

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
)
DLC, LTD., a Nebraska corporation,) CASE NO. BK97-82177
)
DEBTOR.) A98-8113
_____)
THOMAS D. STALNAKER, TRUSTEE,)
) CH. 7
Plaintiff,)
vs.)
)
DLC, LTD., a Nebraska corporation,))
and DLC FAMILY TRUST, LTD., a)
Nebraska Corporation,)
)
Defendant.)

MEMORANDUM

Hearing was held on a Motion for Partial Summary Judgment and Motion to Dismiss Defendants' Counterclaims filed by plaintiff and on Motion for Summary Judgment filed by defendants. Appearances: Donald Swanson for the plaintiff and Larry Demerath for the defendants. 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)(H).

Introduction

By amended complaint, Filing No. 90, the trustee asserts that certain real property transfers made by the debtor DLC, Ltd., ("DLC") are avoidable as fraudulent conveyances. In addition, the trustee asserts that a certain "Assignment," dated July 5, 1995, of three causes of action from the debtor to DLC Family Trust, Ltd., ("Trust") was a fraudulent transfer and is avoidable by the exercise of the trustee's avoiding powers under the United States Bankruptcy Code.

In response to the amended complaint, the defendants each filed answers asserting affirmative defenses including the assertion that the "statute of limitations" has run on any fraudulent conveyance action; that prior state court lawsuits raising the same issues concerning the real estate transfers are "res judicata" and binding upon the trustee with regard to

all issues concerning alleged fraudulent conveyances. The defendants have each filed a counterclaim asserting that the trustee has breached his fiduciary duty to the bankruptcy estate by failing to pursue any of the three causes of action referred to in the complaint and specifically allowing the "statute of limitations" to run on the third cause of action, a claim against Kayton International. The counterclaims also assert that the trustee has further breached his fiduciary responsibilities by employing the services of attorneys who represented, in the bankruptcy case, one of the creditors of the estate, Central Farmers Cooperative Non-Stock ("CFC"), an entity which is also the subject of one of the causes of action the defendants suggest should have been pursued by the trustee.

The affirmative defense asserting an expiration of the "statute of limitations" and "res judicata" appears in both the original answers filed to the initial Complaint and in the Answers to the Amended Complaint at Filing Nos. 112 and 113. The trustee filed a motion for partial summary judgment, Filing No. 23, requesting that the court enter summary judgment against both defendants, thereby striking and dismissing the affirmative defenses of "statute of limitations" and "res judicata". Both defendants filed a motion for summary judgment, Filing No. 125, asserting that the "statute of limitations" has run on the real estate transfers prior to the filing of the bankruptcy complaint and requesting summary judgment on the theory of "res judicata" and/or collateral estoppel concerning all counts. The motion for partial summary judgment filed by the trustee and the motion for summary judgment filed by the defendants shall be dealt with in one section of this opinion.

The trustee has also filed a motion to dismiss the counterclaims filed by the defendants. Such motion has been resisted.

I. Motion for Summary Judgment Concerning the Affirmative Defenses of the Statue of Limitations and Res Judicata

A. Decision

Trustee's motion for partial summary judgment concerning the affirmative defenses of "statue of limitations" and "res judicata" is granted. The motion for summary judgment filed

by defendants concerning the defenses of "statute of limitations" and "res judicata" is denied.

B. Undisputed Facts

1. In 1993, the shareholders of the debtor, DLC, Ltd., ("DLC") created a new corporation, DLC Family Trust, Ltd., ("Trust"). DLC agreed to transfer to Trust and Trust agreed to accept from DLC, certain assets, including several parcels of real estate. As partial consideration for the transaction, Trust executed and delivered to DLC a promissory note in the amount of \$84,213.00. Although, thereafter, DLC and Trust filed tax returns reflecting that such transaction had taken place, and although one or the other of the entities notified various county recording offices and an office of the United States Department of Agriculture that such transaction had taken place, no deeds representing a conveyance of the real estate were prepared, delivered or recorded until March 24, 1994.

2. On July 5, 1995, DLC, through an "Assignment", conveyed to Trust all claims and demands which it had concerning a herbicide damage claim for the years of 1989, 1990, and 1991; a hail insurance claim for the year 1991; and a wrongful replevin and/or taking and/or disposition of certain personal property by Fort Calhoun State Bank, and others, in the year of 1994. DLC also canceled, forgave and discharged the \$84,213.00 note referred to above. As consideration for the transfer of the claims and the cancellation of the indebtedness, the Trust apparently agreed to prosecute the three claims. The "Assignment" was also subject to the contingency that "if Trust collects from all claims an accumulated total sum greater than the amount of the note. . .any accumulated interest on said note . . . , and the total amount of any fees and expenses expended and paid by the Trust in collection efforts, then DLC shall receive from Trust a payment equal to twenty-five percent (25%) of such excess proceeds."

