IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TEXAS
SHERMAN DIVISION

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| IN RE: | § | |
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| JOHN C. DUNCAN, | § | Case No.02-46291 |
| | § | (Chapter 7) |
| Debtor. | § | |

**MEMORANDUM OPINION AND ORDER REGARDING MOTION TO APPROVE COMPROMISE AND MOTION FOR RECONSIDERATION**

Mark A. Weisbart, the Chapter 7 trustee of the bankruptcy estate of John C. Duncan, the debtor, moves the Court to approve a global settlement with the debtor's wife, Barbara Duncan, pursuant to Bankruptcy Rule 9019. The settlement, if approved, would resolve all issues between the trustee and Mrs. Duncan in an action by the trustee to recover property transferred by the debtor to Mrs. Duncan. The settlement also would resolve an objection by the trustee to the debtor's claimed exemption of his community property interest in the transferred property. The Court conducted an evidentiary hearing on the trustee's settlement motion on September 6, 2006 and, at the conclusion of the hearing, approved the proposed settlement on the record.

## I. JURISDICTION

A motion by a trustee under Bankruptcy Rule 9019 raises a core matter over which this Court has jurisdiction to enter a final order pursuant to 28 U.S.C. §§157(b)(2)(A), (B), (C) and (O) and 1334. This Memorandum Opinion contains the Court's findings of fact and conclusions of law. *See* FED. R. BANKR. P. 7052 and 9014.

## II. THE PROPOSED SETTLEMENT AGREEMENT

In this case, the trustee proposes a settlement whereby Mrs. Duncan will pay the

Chapter 7 trustee $27,000 (the "Settlement Amount") in monthly installments of $2,000 until the Settlement Amount is paid in full. The Settlement Amount will be secured by entry of an agreed judgment in favor of the trustee in the sum of $40,000. The trustee will not record or otherwise seek to collect on the agreed judgment so long as Mrs. Duncan makes monthly payments of $2,000. The trustee also proposes to withdraw his objection to the debtor's claimed exemption of the transferred property and to release Mrs. Duncan of the claims asserted in his fraudulent transfer complaint.

Cadle Company ("Cadle") objects to the proposed settlement. Cadle complains that the Settlement Amount is too low and, when reduced by approximately $15,000 in attorneys' fees for the Chapter 7 trustee, only modestly enhances the value to the debtor's estate. Cadle also suggests that the trustee's claims would be easy to try, that the Chapter 7 trustee's claims appear to be "viable," and that the property that is the subject of the Chapter 7 trustee's fraudulent transfer action is "quite valuable."[1]

## III. BACKGROUND

During the course of the debtor's marriage to Mrs. Duncan, Mrs. Duncan made several loans to the debtor from her separate property. Mrs. Duncan provided the loans to the debtor in order for him to operate his solely managed construction business. The loans totaled approximately $208,000 (collectively, the "Loans").

[1] Following the hearing and prior to the entry of this Order, Cadle raised additional objections to the trustee's motion in the form of a motion to reconsider the Court's oral ruling on the trustee's motion. In its so-called "motion for reconsideration," Cadle, in essence, objects that the language in the proposed settlement agreement is too broad, because it would release all of the trustee's claims relating to transfers of property by the debtor. However, a motion to alter or amend a judgment under Federal Rule of Civil Procedure 59(e) cannot be used to raise arguments which could and should have been made before the Court's ruling. *See Ross v. Marshall*, 426 F.3d 745, 763 (5th Cir. 2005). Furthermore, Cadle's argument ignores the narrow definitions of "Property," "Transfer," and "Trustee's Claims" set forth in the proposed settlement agreement. This Court cannot and will not provide Cadle with an advisory opinion on the *res judicata* effect of the settlement agreement. To the extent Cadle asserts that the proposed agreement would release potential state law fraudulent transfer claims, Cadle has failed to point the Court to any such claims.

The debtor and Mrs. Duncan reside at 4832 Briargrove Lane in Dallas, Texas (the "Briargrove Property"). Mrs. Duncan made the down payment on the Briargrove Property from her separate property. She also made all mortgage and tax payments from her separate property.

The debtor commenced a proceeding under Chapter 7 of the Bankruptcy Code by filing a petition with this Court on December 4, 2002. Mark A. Weisbart was appointed to serve as the Chapter 7 trustee to administer the debtor's bankruptcy estate.

The debtor filed his original bankruptcy schedules on December 23, 2002. In his original Schedule A, the debtor listed a homestead interest in the Briargrove Property. The debtor described the Briargrove Property as having a value of $395,000 with secured debt of $225,000 as of his bankruptcy petition date. The debtor stated in his Schedule A that he had transferred his community interest in the Briargrove Property to his wife prior to bankruptcy. The debtor stated that this transfer was made "in settlement of loans made by her separate estate to the community."

On September 28, 2004, the debtor filed amended bankruptcy schedules. The amended Schedule A states that Mrs. Duncan re-conveyed her husband's community interest in the Briargrove Property to him effective September 24, 2004. In his amended Schedule C, the debtor claims his interest in the Briargrove Property as his exempt property pursuant to the Texas Constitution and Property Code. *See* TEX. CONST. art. 16 §§50 and 51; TEX. PROP. CODE §§41.001 and 41.002.

On October 5, 2004, Washington Mutual Bank, N.A. ("Washington Mutual") filed a motion seeking relief from the stay to foreclose its lien on the Briargrove Property. On November 16, 2004, the Court entered an agreed order conditioning the automatic

stay. The agreed order provides that the stay will lift unless an arrearage of $9,256.64 is cured before the date of the debtor's discharge.

On October 27, 2004, the trustee objected to the debtor's claimed exemption of his interest in the Briargrove Property (the "Objection to Exemption"). In his objection, as amended, the trustee argues that a debtor's entitlement to exemptions is determined as of the petition date. The trustee further argues that a debtor cannot retroactively claim as exempt property which he acquires after the bankruptcy case is commenced.

On November 22, 2004, the trustee filed a Complaint to Avoid and Recover Avoidable Transfer (the "Complaint") against the debtor's wife pursuant to 11 U.S.C. §§547 and 548. On January 19, 2005, the Court procedurally consolidated the Complaint and the Objection to Exemption.

In the Complaint, the trustee asserts that the transfer of the Briargrove Property was a preferential transfer pursuant to §547(b), an actually fraudulent transfer pursuant to §548(a)(1)(A), and/or a constructively fraudulent transfer pursuant to §548(a)(1)(B). The trustee seeks to recover the Briargrove Property or its value pursuant to §550. In her answer to the Complaint, Mrs. Duncan denies that the trustee is entitled to any recovery. She asserts, as an "affirmative defense," that she has already re-conveyed the debtor's interest in the Briargrove Property to him.

The trustee has undertaken discovery in this matter. Among other things, both Mrs. Duncan and the trustee have obtained expert reports on whether the debtor was insolvent at the time he transferred his interest in the Briargrove Property to Mrs. Duncan. Mrs. Duncan's expert concluded that the value of the Debtor's interest in a company called Duncan Sanders Custom Builders Ltd. was $220,000 in January 2002

and that, as of July 2002, the debtor had a net worth of at least $83,000. The trustee's expert concluded that the Debtor's interest in Duncan Sanders Custom Builders, Ltd. was worth only $20,000.

During the course of the debtor's bankruptcy case, Cadle filed an adversary proceeding seeking a denial of the debtor's discharge (the "Discharge Action"). Among other things, Cadle complained that the debtor transferred the Briargrove Property to his wife prior to filing for bankruptcy with the intent of hindering, delaying, or defrauding his creditors and, therefore, that his discharge should be denied pursuant to 11 U.S.C. §727(a)(2).[2]

The Court tried the Discharge Action on October 18, 2004, and the Court issued its Memorandum Opinion regarding the trial on March 31, 2006. In its Memorandum Opinion, the Court concluded that the debtor did not have the requisite intent to hinder, delay or defraud his creditors in connection with the transfer of the Briargrove Property to his wife. The Court's decision was recently affirmed by the United States District Court for the Eastern District of Texas upon an appeal by Cadle.[3]

As of the hearing on the trustee's Bankruptcy Rule 9019 motion, the trustee had incurred approximately $12,000 in legal fees in prosecuting the Objection and Complaint. A trial would involve the testimony of two experts and at least three fact witnesses. The trustee estimated that he would incur additional costs of at least $15,000 to bring the

[2] In its objection to the trustee's Bankruptcy Rule 9019 motion, Cadle suggests that the trustee has not conducted sufficient discovery in this case. In weighing the sincerity of this objection, it is significant that Cadle chose not to assist in the trustee's investigation. There appeared to be no dispute at the hearing that the trustee requested copies of the transcripts of Cadle's examinations of the debtor in connection with the Discharge Action or that Cadle refused to provide any copies.

[3] The District Court's Order was entered on the docket of Adversary Proceeding No. 03-4186 on September 17, 2007. In the Order, the District Court upheld, among other things, this Court's conclusion that Cadle had failed to establish an intent to defraud by Mr. Duncan.

Objection to Exemption and Complaint to trial. As of the hearing on the trustee's Bankruptcy Rule 9019 motion, there was $20,200 in the debtor's bankruptcy estate.

In the two years since Mrs. Duncan re-conveyed the debtor's interest in the Briargrove Property to the debtor and prior to trial, she has made 48 monthly mortgage payments of $2,932 from her separate property, and she has used her separate property to pay taxes and insurance relating to the Briargrove Property. The total amount Mrs. Duncan has paid since September 2004 is $140,781.16.

## IV. ANALYSIS

A bankruptcy court should approve a settlement under Bankruptcy Rule 9019 if the settlement is within a range of reasonableness, fair and equitable, and in the best interest of the bankruptcy estate. In making that determination, a bankruptcy court must make a well-informed decision, comparing the terms of the compromise with the likely rewards of litigation. The court must evaluate (1) the probability of success in the litigation with due consideration for the uncertainty in fact and law, (2) the complexity and likely duration of the litigation and any attendant expense, inconvenience and delay, and (3) all other factors bearing on the wisdom of the compromise. Under the first factor, the court does not conduct a mini-trial, but the court does apprise itself of the relevant facts and law to make an informed decision. *See Rivercity v. Herpel (In re Jackson Brewing Co.)*, 624 F.2d 599, 602 (5th Cir. 1980). Under the third category, the court should consider the best interest of creditors, with proper deference to their reasonable views. *See In re Cajun Elec. Power Co-op, Inc.*, 119 F.3d 349, 356 (5th Cir. 1997).

Against this background, the Court assesses the probability of success in the pending litigation and the paramount interest of creditors, giving due deference to the

reasonable views of the creditors while considering the trustee's handicaps. *See In re Cajun Elec. Power Co-op, Inc.*, 119 F.3d at 751. The Court also considers "the extent to which the settlement is truly the product of arms-length bargaining, and not of fraud or collusion." *In re Foster Mortgage Corp.*, 68 F.3d 914, 917, 918 (5th Cir. 1995) (internal citations omitted).

Here, there is no relationship between the trustee and Mrs. Duncan or between the trustee and the debtor. The trustee, who is an attorney, has conducted discovery and has researched and analyzed his claims against Mrs. Duncan as well as his objection to the debtor's homestead exemption. The parties reached the proposed settlement agreement after extensive negotiations. The Court finds that the proposed settlement is the product of arms-length bargaining and is not the result of collusion or fraud.

In evaluating whether the trustee would succeed on the claims and objections he proposes to settle, the parties present several issues for the Court's consideration:

**A. The Trustee's Avoidance Claims**

There are many obstacles to the Trustee's ability to prevail on the avoidance action. The Court first notes that the trustee bears the burden of proof on his claims for a preferential transfer and fraudulent conveyance. *See, e.g., In re Major Funding Corp.*, 126 B.R. 504 (Bankr. S.D. Tex. 1990). A required element of both a preferential transfer and a constructively fraudulent transfer is that the debtor was insolvent at the time the challenged transfer occurred. *See* 11 U.S.C. §547(b)(3), §548(a)(2)(B)(ii)(I). The Bankruptcy Code's definition of insolvency is essentially a balance sheet test which examines whether the sum of the debts is greater than the sum of the assets, at a fair valuation, exclusive of property transferred with actual fraudulent intent, and property

that may be exempted from the bankruptcy estate. *See* 11 U.S.C. §101(32).

In this case, as discussed below, the parties disagree as to whether a transfer of the Briargrove Property actually occurred. Additionally, the parties' experts disagree about whether the debtor was solvent at the time of the alleged transfer of the Briargrove Property to Mrs. Duncan. The solvency dispute turns, in part, on how to value the debtor's interest in a company called "Duncan Sanders Custom Builders Ltd." Given that valuation is a highly factual question and depends, in part, on the credibility of experts and their reports, there is a risk that Mrs. Duncan may ultimately prevail on the solvency issue.

