UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF NORTH CAROLINA
Asheville Division

FILED
Clk, US Bankruptcy Court
JUL 22 2004
SYM
WDNC, Asheville, NC

In Re: **JOHN C. CONNELLY,** Debtor.	Case No.: 01-11094 Chapter 7
ROBERTS & STEVENS, P.A., Trustee, Plaintiff, v. **JOHN C. CONNELLY, MARC CONNELLY and LYNN CONNELLY,** Defendants.	Adv. Proc. 02-1032 **JUDGMENT ENTERED ON** JUL 22 2004

ORDER

This matter came before the court upon the Trustee's complaint seeking a determination that a transfer of property from John C. Connelly (the "Debtor") to his son and daughter-in-law, Marc and Lynn Connelly, should be set aside under 11 U.S.C. § 548(a)(1) as a fraudulent transfer. Based upon the facts presented, the court finds that the Trustee has met her burden of establishing by a preponderance of the evidence that the transfer of property from John Connelly to Marc and Lynn Connelly was a fraudulent conveyance and should be set aside.

FINDINGS OF FACT

1. The Debtor filed a voluntary Chapter 11 case with this court on November 1, 2001. The case was subsequently converted to

a Chapter 7, and Roberts & Stevens, P.A. was appointed Chapter 7 Trustee.

2. Prior to filing bankruptcy, the Debtor was a defendant in a lawsuit filed by Great States Mortgage Corp ("Great States") in the Circuit Court for Hillsborough County, Florida, Case No. 98-8202 - Division E. In that action, Great States was seeking to collect a deficiency judgment from the Debtor following its foreclosure on a piece of property owned by the Debtor in Florida.

3. A hearing to obtain a default judgment against the Debtor was scheduled to take place in the pending Florida action on November 1, 2001, but the hearing was stayed by the Debtor's bankruptcy filing.

4. On October 26, 2001, six days before the Debtor filed his Chapter 11 Petition and the hearing on the default judgment in the Florida action was scheduled to take place, the Debtor conveyed real property located in Henderson County, North Carolina, to his son and daughter-in-law, Marc and Lynn Connelly. This transfer is the subject of this fraudulent conveyance action.

5. The property transferred by the Debtor to Marc and Lynn Connelly consists of approximately 26 acres, comprised of six separate tracts, which is more particularly described in Deed Book 1079, Page 291 of the Register of Deeds for Henderson County (the "Henderson County Property" or the "Property").

6. As consideration for the Henderson County Property, the defendants, Marc and Lynn Connelly, executed a promissory note in favor of the Debtor in the amount of One Hundred Ninety-Seven Thousand Eight Hundred and 00/100 Dollars ($197,800.00). The interest rate on the note was seven percent (7.0%) annually, and it was amortized pursuant to a thirty year schedule. The note was to be paid in monthly installments of $1,315.97 with the first payment due on November 26, 2001, and subsequent payments due on the same day of each month thereafter until September 26, 2011. On that date, a balloon payment in the amount of $170,060.61 would be due in full; thus, very little would have been paid down on the promissory note eleven years and three months after its execution. It does not appear from the evidence that Marc and Lynn Connelly made these monthly note payments to the Debtor on a regular basis.

7. The promissory note indicates that it was given "as a portion of the purchase price for real property purchase money deed of trust of even date herewith." However, Marc and Lynn Connelly made no down payment nor did they provide the Debtor with any other form of payment as additional consideration for the purchase of the Henderson County Property.

8. The debt owed by Marc and Lynn Connelly to the Debtor was secured by a Deed of Trust in favor of the Debtor and recorded in the Office of the Register of Deeds for Henderson County, North Carolina at Book 1028, Page 540.

9. The Debtor currently resides on the Henderson County Property despite the fact that he has no written agreement with Marc and Lynn Connelly to lease the property. Moreover, the Debtor has not made any rental payments to his son and daughter-in-law since he transferred the Property to them in October of 2001.

10. At the trial of this matter, the Debtor offered several explanations regarding why he chose to transfer the Henderson County Property on the eve of bankruptcy and in the face of a substantial default judgment being obtained against him by Great States. The Debtor testified that he sold the Henderson County Property to his son and daughter-in-law because he needed the stream of income to fund his Plan, which he believed would be completed in a period of about six months. In addition, the Debtor indicated that he transferred the Property in exchange for monthly payments from his son and daughter-in-law so he would have enough money to live on. At the time, the Debtor was subsiding on a small veterans pension, a disability pension from the Army, and social security, leaving him without enough money to pay his bills on a month to month basis. In fact, the Debtor testified that his CPA told him he was "a walking bankrupt situation because he was borrowing from friends and borrowing from Peter to pay Paul" due to legal fees he had incurred defending the Florida action. In addition, the Debtor was experiencing some medical problems at the time which necessitated his having surgery. The surgery caused the

Debtor to be off of his feet, affecting his ability to generate income.

11. Finally, the Debtor indicated that he transferred the Property to preserve it for his family and to keep it from the reach of his "illegitimate creditors". Specifically, the Debtor testified that he "had creditors, legitimate people that I owed and wanted to protect, and I had some illegitimate creditors pursuing the action in Florida."

12. With respect to the value of the Henderson County Property, Great States had the Property appraised close to the time of the filing of the Petition, which appraisal indicated that the value was approximately Two Hundred Thousand Dollars ($200,000.00).

13. The Trustee has received an offer for the purchase of the Property in the amount of Two Hundred and Fifty Thousand Dollars ($250,000.00). The offer was approved by the court in an Order dated April 2, 2004, which provided for the approval of the sale subject to the ability of a third party to provide the Trustee with a written offer or higher bid prior to the trial of this matter, at which time an auction would occur.

14. A higher offer was tendered to the Trustee prior to the scheduled trial date. However, at the time of trial, it was determined that the party submitting the offer did not desire to proceed with the higher bid and auction.

CONCLUSIONS OF LAW

1. As a transfer avoidance action under 11 U.S.C. § 548, this is a "core proceeding" pursuant to 11 U.S.C. § 157, and this court has subject matter jurisdiction over the same. See 28 U.S.C. § 1334.

2. Under section 548, a trustee may avoid any transfer of an insolvent debtor's property made within one year of bankruptcy which was intended to hinder, delay, or defraud creditors, or which was made for less than reasonably equivalent value. See 11 U.S.C. § 548(a)(1)(A) & (B).

3. Specifically, section 548(a)(1) provides as follows:

> (a)(1) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily-
>
> > (A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
> >
> > (B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
> >
> > (ii)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation . . . .

See 11 U.S.C. § 548(a)(1)(A) & (B).

4. The Trustee bears the burden of proving the elements of a fraudulent conveyance under section 548, and the defendant has

the burden of proving defenses to a fraudulent conveyance under 11 U.S.C. § 550.

5. The court begins by noting that almost any kind of case for a fraudulent conveyance under section 548 is made out of circumstantial evidence, as one would rarely have hard and fast proof of a debtor's actual intent to hinder, delay, or defraud a creditor. Here, the circumstances demand a finding that the Trustee has met her burden of establishing by a preponderance of the evidence that the transfer of property from John Connelly to Marc and Lynn Connelly was a fraudulent conveyance and should be set aside under 11 U.S.C. § 548.

6. First, under 11 U.S.C. § 548(a)(1)(A), the timing of the transaction supports a finding that the Debtor transferred the Property with the intent to hinder, delay, or defraud his creditors. The Henderson County Property was transferred six days before the Debtor filed bankruptcy - presumably to keep it out of the reach of his creditors. Moreover, the transfer took place six days before the hearing on the default judgment in the Florida action was scheduled to take place. That hearing had the potential of giving rise to a substantial judgment against the Debtor by Great States, a creditor whom the Debtor characterized as "illegitimate". In that regard, the Debtor also testified that he transferred the Property to preserve assets for those creditors he considered to be legitimate.

7. In addition, the transfer was made to the Debtor's son and daughter-in-law for less than adequate consideration, which gives rise to a presumption of a fraudulent intent under section 548(a)(1)(A). As the Fourth Circuit Court of Appeals has held:

> In the context of Section 548(a)(1)(A), courts closely scrutinize transfers between related parties. Indeed, such transfers, if made without adequate consideration, create a presumption of actual fraudulent intent.
>
> This presumption establishes the trustee's prima facie case and shifts the burden of proof to the debtor to establish the absence of fraudulent intent.

See In re Smiley, 257 F.3d 401 (4th Cir. 2001) (citations omitted). In this case, the Debtor's transfer of the Property to the Connellys was without adequate consideration, as it left the Debtor's Estate with a long term debt payable under a note with illusory terms. For example, the note had a balloon payment due upon its maturity date which is not much less than the face amount of the note such that the Connellys were, in essence, making interest only payments until the note matured. And, the interest rate on the note was less than the market rate. Moreover, it does not appear from the evidence that the Connellys made very many payments on the note following its execution. Finally, the note indicated that it was given as a portion of the purchase price for the Henderson County Property, but the Connellys made no down payment nor did they provide the Debtor with any other form of additional payment as consideration for the purchase of the Property.

8. In addition to proving the elements of a fraudulent transfer under 11 U.S.C. § 548(a)(1)(A), the Trustee met her burden of showing that the transfer was fraudulent pursuant to 11 U.S.C. § 548(a)(1)(B). Under 11 U.S.C. § 548(a)(1)(B), the Debtor received less than a reasonably equivalent value in exchange for the transfer of the Property. The Property is worth at least Two Hundred Thousand Dollars ($200,000.00) as is evidenced by the appraisal done by Great States. The offer of Two Hundred and Fifty Thousand Dollars ($250,000.00) is evidence that the Property is worth significantly more. As indicated above, the terms of the note were illusory and simply did not equate to a reasonably equivalent value for the house. The court is somewhat bolstered in this conclusion by the fact that in defining the term "value" in section 548, the Code specifically excludes "an unperformed promise to furnish support to the debtor or to a relative of the debtor." See 11 U.S.C. § 548(d)(2)(A). That appears to be exactly the situation we have here.

9. