U.S. BANKRUPTCY COURT
NORTHERN DISTRICT OF TEXAS
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IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
DALLAS DIVISION

In re:	§	
	§	
OLA INEZ GORDON,	§	**Case No. 02-32599-HDH-7**
	§	
Debtor.	§	
	§	
JOHN H. LITZLER, Chapter 7 Trustee	§	
	§	
Plaintiff,	§	**Adversary No. 03-3787**
	§	
vs.	§	
	§	
CHERYL ETHRIDGE and	§	
SUSAN EASTUS,	§	
Defendants.	§	
	§	

MEMORANDUM OPINION ON COMPLAINT
TO RECOVER FRAUDULENT TRANSFERS

Came before the Court for trial, the Complaint to recover fraudulent transfers to Cheryl Ethridge and Susan Eastus, filed by the Trustee. This memorandum opinion constitutes the Court's findings of fact and conclusions of law pursuant to Federal Rule of Bankruptcy Procedure 7052. The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 1334 and 151, and the standing order of reference in this district. This matter is a core proceeding, pursuant to 28 U.S.C. § 157(b)(2)(A), (H) and (O).

In this adversary proceeding John H. Litzler ("Trustee"), the Chapter 7 Trustee of the bankruptcy estate of Ola Inez Gordon, the Debtor, seeks to recover transfers in the form of loan forgiveness by the Debtor to her daughters.

I. BACKGROUND FACTS

The Court generally adopts the statement of undisputed facts in the Joint Pretrial Order, and will give a brief summary. Alli Douglas, the widow of Townsend Douglas, died intestate on December 12, 1999. Ola Inez Gordon ("Gordon" or "Debtor") survived her sister Alli Douglas. Upon Alli's death, Gordon became the successor trustee of the Alli V. Douglas Revocable Living Trust. Unknown to Gordon, a Last Will and Testament of Townsend Douglas also existed ("Townsend Will") and Alli Douglas had transferred certain property to her Living Trust, which should have been disposed of through the Townsend Will.

Gordon netted over $360,000 as the sole beneficiary under her sister's trust. In addition to stock and personal items, Gordon received a house from the trust, which she eventually sold. Out of the trust proceeds, Gordon made loans totaling $177,000 to her daughters. The loans were not documented; however, both Gordon and her daughters testified that when they were made, the loans were expected to be repaid.

Approximately ten months after Alli's death, a Townsend Will beneficiary contacted Gordon and threatened her with suit. The beneficiary brought an action to recover the assets Gordon obtained through her sister's trust that arguably should have been transferred through the Townsend Will to the beneficiaries of that will. After a mediation on December 19, 2001, Gordon agreed to pay the Townsend Will beneficiaries $185,000. At some time after the agreement to pay the Townsend Will beneficiaries was made, Gordon forgave both loans to her daughters. She claims the loan forgiveness occurred in February, 2001. The Trustee argues that the loans were forgiven later. Gordon filed Chapter 7 bankruptcy on March 26, 2002. Her

petition, schedules, and statement of financial affairs indicate that she has little nonexempt assets.

The Trustee claims Gordon made fraudulent transfers to her daughters when she forgave the loans. The Trustee seeks to avoid the transfers, claiming Gordon actually intended to hinder, delay or defraud her creditors. The Trustee requests the Court to disallow any of the daughters' proofs of claim unless the Defendants remit to the Trustee the full amount of the transfers. Gordon and her daughters maintain the transfers were not fraudulent.

II. ISSUE

The issue for the Court to determine is whether two loans that were made by the Debtor to her daughters and were later forgiven are avoidable as fraudulent transfers.

III ANALYSIS

A. LAW

Section 548 of the Bankruptcy Code allows the Trustee to avoid transfers of debtor property made within one year prior to filing bankruptcy, if, inter alia, the debtor made the transfers with actual intent to hinder, delay, or defraud creditors. *See* 11 U.S.C. § 548. However, where as here, over one year arguably has passed between the time that the transfers took place and the filing of the bankruptcy, the Trustee may also avoid any transfer of an interest of the debtor in property that is avoidable under applicable state law by a creditor holding an allowed unsecured claim. *See* 11 U.S.C. § 544(b).

Known as the "strong arm" provision of the Bankruptcy Code, § 544 "allows the trustee to step into the shoes of a creditor for the purpose of asserting causes of action under state fraudulent conveyance laws and confers on the trustee the status of a hypothetical creditor or

bona fide purchaser as of the commencement of the case." *In re Zedda,* 103 F.3d 1195, 1201 (5th Cir.1997).

The Texas Uniform Fraudulent Transfer Act ("TUFTA") creates the statutory cause of action through which a creditor may pursue a fraudulent transfer claim in Texas. TUFTA, proscribes transfers made with actual intent to hinder, delay, or defraud creditors. Tex. Bus. & Comm. Code § 24.005(a)(1) (Vernon 2002). The state law statute of limitations is four years. *Id.* To the extent that a transfer is avoided under § 544, the trustee may recover, for the benefit of the bankruptcy estate, the property transferred, or, if the court so orders, the value of such property, from the initial transferee of such transfer or the entity for whose benefit the transfer was made. 11 U.S.C. § 550(a).

Under both the Bankruptcy Code and Texas law, the intent to hinder or delay or defraud are three separate elements. *Sherman v. FSC Realty, LLC (In re Brentwood Lexford Partners LLP)*, 292 B.R. 255, 263 (Bankr. N.D. Tex. 2003). The presence of any one of these elements can trigger culpability and, therefore, liability, under both the Bankruptcy Code and Texas law. *Id.*

Since direct proof of fraud often is not available, courts may rely on circumstantial evidence to establish fraudulent intent. *Roland v. United States*, 838 F.2d 1400 (5th Cir. 1998); *Williams & Chastain v. Laird*, 32 S.W.2d 502, 505 (Tex. Civ. App. 1930). When several indicia of fraud are found, they may form the foundation for an inference of fraud. *Roland*, 838 F.2d at 1403. This foundation is built upon what are known as "badges of fraud." *Texas Sand Co. v. Shield*, 381 S.W.2d 48, 53 (Tex. 1964). The TUFTA lists eleven non-exclusive badges of fraud that may be used to prove actual fraudulent intent:

a. the transfer or obligation was to an insider;

b. the debtor retained possession or control of the property transferred after the transfer;

c. the transfer or obligation was concealed;

d. before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

e. the transfer was of substantially all the debtor's assets;

f. the debtor absconded;

g. the debtor removed or concealed assets;

h. the value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of obligation incurred;

i. the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation incurred;

j. the transfer occurred shortly before or shortly after a substantial debt was incurred; and

k. the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

Tex. Bus. & Comm. Code § 24.005(b) (Vernon 2002). Although the presence of any one badge of fraud is not conclusive, a concurrence of numerous badges in the same case will always make out a strong case of fraud. *Adams v. Wilhite*, 636 S.W.2d 851, 856 (Tex. Civ. App.—Tyler, 1982), *rev'd on other grounds*, 640 S.W.2d 875. Even where actual fraudulent intent by the debtor is established under § 24.005(a), transfers made by a debtor with fraudulent intent will not be voidable as against a transferee who accepted the transfer (1) in good faith, and (2) for a reasonably equivalent value. Tex. Bus. & Comm. Code § 24.009(a) (Vernon

2002). Unlike § 24.004(a) which focuses on the transferor or debtor, the defense provided in § 24.009(a) focuses on the transferee and is effective even if the debtor acted with fraudulent intent.

However, if the transferee has either actual or constructive knowledge of the debtor's intent, the transfer is void even where valuable consideration is paid. *Wilhite*, 636 S.W.2d at 855. Constructive knowledge of the debtor's fraudulent intent is present where the transferee "knows facts which would put a reasonably prudent person on inquiry and if diligence would lead to knowledge of the transferor's fraudulent intent, the [transferee] is charged with constructive notice of the intent and is not protected." *Id.* (quoting Creditors' Bills To Discover and Reach Property, in State Bar of Texas, Creditors' Rights in Texas § 14.43(a)(2), at 631 (2d ed. 1981)).

B. APPLICATION

The facts present a number of badges of fraud that allow this Court to find that Gordon forgave the loans to her daughters with actual intent to hinder, delay or defraud her creditors.[1] When Gordon forgave the loans to her daughters, this constituted transfers of property that fall within the scrutiny of fraudulent transfers under the TUFTA. Under the TUFTA, the presence of a number of badges of fraud will always make out a strong case of fraud, and in the instant case, as explained below, at least six of the eleven factors the statute provides are present. Thus, even though direct proof of fraud is not available from the evidence, this Court is allowed to infer fraud from the existence of these badges. Moreover, the transfers to her

[1] The Trustee also argues the presence of a constructively fraudulent transfer. Since this court finds actual intent to hinder, delay or defraud, it need not also find the presence of constructive fraudulent intent.

daughters were not made for reasonably equivalent value, one of the necessary elements of the defense provided in § 24.009(a). Therefore, under § 544 of the Bankruptcy Code, the Trustee can avoid these transfers since Gordon acted with actual fraudulent intent to defraud her creditors under Texas law.

