

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
DLC, LTD.,)
)) CASE NO. BK97-82177
Debtor(s).)
A98-8113
THOMAS D. STALNAKER, Trustee,)
)
Plaintiff,) CH. 7
)
vs.)
)
DLC, LTD. a Nebraska corporation,)
and DLC FAMILY TRUST, LTD.,)
a Nebraska corporation,)
)
Defendant.)

MEMORANDUM

Trial was held in Omaha, Nebraska, on February 26, 2002, on the adversary complaint and on the defendants' motion to dismiss the case (Fil. #180) and resistance by the plaintiff (Fil. #187). Richard Myers and Larry Demerath appeared for the defendants, and Donald Swanson and Charles Benish appeared for the trustee. This memorandum contains findings of fact and conclusions of law required by Fed. R. Bankr. P. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(H).

A ruling on the pending matters was stayed while the case was subsequently referred to informal mediation for settlement discussions, but those negotiations were unsuccessful. Therefore, the matters are now ready to be decided.

Background

Count 1 of the trustee's amended complaint alleges fraudulent transfers in connection with four quit-claim deeds and an assignment of certain causes of action, in violation of the Uniform Fraudulent Transfer Act, Neb. Rev. Stat. §§ 36-701 to -712. The trustee asserts that each of the transfers fits the elements of fraudulent intent set out Neb. Rev. Stat. § 36-705.

The quit-claim deeds were all executed on March 24, 1994, and purport to transfer four parcels of real estate, totaling approximately 873 acres in three counties, from the debtor to DLC Family Trust, Ltd. The assignment occurred on July 5, 1995, and transferred three "causes of action and/or debts from three (3) separate companies" from the debtor to DLC Family Trust, Ltd. The causes of action dealt with herbicide damage claims valued at \$190,000, a hail insurance claim valued at \$30,000, and a wrongful replevin or taking of personal property claim valued at \$20,000. The debtor also forgave an \$84,213 note owed to it by DLC Family Trust, Ltd.

The debtor disputes the trustee's standing to bring this action, pointing out that all pre-petition creditors have either been paid in full or have withdrawn their claims, so there is no creditor to whose rights the trustee may ascend. The debtor further argues that in no way should the trustee be permitted to pursue this lawsuit when his success will not benefit the bankruptcy estate, as no creditors remain, and any assets that are recovered by the trustee will be used to pay his legal fees and the costs of this litigation.

Applicable Law

A. Standing

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 ("NUFTA").¹ Avoidance of a transfer is a two-part process. "Specifically, after demonstrating the *right* to recover conveyances under section 544(b), a trustee must then establish the *amount* of recovery under section 550(a) of the Bankruptcy Code[.]" Acequia, Inc. v. Clinton (In re Acequia, Inc.), 34 F.3d 800, 809 (9th Cir. 1994). The state fraudulent transfer statutes are relevant only to determine whether a transfer was fraudulent. The focus then

¹This court previously determined that the real estate transfers, recorded in 1994, were within the four-year statute of limitations in Neb. Rev. Stat. § 36-710, as is the 1995 assignment of the right to prosecute claims. See Memorandum of Dec. 14, 2000 (Fil. #134).

reverts to the Bankruptcy Code in order to determine the remedy.

The debtor has vigorously contested the trustee's standing to bring this action, asserting that the trustee lacks standing to pursue the matter because there are no unsecured creditors for whom the trustee could be collecting assets. All unsecured creditors have either withdrawn their claims or been paid in full, according to the debtor.

To exercise his § 544(b)(1) avoidance power, the trustee must show that the transfer is voidable under state law by at least one unsecured creditor of the bankruptcy estate with an allowable claim. Williams v. Marlar (In re Marlar), 267 F.3d 749, 753 (8th Cir. 2001) (citing Young v. Paramount Communications, Inc. (In re Wingspread Corp.), 178 B.R. 938, 945 (Bankr. S.D.N.Y. 1995)). See also Williams v. Marlar (In re Marlar), 252 B.R. 743, 754 (B.A.P. 8th Cir. 2000) (citing Panama Williams, Inc. v. Parr (In re Panama Williams, Inc.), 211 B.R. 868, 870 (Bankr. S.D. Tex. 1997) ("[T]he trustee must locate an existing unsecured creditor of the debtor who, on the date of bankruptcy, is able to avoid a transfer of property." (emphasis added))); Le Café Creme, Ltd. v. LeRoux (In re Le Café Creme, Ltd.), 244 B.R. 221, 238 (Bankr. S.D.N.Y. 2000) ("There can be no real contest . . . as to the existence of at least one actual, unsecured creditor at the time of the filing of the Debtor's petition who could set aside these Payments as fraudulent transfers [under New York law].").²

NUFTA protects both present and future creditors, Neb. Rev. Stat. § 36-705(a), so the trustee's standing is determined on the date the bankruptcy petition was filed. It is clear that creditors of DLC existed at that time who could have pursued this lawsuit. Therefore, the trustee in this case has standing to litigate this action. Contrary to the debtor's assertion, there is no requirement that the subsequent pay-off of all

²In contrast to NUFTA, cases seeking to set aside fraudulent conveyances indicate that the relevant unsecured creditor must have been in existence at the time the transaction was made. See, e.g., Wingspread Corp., 178 B.R. at 945; Ferrari v. Barclays Business Credit, Inc. (In re Morse Tool, Inc.), 148 B.R. 97, 131 (Bankr. D. Mass. 1992) (Section 4 of the Uniform Fraudulent Conveyance Act limits standing to creditors whose claims against the debtor were in existence at the time the interest was transferred or the obligation incurred.)

unsecured creditors requires the trustee to discontinue the lawsuit.

B. Fraudulent Transfer

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).

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).

Facts and Discussion

The debtor admits a number of facts, namely that the transfers at issue were between two corporations that at least

initially shared common officers, directors, and shareholders; the debtor had been sued before the transfers were made; the transfer under the assignment of the causes of action constituted a transfer of substantially all of the debtor's assets; the debtor received no cash for the transfers; the debtor was insolvent shortly after the assignment was made; and at the time of each transfer, the debtor was indebted to creditors whose claims at such time remained unpaid. See Joint Preliminary Pretrial Statement ¶ 2 (Fil. #182).

Under NUFTA, an insider, when the debtor is a corporation, is defined as a director of the debtor; an officer of the debtor; a person in control of the debtor; a partnership in which the debtor is a general partner; a limited liability company of which the debtor is a member; or a relative of a general partner, director, officer, or person in control of the debtor. Neb. Rev. Stat. § 36-702(7)(ii).

Here, the debtor admits that the transferee entity shared officers and directors. Moreover, the evidence indicates that the debtor's principal officer, director, and/or shareholder signed the assignment on behalf of both DLC entities. The debtor asserts that the real estate transfers were the result of a business decision to "spin off" the land division of the corporation while retaining the farming division. This decision appears to have been made in May 1993 at a special meeting of the debtor's board of directors. However, the record leaves unanswered the question of why the deeds were not executed and recorded until the following March. I find that the insider badge of fraud weighs in the trustee's favor.

While there is no evidence that the debtor retained possession or control of the property transferred after the transfers,³ the evidence is clear that the debtor's principal officer continued to make decisions and conduct business involving the assets in his additional capacity as officer of the transferee entity. This badge of fraud tends to weigh in favor of the trustee.

The debtor admits that it was involved in on-going litigation with creditors at the time each of the transfers were made. The debtor's lender had filed actions to collect on an

³The evidence does indicate that DLC Family Trust, Ltd. sold one of the tracts to a third party in December 1995.

unpaid operating note and to foreclose on residential real estate securing the note. I find that this badge of fraud weighs in the trustee's favor.

Concerning the real estate transaction, the evidence indicates that the land transferred by the debtor was worth more than \$750,000. In return, DLC Family Trust assumed \$395,000 in liabilities and gave the debtor an \$84,213 promissory note. The debtor retained \$94,000 in personal property assets, and \$337,000 in liabilities. This transfer for less than a reasonably equivalent value rendered the debtor insolvent.

The debtor admits that the assignment transferred substantially all of its assets at the time to DLC Family Trust, Ltd., and that the debtor became insolvent shortly after making the assignment. The debtor assigned claims worth a face value of \$240,000 and forgave the \$84,213 note. In return, the Trust agreed to expend its funds to prosecute the claims and share the net proceeds with the debtor. However, the right of the debtor to share in the net proceeds kicked in only if the Trust were to collect from all claims an accumulated total sum greater than the amount of the note, plus accumulated interest, plus the total of fees and expenses incurred in the collection effort. Then, and only then, would the debtor have a right to 25 percent of the excess proceeds. In other words, the debtor gave up \$84,213 principal of the promissory note plus interest on the note in consideration for the Trust prosecuting the claims and giving the debtor 25 percent of the remaining collected proceeds.

See the July 5, 1995, Assignment (Ex. 5). Such assignment was not for "reasonably equivalent value." "[R]easonably equivalent value is a means of determining if the debtor received a fair exchange in the market place for the goods transferred." Jacoway v. Anderson (In re Ozark Restaurant Equip. Co.), 850 F.2d 342, 344-45 (8th Cir. 1988).