3. After the recordation of the deeds representing the conveyance of the real estate from DLC to the Trust, two tax foreclosure lawsuits were filed by the County of Madison, Nebraska. The tax foreclosure actions named as defendants Trust and CFC. CFC was named because of a lien filed against the real estate. In the amended answer filed by CFC, the real estate transfers represented by the deeds referred to above

were asserted by CFC to be fraudulent conveyances under the Nebraska Fraudulent Transfer Act.

4. In September of 1995, the taxes were paid and the foreclosure actions dismissed. No trial was had and no judgment was entered. An order of dismissal with prejudice was filed.

5. Following the recordation of the deeds conveying the real estate, lawsuits were filed by Fort Calhoun State Bank against DLC, the Trust and others. Those lawsuits alleged that the real estate conveyances were fraudulent transfers under the Nebraska Uniform Fraudulent Transfer Act. Each of the Fort Calhoun State Bank lawsuits was resolved by settlement between the plaintiff and defendants which resulted in a dismissal of each of the three fraudulent conveyance claims. The parties filed a "Joint Stipulation and Motion for Dismissal" in each case and the court entered a "Order of Dismissal" in each case. No trial was held and no judgments were entered.

6. DLC filed a Chapter 7 petition on September 2, 1997. This adversary proceeding was filed on December 23, 1998, by the trustee against DLC and Trust. CFC is an unsecured creditor of the bankruptcy estate.

7. DLC, the debtor, listed as assets of the bankruptcy estate the three claims previously assigned to Trust. In addition to a general statement concerning the claims, the debtor provided a detailed analysis, identified as Exhibit B to the Statement of Financial Affairs. In that detailed description of the claims, the debtor described its interest as follows: "DLC, Ltd., a Nebraska Corporation, was originally the owner of three (3) causes of action. DLC, Ltd., without income, was unable to proceed with three (3) lawsuits, and, therefore, assigned the same to a second Nebraska corporation, DLC Family Trust, Ltd., in exchange for a percentage of the net recovery, that is twenty-five percent (25%)."

C. Law

1. Summary Judgment

Summary judgment is appropriate only where the record shows that no material issue of genuine fact exists and the moving party is entitled to judgment as a matter of law.

Dulany v. Carnahan, 132 F.3d 1234, 1237 (8th Cir. 1997)(quoting Fed. R. Civ. P. 56(c)); Williams v. Marlar (In re Marlar), 252 B.R. 743 (8th Cir BAP 2000); See also Fed R. Bankr. P. 7056 (stating that Fed. R. Civ. P. 56 is applicable in bankruptcy adversary proceedings). A court's duty when making this determination is not to weigh the evidence and determine credibility but rather to determine whether there is a genuine issue for trial. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Summary judgment must be entered according to Rule 56(c) when, after time for discovery and upon motion, a party does not make a sufficient showing to establish the existence of an element essential to that party's case and on which they will bear the burden of proof at trial. Celeotex Corp v. Catrett, 477 U.S. 317, 106 S.Ct.2548, 91 L.Ed.2d 265 (1986); In re Marlar, 252 B.R. at 750; Nelson v. Kingsley (In re Kingsley), 208 B.R. 918 (8th Cir. BAP 1997).

2. Statute of Limitations

Both the trustee and the defendants have made a motion for summary judgment regarding the issue of the "statute of limitations".

This adversary complaint is based upon 11 U.S.C. § 544(b), a section of the Bankruptcy Code that permits the trustee to file avoidance actions based upon state law. Therefore, initially, in order to determine if the "statute of limitations" has run on this state-law based action, it must first be determined whether, at the time of filing the bankruptcy petition, the applicable state law "statute of limitations" had run. Mahoney, Trocki & Assoc., Inc., v. Kunzman (In re Mahoney, Trocki & Assoc., Inc.) 111 B.R. 914, 917 (Bankr. S.D. Cal. 1990) (citing In re Mankin, 823 F.2d 1296, 1299 n. 1 (9th Cir. 1987)).

The Nebraska statutes provide that fraudulent transfers may be avoided if such action is brought within four years following the date of the transfer. Neb. Rev. Stat. § 36-701 (Reissue 1998). The Nebraska Fraudulent Transfer Act defines when a transfer is made. Neb. Rev. Stat. § 36-707 (Reissue 1998). Section 36-707 states that a transfer is made for the purpose of the Uniform Fraudulent Transfer Act "with respect to real property when a transfer is so far perfected that a good faith purchaser of the asset from the debtor against whom applicable law permits the transfer to be perfected cannot

acquire an interest in the asset superior to the interest of the transferee." Neb. Rev. Stat. § 36-707(1)(i). To determine the point at which a good faith purchaser cannot acquire a superior interest to that of the transferee of real estate, Nebraska real estate law must be reviewed. Nebraska law provides:

All deeds, mortgages and other instruments of writing which are required to be or which under the laws of this state may be recorded, shall take effect and be enforced from and after the time of delivering the same to the Registrar of Deeds for recording, and not before, as to all creditors and subsequent purchasers in good faith, without notice; and all such deeds, mortgages and other instruments shall be adjudged void as to all such creditors and subsequent purchasers without notice whose deeds, mortgages or other instruments shall be first recorded; Provided that such deeds, mortgages or other instruments shall be valid between the parties.

Neb. Rev. Stat. § 76-283 (Reissue 1998).

According to Nebraska law, then, until a deed is recorded or a party has notice, a subsequent purchaser who records first may acquire rights superior to the transferee. Therefore, for purposes of the fraudulent transfer act, the "transfer" did not occur until the deeds were recorded.

In this case, the deeds were recorded on March 24, 1994. DLC filed for bankruptcy on September 2, 1997. The date of filing was well within the four-year "statute of limitations" provided by the Nebraska Fraudulent Transfer Act. As long as, at the time of filing the bankruptcy petition, the "statute of limitations" had not run, further consideration of the "statute of limitations" is unnecessary. In re Mahoney, Trocki & Assoc., Inc., 111 B.R. 917. If, at the time of the filing of the bankruptcy petition there existed a creditor that could pursue a cause of action against the debtor, the trustee is not barred from doing so. Id. If the action is not barred by state law, then the applicable "statute of limitations" becomes that provision of the Bankruptcy Code which limits the trustee's avoidance powers.

The Bankruptcy Code, at 11 U.S.C. § 546(a) requires that actions being commenced pursuant to Section 544 are to be brought within two years after the order for relief is entered or one year after the trustee is appointed, whichever occurs later. In this case, the bankruptcy petition was filed on September 2, 1997, and a trustee was appointed in 1998. This adversary proceeding was filed in December of 1998. It was filed well within either the one year or two year limitation and the action is not barred by Section 546(a).

3. Res Judicata

In Nebraska, the term "res judicata" refers to the principle that a final judgment on the merits by a court of competent jurisdiction is conclusive upon the parties in any other litigation involving the same cause of action. Acosta v. Seedorf Masonry, Inc., 253 Neb. 196, 569 N.W.2d. 248, 251 (1997)(quoting Kirkland v. Abramson, 248 Neb. 675, 538 N.W.2d 752 (1995)). The question then becomes whether there was a final judgment on the merits in either the lawsuits brought by Madison County, Nebraska, or the lawsuits brought by Fort Calhoun State Bank. "Res judicata" stands as a bar not only to those issues actually litigated, but also to those issues which could have been litigated in a previous proceeding in which a final judgment was entered. Lincoln Lumber Co., v. Fowler, 248 Neb. 221, 533 N.W.2d 898, 903 (1995).

As recited above, the debtor and the Trust were sued by Fort Calhoun State Bank and the issue of fraudulent transfers was asserted. In addition, in the Madison County lawsuits, CFC raised the issue of fraudulent transfer. All of these lawsuits were settled and orders were entered dismissing the lawsuits.

Several federal courts have held that settlement of a lawsuit is the equivalent of a final judgment on the merits. In re Teal, 16 F.3d 619 (5th Cir. 1994); CitiBank N.A. v. Data Lease Financial Corp., 904 F.2d 1498, 1501 (11th Cir. 1990). If the parties have previously litigated an issue in state court, the bankruptcy court will apply the law of issue preclusion of that state. Madsen v. Lease (In re Madsen), 195 F.3d 988 (8th Cir. 1999); Harberer v. Woodbury County, 188 F.3d 957, 960-61 (8th Cir. 1999).

In contrast to the federal decisions, under Nebraska case law, an order which dismisses a case with prejudice but does

not pronounce a judgment, nor grant or deny any relief, is not a "judgment" and, therefore, cannot be a final judgment binding upon the parties. J.K. v. Kolbeck, 257 Neb. 107, 110-11, 595 N.W.2d 875, 877-78 (1999). According to the Nebraska Supreme Court, an order of dismissal, even if the settlement agreement is incorporated into the order, is a representation of a court's relinquishment of, rather than an exercise of, the court's power. J.K. v. Kolbeck, 257 Neb. at 111, 595 N.W.2d at 878. In conclusion, since there has been no final judgment on the merits of the fraudulent transfer issue in any case, the doctrine of "res judicata," as a matter of law, is inapplicable.

II. Trustee's Motion to Dismiss Counterclaim
filed by DLC and Trust.

A. Trustee's Breach of Fiduciary Duty

DLC and Trust allege that the trustee has breached his fiduciary duty to the bankruptcy estate by failing to pursue the three causes of action identified above which were the subject of the "Assignment" transferring the right to prosecute the claims from DLC to Trust. That assignment was executed in 1995. As referred to earlier, debtor listed these three claims in the schedule of financial affairs and described them as having been assigned to Trust for certain consideration, although the description of the consideration and remaining interest of DLC in the claim is significantly different in the schedule of financial affairs from the description in the "Assignment."

One count of the fraudulent conveyance action brought by the trustee against both DLC and Trust concerns the "Assignment." The trustee asserts that the "Assignment" of the claims was a fraudulent transfer and, in another count, asserts that the promissory note in the amount of \$84,213.00 plus accruing interest, is an asset of the bankruptcy estate on which the Trust is liable.

In their answers, both DLC and Trust acknowledge the "Assignment" and assert that it was for valid consideration, and further assert that the promissory note was canceled by virtue of the "Assignment."

It is obvious that the position taken by the defendants in their Answers to the asserted fraudulent conveyances and

viability of the note are totally inconsistent with the position taken by them in the Counterclaims.

In the Answers, they claim that the "Assignment" does not represent a fraudulent transfer. One can infer from such a statement that both defendants are asserting that the Trust is now properly the owner of the claims and has the right to prosecute the claims, pursuant to the terms of the "Assignment."

On the other hand, in the Counterclaims, they are asserting that the trustee has an obligation to prosecute the claims and his failure to do so is a breach of his duty to the bankruptcy estate. The inconsistency is patent and the defendants have no legal or factual basis for bringing the Counterclaims. If the "Assignment" is not a fraudulent transfer, then Trust owns all rights to the claims, including the right, exclusive of the trustee to prosecute the claims. According to the "Assignment," if it does so, and the net proceeds exceed the amount of the promissory note, accrued interest, and cost of prosecution, DLC has a claim against Trust for 25% of such excess proceeds.

Separately from the inconsistent positions taken in the Answer and Counterclaim of Trust, Trust does not claim to be a creditor of this estate. It, therefore, has absolutely no standing to sue the bankruptcy trustee for breach of duty to the estate. The bankruptcy trustee has no duty to Trust.

B. Assertions that Trustee's Counsel
has a Conflict of Interest

The defendants claim that counsel for the trustee has a conflict of interest because counsel, and/or counsel's firm represented CFC in the bankruptcy proceeding prior to being employed by the trustee to prosecute this adversary proceeding. The Bankruptcy Code, at 11 U.S.C. § 327(c) specifically states that "a person is not disqualified for employment under this section solely because of such person's employment by, or representation of a creditor, unless there is objection by another creditor or the United States Trustee, in which case the court shall disapprove such employment if there is an actual conflict of interests." 11 U.S.C. § 327(c).

Neither DLC nor Trust are creditors of this estate. Therefore, from the face of the statute, one can determine that they do not have standing to raise such an objection. Even if they have standing to raise the issue, they have failed to produce any evidence concerning an interest adverse to the bankruptcy estate.

C. Decision

The motion of the trustee to dismiss the counterclaim filed by each of the defendants is granted.

Separate judgment to be entered. Parties shall file a joint pretrial statement by February 1, 2001.

DATED: December 14, 2000

BY THE COURT:

/s/Timothy J. Mahoney

Timothy J. Mahoney
Chief Judge

Copies faxed by the Court to:

DEMERATH, LARRY 359-5304
SWANSON, DONALD 48

Copies mailed by the Court to:

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.

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF:)
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DLC, LTD., a Nebraska corporation,) CASE NO. BK97-82177
) A98-8113
)
DEBTOR.) CH. 7

JUDGMENT

Judgement is entered in favor of the plaintiff/trustee on the motion for partial summary judgment and on the motion to dismiss the counterclaims. Motion for summary judgment filed by the defendants is denied. See Memorandum entered this date.

DATED: December 14, 2000

BY THE COURT:

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

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