With respect to the trustee's claim that the alleged transfer of the Debtor's interest in the Briargrove Property was actually fraudulent under §548(a)(1)(A), there is a risk that the Court may determine that its ruling regarding the Debtor's lack of fraudulent intent in the Discharge Action is preclusive. *Pace v. Bogalusa City Sch. Bd.*, 403 F.3d 272, 290 (5th Cir. 2005) (setting forth the elements required for preclusion). In the Discharge Action, the issue of fraudulent intent was actually litigated by Cadle in connection with its claim under §727(a)(2) of the Bankruptcy Code. The fraudulent intent element set forth in §§548(a)(1)(A) and 727(a)(2)(A) is identically worded. Further, the burden of proof in §§548(a)(1) and 727(a)(2)(A) are identical. *See In re Sullivan*, 161 B.R. 776, 781 (Bankr. N.D. Tex. 1993) (discussing the burden under §548(a)); *In re Jones*, 292 B.R. 555, 560 (Bankr. E.D. Tex. 2003) (discussing the burden under §727(a)(2)).

More generally, courts are divided over the question of whether a debtor's creditors can be harmed by the pre-petition transfer of property that was exempt from

their claims. Under Texas law, exempt property is not subject to state fraudulent conveyance statutes. *See, e.g., Crow v. First Nat. Bank of Whitney*, 64 S.W.2d 377, 379 (Tex. Civ. App. – Waco 1933, writ ref'd). With respect to §548(a) of the Bankruptcy Code, courts disagree about whether transfers of potentially exempt property can be avoided as fraudulent, and there is no controlling authority in this jurisdiction. *See Kapila v. Fornabaio (In re Fornabaio),* 187 B.R. 780, 782 (Bankr. S.D. Fla. 1995). Some courts have adopted a "no harm, no foul" concept, reasoning that the transfer of property that would have been exempt from the reach of creditors does not harm creditors. *See, e.g., Jarboe v. Treiber (In re Treiber),* 92 B.R. 930 (Bankr. N.D. Okla. 1988). Other courts that have considered the issue have reasoned that, while the "no harm, no foul" approach was appropriate under the old Bankruptcy Act (under which exempt property was not part of the bankruptcy estate), it is not appropriate under the current Bankruptcy Code (under which all property, including potentially exempt property, is part of the estate unless exempted by the debtor). *See, e.g., In re Wickstrom,* 113 B.R. 339, 350 (Bankr. W.D. Mich. 1990).

The foregoing obstacles present a material litigation risk to the trustee in pursuing his preference and fraudulent conveyance claims. On the other hand, in the event the trustee succeeds in establishing a fraudulent transfer or preference claim, Mrs. Duncan faces her own litigation risks with respect to her "affirmative defense" that her post-petition re-conveyance of the debtor's interest in the Briargrove Property cured any previous fraudulent conveyance or preferential transfer. A trustee's avoidance powers under §544 of the Bankruptcy Code are determined as of the petition date. *See Lewis v. Manufacturers Nat. Bank of Detroit,* 364 U.S. 603 (1961). In *In re Shelton*, 33 B.R. 377

(D.C. Tenn. 1983), the court reasoned that the re-conveyance of property cannot cure a prior fraudulent or preferential conveyance:

> The court cannot accept these defendants' assertion that Clyde Shelton's postpetition reconveyance of these properties to the debtor "cured" any previous fraudulent conveyances and therefore the trustee no longer has a cause of action to pursue. The law is well settled that the trustee's interest arising under § 544(b) is determined at the time of the commencement of the case. The post petition reconveyance of these properties to the debtor and his wife cannot foreclose the trustee from asserting his intervening rights, which vested when the debtor filed his bankruptcy petition, and attempting to recover this property for the benefit of the estate. This is true regardless of whether the property is now in the hands of the original transferee or a subsequent transferee, such as the debtor. Section 550(a) specifically states that, to the extent a transfer is avoided under § 544(b), the trustee may recover the property transferred or the value of such property from either the initial transferee or any immediate transferee of this initial transferee, subject to certain exceptions which are not relevant in this case.

*Id.* at 377 (citations omitted). Thus, if the trustee prevails in establishing an avoidance claim, there is a possibility that Mrs. Duncan's "affirmative defense" may fail.

**B. The Trustee's Objection to Exemption**

As previously discussed, the debtor purported to transfer his interest in the Briargrove Property prior to filing for bankruptcy. He amended his schedule of exemptions after Mrs. Duncan re-conveyed his interest in the Briargrove Property to him. In his Objection to Exemptions, the trustee asserts that, since the Debtor no longer had any interest in the Briargrove on the petition date, he cannot claim the Briargrove Property as his exempt property

The debtor responds that the Briargrove Property was in fact his property on the petition date and can be claimed as his exempt property. A debtor's interest in property is determined by reference to state law. *See Butner v. United States*, 440 U.S. 48, 55 (1979). Under Texas law, "[a] conveyance of a homestead that is not intended to pass

title and that has been simulated to shield the homestead from creditors is void." *In re Moody*, 862 F.2d 1194, 1999 (5th Cir. 1989). Thus, if the debtor's purported transfer of his interest in the Briargrove Property was actually fraudulent -- as the trustee has alleged -- then the debtor has a legal basis for arguing that the transfer to his wife was void and not merely voidable. While this legal argument may have flaws (such as effectively reading §522(g) out of the Bankruptcy Code with respect to Texas homesteads), given the existing legal authorities and absence of controlling authority, a litigation risk nevertheless exists for the trustee.

**D. Offset and Collection Issues**

Even if the Court were to sustain the trustee's Objection to Exemption and the trustee prevailed on the Complaint, the trustee would face significant obstacles in seeking to sell the Briargrove Property and/or realizing on the judgment. Mrs. Duncan argues that her homestead interest in the Briargrove Property would not be affected by the avoidance of the debtor's transfer to her. Mrs. Duncan had a one-half community interest in the Briargrove Property prior to the transfer, and the most the debtor could have conveyed to her was his own community property interest in the Briargrove Property. Mrs. Duncan further argues that the Briargrove Property would not be subject to forced sale under Texas law and that the value of the debtor's interest in the Briargrove Property would be greatly diminished by her right to possession.

Mrs. Duncan also argues that she has an equitable right of reimbursement to offset against any damages alleged by the trustee. Under Texas law, "[i]f community property is purchased or improved by the use of separate funds of the husband or wife, the separate estate of the spouse supplying the funds must be reimbursed therefore." 39 TEX.

JUR. *Family Law* §321 (collecting authority). "[U]sing separate funds to purchase community property creates a *prima facie* right to reimbursement because the separate estate has been used to enhance the community." *Id.*

The trustee has discovered no evidence that any judgment obtained against Mrs. Duncan would be immediately collectible. The trustee anticipates that the costs of attempting to collect any favorable judgment could be considerable. Indeed, it was Cadle's attempt to collect a judgment it acquired against the debtor that triggered this bankruptcy case.

Finally, even if the transfer was improper and avoidable, and even if the Debtor's claimed exemption is disallowed, the debtor transferred, at most, his one-half interest in the Briargrove Property. Mrs. Duncan had at least a community property interest in the Briargrove Property prior to the transfer. *See* 11 U.S.C. §363(i). The total equity in the Briargrove Property was $170,000 as of the petition date, according to the debtor's bankruptcy schedules. Thus, the most the debtor could have transferred to Mrs. Duncan, and the most the trustee could recover, is the debtor's one-half equity interest in the Briargrove Property (*i.e.*, $85,000).

Considering the complexity of the litigation and the lack of controlling legal authority on some of the issues before the Court, it is less than certain that the trustee will prevail on the merits of his claims. In addition to this analysis of the probability of success on the merits, continued litigation would be expensive. The Settlement Amount is reasonable in light of the cost of litigation, the potential recovery, and the obstacles the trustee must overcome in order to prevail on both the avoidance action and the Objection to Exemption.

## V. CONCLUSION AND ORDERS

The responsibility of this Court is not to decide the numerous questions of law and fact raised, but to canvass the issues and determine whether the proposed settlement falls below the lowest point in the range of reasonableness. *See In re Imperial Tooling and Mfg., Inc.,* 314 B.R. 340, 342 (Bankr. N.D. Tex. 2004); *In re Pinnacle Brands, Inc.*, 259 B.R. 46, 54 (Bankr. D. Del. 2001) (citing *Newman v. Stein*, 464 F.2d 689, 693 (2nd Cir. 1972)). In this case, for all of the foregoing reasons, the Court finds and concludes that the proposed settlement within a range of reasonableness, fair and equitable, in the best interest of the bankruptcy estate, and meets the requirements set forth in by the Fifth Circuit. It is, therefore,

**ORDERED** that the Motion to Approve Compromise filed by Mark A. Weisbart, the Chapter 7 trustee, shall be, and it is hereby, **APPROVED**; it is further

**ORDERED** that Mark A. Weisbart, the Chapter 7 trustee, is authorized to execute all documents necessary to consummate the settlement with Barbara and John Duncan; it is further

**ORDERED** that Cadle's Motion for Reconsideration shall be, and it is hereby, **DENIED.**

Signed on 9/28/2007

Brenda T. Rhoades MD

HONORABLE BRENDA T. RHOADES,
UNITED STATES BANKRUPTCY JUDGE