The real estate conveyance and claim assignment, both for less than reasonably equivalent value, are two badges of fraud that weigh in the trustee's favor.

The evidence does not indicate that the debtor concealed or removed assets, or absconded. There is no evidence that the debtor transferred assets to a lienor who transferred them to an insider. These badges weigh in the debtor's favor.

When considered in toto, the evidence is clear and convincing that the debtor transferred these assets with actual intent to hinder, delay, or defraud creditors, and these transfers are fraudulent under the NUFTA.

Avoidance

The defendants assert that the trustee should not be permitted to recover the alleged fraudulent transfers because none of the recovery would benefit the creditors. Any funds recovered would be paid toward administrative expenses, and specifically the costs of this litigation.

The posture of the case is unusual in that the debtor did settle with all of the unsecured creditors during the pendency of this action, although apparently an entity related to the debtor paid the claims and now holds subrogation rights. From the inception of this adversary proceeding, when the bankruptcy estate was still subject to the claims of creditors, the debtor's principal, an attorney, took an active role in opposing the trustee's efforts to recover these transfers. The opposition resulted in increased litigation costs for the trustee. It is hardly appropriate for the debtor to have caused the administrative expenses to burgeon, then arrange for all unsecured claims to be satisfied, and yet argue that the trustee should not be allowed to recover funds to pay those administrative expenses because there are no unsecured claims remaining.

The general purpose of 11 U.S.C. § 550(a) supports the trustee's position. Under that section, when a transfer is avoided, the trustee may recover the property or the value thereof "for the benefit of the estate." That phrase precludes recovery for the benefit of the debtor. Any recovery must benefit all unsecured creditors. Obviously, direct monetary benefits to the creditors qualify, but courts have expanded the phrase to include indirect or intangible benefits such as enhanced value of the corporate debtor in a Chapter 11 case, Trans World Airlines, Inc. v. Travellers Int'l AG (In re Trans World Airlines, Inc.), 163 B.R. 964 (Bankr. D. Del. 1994), or the increased likelihood that creditors will receive their payments under a plan of reorganization, Centennial Indus., Inc. v. NCR Corp. (In re Centennial Indus., Inc.), 12 B.R. 99 (Bankr. S.D.N.Y. 1981).

The Ninth Circuit Court of Appeals has broadened the scope

of the phrase even further, permitting recovery to reimburse the estate for the costs of pursuing the fraudulent conveyance litigation. See Acequia, 34 F.3d at 812. That court also decided that the debtor had a greater equitable claim to the funds than did the former controlling shareholder. The court found that "on the unique facts of this case, Acequia's section 544(b) fraudulent conveyance actions will 'benefit the estate' within the meaning of section 550(a)." Id.

The present case also rests on unique facts, as noted previously. This lawsuit has been going on for four years. It has generated 200 filed documents and numerous hearings. Discovery disputes account for a significant portion of the judicial time (and, presumably, litigant time) spent on this case. As noted above, the defendants, through their principal, an attorney who appeared regularly in the bankruptcy case and the adversary proceeding, have challenged the trustee's efforts at every turn. Such contentiousness contributed greatly to the costs of this litigation, and the defendants should not now be permitted to avoid facing the ramifications of their activities through creative legal maneuvers. I find, therefore, that the trustee's action, at a minimum, benefitted this estate by apparently causing the debtor to find the necessary funds to settle the very claims that caused the case to be filed in the first place. The debtor did not settle with the remaining creditors until late in this lawsuit, well after the bulk of the trustee's work on this action was done.

All of the real estate transfers and the assignment of claims and forgiveness of debt are avoided. Assuming that all unsecured claims have been satisfied, the trustee shall recover the value of the conveyances, assignment, and forgiveness of debt to the extent necessary to compensate the trustee for all administrative expenses incurred by the estate in the general administration of the bankruptcy case and those litigation expenses incurred in this adversary proceeding. The amount recoverable by the trustee shall be determined upon notice and hearing in the bankruptcy case on the trustee's fee application for this litigation and the trustee's request for other general administrative expenses incurred.

This is not a final appealable order. A final appealable order shall be entered in the form of a judgment in an amount certain after the above-listed matters are resolved. Trustee shall file a renewed motion for approval of the prior fee application, with an itemization of additional litigation-

related fees and expenses, and a final request for administrative expenses, by January 6, 2003.

IT IS ORDERED: All of the real estate transfers and the assignment of claims and forgiveness of debt are avoided.

DATED: December 9, 2002

BY THE COURT:

/s/Timothy J. Mahoney
Chief Judge

Notice given by the Court to:

*Don Swanson/Charles Benish
*Richard Myers
Larry Demerath
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.