranteed all of the payments under the purchase contract.

. . .

Sandra Smith testified that she does not manage or administer any of the Trust property, nor does she recall signing any paperwork dealing with these trusts. Sandra Smith has, in fact, singed several documents as trustee, but her lack of recollection demonstrates that she signed these documents with little knowledge as to the contents of what she was signing. According to Joyce Smith and Sandra Smith, Robert Smith makes all of the decisions regarding the Trust properties and the proceeds from the Trust properties. Robert Smith testified at the 2004 exam that he did not make any decisions regarding the Trust properties, but this statement simply lacks credence. Not only do the trustees, who are his

mother and his wife, contradict his testimony, but also, his mother's and wife's consistent lack of knowledge of the business of the Trust and the lack of records regarding the Trust's operations supports their testimony that Robert has constructive ownership of the property in the Trust, and the trustees do not actively make decisions regarding the Trust property.

On February 5, 1992, the Trust purchased another portion of property in Sedgwick County, Colorado (Second Sedgwick County Purchase), which happened to be adjacent to the Sedgwick County Properties already in the Trust . . .

. . . [T]he Trust borrowed \$68,000 from the Farm Credit Bank of Wichita for the purchase of the Second Sedgwick County Purchase. The loan is secured by the Second Sedgwick County Purchase and the Sedgwick County Properties which are already in the Trust . . .

Sandra Smith and Joyce Smith signed the Deed of Trust in their capacities as trustees, and the Deed of Trust is signed by the debtors . . . However, Joyce Smith did not sign in her capacity as trustee on the Note and Loan Agreement with Farm Credit Bank. Only Sandra Smith signed as trustee and the debtors signed individually for the \$68,000 note. Joyce Smith also states that she did not participate in the discussions concerning the financing agreement and that the debtors arranged all of the financing and the mortgaging of the Second Sedgwick Property.

Like the other property in the Trust, Robert Smith farms this property and fully exercises control of the property . . . It appears that Robert Smith is the constructive owner of the property because he makes all decisions regarding this property and has made all payments towards the purchase of the property.

. . .

The creation and continuation of the Trust appears to be fraudulent. There is no evidence that Joyce Smith tendered any consideration for the purchase of any of the properties in the Trust. The evidence also overwhelmingly shows that Robert Smith acts as the true owner of the Trust properties. The debtors use the income from the farming operations to pay all expenses related to the purchase price of the property, taxes and upkeep of the Trust properties. Joyce Smith and Sandra Smith do not exercise any of the trustee powers that they are authorized to use under the Trust, and neither of the trustees appears to even have a working knowledge of the Trust. In addition, Joyce Smith has not received any beneficial interest from owning the Trust, which she

claimed was supposed to be an investment. Robert Smith and Joyce Smith appeared to have entered into this arrangement so Robert Smith could operate a profitable farming operation and rid himself of the Deuel County Property and of his debts to Porter.

In re Smith, Neb. Bkr. 94:764, 768-771 (Bankr. D. Neb. 1994).

Farm Credit Bank filed a claim on March 22, 1995 in the amount of \$67,929.61. The debtors had scheduled this debt as a nonpriority unsecured claim. Farm Credit bank, in its proof of claim, stated that to the best of its information, its claim was over secured, but if the Sedgwick property was not property of the estate, then the claim was an unsecured claim.

On March 23, 1995, one day after Farm Credit Bank filed its proof of claim, a stipulation was reached between the debtors, Joyce Smith, Clifford Johnson (a friend and neighbor of the debtors who leased farm land to them), and Leland Porter (an unsecured creditor of the debtors). The stipulation provided that certain property, which included Farm Credit Bank's secured real estate, was property of the debtors' bankruptcy estate. After notice and hearing, an order was entered approving the stipulation, and it was filed on June 19, 1995. However, Farm Credit Bank did not receive notice of the stipulation or the hearing until after the order had been entered.

On June 10, 1996, the Chapter 7 Trustee filed an objection to Farm Credit Bank's claim, contending that Farm Credit Bank had taken the position that it was entitled to a distribution as an unsecured creditor. The Trustee argued that Farm Credit Bank's claim is over secured (the Sedgwick property has been appraised at \$159,000) and that it is inequitable to the creditors of the estate to allow Farm Credit Bank to receive payment of its claim from the estate since it has security for its claim. Porter joined in the Trustee's objection.

Farm Credit Bank filed a resistance to the Trustee's objection, claiming that the real estate that secured its claim was property of the Joyce E. Smith Trust, not property of the debtors or the estate, and that it did not receive notice of the stipulation which purports to make the collateral property of the estate and was, therefore, not bound by its terms.

Decision

Farm Credit Bank did not receive notice of the stipulation or the hearing date prior to the entry of the order approving the stipulation, as required by Rule 9019(a). Therefore, a hearing date shall be set for Farm Credit Bank to present its objection to the stipulation.

Discussion

The Trustee has asserted that the real estate which secures Farm Credit Bank's claim was determined to be a part of the debtors' bankruptcy estate in the December 22, 1994 order. That order stated:

Based on the findings of fact . . . the court concludes that before 1990 the debtors did intend to fraudulently convey property into the trusts and did fraudulently purchase property under the alter ego of the trusts to delay, hinder and defraud Porter. The evidence establishes that all of the "badges of fraud" are present in this case, and the evidence is clear and convincing that the debtors did intend to delay, hinder and defraud Porter from collecting his deficiency judgment.

...

The transactions that occurred after 1990 would be the acquisition by the Trust of the Second Sedgwick County Property and the sale of the debtors' farming equipment and business assets. The court finds that both of these transactions clearly and convincingly constitute fraudulent transfers under Nebraska law because the reasons cited in the findings of fact show that the debtors had a fraudulent intent with respect to these conveyances.

Smith at 781-782. Though it was determined that fraud existed, the issue before the court was not the ownership of the real estate in question, but rather whether there was evidence of fraud such that the debtors' motion to dismiss should be overruled and Porter's motion to convert the case to Chapter 7 should be granted. The issue of whether the real estate was the property of the bankruptcy estate or the Joyce E. Smith Trust was not determined.

The trustee also contends that Farm Credit Bank filed a secured claim and received attorney fees for its claim under § 506(a) of the Bankruptcy Code, and should therefore be estopped from asserting an unsecured status. However, Farm Credit Bank did provide in its proof of claim that "if the [subject] property . . . is not property of the bankruptcy estate, then this claim is an unsecured claim."

In evidence presented at the hearing on this matter, and during argument, Farm Credit Bank maintains that it is not bound by the Stipulation entered into on March 23, 1995, because it did not receive notice of the Stipulation or the hearing regarding it. "It is well established that creditors' rights in bankruptcy cases are property interests that are protected by the Fifth Amendment and that cannot be impaired without notice and an opportunity to be heard." Continental Casualty Co. V. General Dev, Corp. (In re General Dev. Corp.), 165 B.R. 685, 688 (S.D. Fla. 1994). To this end, Rule 9019(a) provides as follows:

On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors,

the United States Trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.

Bank. R. 9019(a).

The purpose of the procedural rules governing notice to creditors is to allow those parties with a pecuniary interest in the settlement to have an opportunity to be heard and to object if they find it unsatisfactory. Saccurato v. Masters, Inc. (In re Masters, Inc.), 149 B.R. 289 (E.D.N.Y. 1992). “Where creditors have expressed sufficient interest in a bankruptcy case to have their names added to the service list, this Court finds that such creditors have a right to actual notice pursuant to Rule 9019(a) and to make objections to any proposed settlement agreement prior to final approval by a bankruptcy judge.” Id. at 292. While it was previously found that the transactions concerning the real estate in question were fraudulent, a bankruptcy judge cannot eliminate the notice requirements even if the ultimate approval of the proposed agreement is a virtual certainty. Id.

In this case, Farm Credit Bank did not receive notice of the stipulation or the hearing. While such a lack of notice may have violated Farm Credit Bank’s due process rights, that does not necessarily mean that this violation cannot be corrected. Other courts which have considered this issue have provided the objecting party with an opportunity to be heard on the objection to the stipulation, and this has been held to cure any constitutional defect. See, e.g., Houston v. Holder (In re Omni Video, Inc.), 60 F.3d 230 (5th Cir. 1995); In re Speir, 190 B.R. 657, 659 n.1 (Bankr. N.D. Ala. 1995); General Dev. Corp., 165 B.R. at 688. Accordingly, a date certain will be set for a hearing for Farm Credit Bank to object to the stipulation. The question of whether Farm Credit Bank’s claim is secured or unsecured will therefore be determined following that hearing.

Separate journal entry to be filed.

DATED: August 28, 1996

BY THE COURT:

/s/Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

LAW, CHRISTINE J.	303-752-0946
WILLIAMS, SUSAN	308-532-2741
KELLY, PHILIP	308-635-1387

Copies mailed by the Court to:
Albert Burnes, Attorney
United States Trustee

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

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
ROBERT D. and SANDRA SMITH,)	CASE NO. BK93-80682
<u>DEBTOR(S)</u>)	
)	CH. 7
)	Filing No. 215, 216, 218, 219
Plaintiff(s))	
vs.)	<u>JOURNAL ENTRY</u>
)	DATE: August 28, 1996
<u>Defendant(s)</u>)	HEARING DATE: August 21, 1996

Before a United States Bankruptcy Judge for the District of Nebraska regarding Objection to Claim of Farm Credit Bank of Wichita (Claim #5); Joinder by Leland Porter; Resistance to the Objection filed by farm Credit Bank of Wichita; Trustee's Response to the Resistance.

APPEARANCES

Christine Law, Attorney for Farm Credit Bank Wichita
Albert Burnes, Attorney for debtors
Susan Williams, Attorney for Leland Porter
Philip Kelly, Trustee

IT IS ORDERED:

Farm Credit Bank did not receive notice of the stipulation or the hearing date prior to the entry of the order approving the stipulation, as required by Rule 9019(a). Therefore, a hearing date shall be set for Farm Credit Bank to present its objection to the stipulation. See memorandum entered this date.

BY THE COURT:

/s/Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

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