First, Gordon's transfers were to insiders and for no consideration. Both transfers to insiders and transfers for no consideration are considered badges of fraud. Tex. Bus. & Comm. Code § 24.005(b)(1), (8) (Vernon 2002). While a close relationship between the transferor and transferee is not, standing alone, a badge of fraud, it may in fact be a badge of fraud when considered in conjunction with other suspicious circumstances. *Wilhite*, 636 S.W.2d at 856. Gordon's undisputed testimony, and that of one of her daughters, was that she transferred a total of $177,000 for no consideration. Therefore, in this case, not only are the transfers for no consideration a badge of fraud, so to is the fact that they were transfers to her daughters.

Moreover, the transfers were made after Gordon had been threatened with suit and shortly before a substantial debt was incurred as a result of that suit. When assets are transferred after suit or threat of suit, or shortly before or after a substantial debt was incurred, these circumstances are considered badges of fraud. Tex. Bus. & Comm. Code § 24.005(b)(4), (10) (Vernon 2002). Only about five months after she was first contacted by a Townsend Will beneficiary and threatened with suit, Gordon allegedly forgave the loans.[1] Then about ten months after that, Gordon settled the lawsuit for $185,000.

[1] In September, 2001, in her deposition, Gordon described the loans in the present tense as if they were still in existence. The Trustee asserts that this Court must determine that the loan forgiveness occurred after September 2001. Loan forgiveness during the litigation would be a badge of fraud. However, this court need not decide precisely when Gordon forgave the loans. As mentioned above, the loan forgiveness occurred after the threat of suit was made, and, combined with the other facts, this Court determines the Debtor acted with fraudulent intent.

Further, Gordon transferred almost all of her nonexempt assets, leading to her insolvency and filing this Chapter 7 bankruptcy about a year after the transfer. Transfers of substantially all of the debtor's assets, as well as the debtor becoming insolvent shortly after the transfer are badges of fraud. Tex. Bus. & Comm. Code § 24.005(b)(5), (9) (Vernon 2002). In September of 2001, Gordon testified at a deposition in the lawsuit brought by the Trustee for the Townsend Roland Douglas Trust, that she then possessed only $2,000. However, no evidence was introduced as to any substantial debts incurred in between the time she forgave the loans to her daughters and the time of her deposition. Moreover, shortly after she settled with the Townsend Will beneficiaries in December of 2001, Gordon apparently became insolvent and filed for Chapter 7 bankruptcy.

Therefore, the combination of these facts can be considered badges of fraud and indicative of an attempt to hinder, delay or defraud creditors. Thereby, from these badges of fraud, an inference can be made that Gordon transferred assets with an actual intent to hinder, delay, or defraud her creditors.

IV. WITNESS CREDIBILITY

The bankruptcy court may judge the credibility of the witness, when making its findings of fact and conclusions of law. *See* Fed. R. Bankr. P. 7052; *see also Robertson v. Dennis (In re Dennis)*, 330 F.3d 696, 701 (5th Cir. 2003). Gordon's version of the facts was impeached many times by Counsel for the Trustee. She did not know the answer to a number of basic questions. Based on this Court's observations of the witness during the trial, the Court must give less weight to the testimony of Gordon.

V. CONCLUSION

From the number of badges of fraud present within the facts, a firm foundation is established upon which an inference of actual fraudulent intent is justified. Further, although § 24.009 provides defenses to the transferees even once fraudulent intent has been established on the part of the debtor, Gordon's daughters cannot satisfy the elements of the defense.

As both Gordon and one of her daughters testified, the daughters received no consideration for the transfers, therefore Gordon's daughters did not accept the transfer for reasonably equivalent value, one element of the defense. Since this element of the defense is not satisfied, the defense as a whole cannot be satisfied. Therefore, under § 544 of the Bankruptcy Code, the Trustee may avoid the transfers Gordon made to her daughters. Pursuant to 11 U.S.C. § 550, the Court will issue a judgment against the defendants for the value of the transfers.

A separate judgment will be entered consistent with this memorandum opinion.

Signed: 9/27/04

HARLIN D. HALE
U.S. BANKRUPTCY JUDGE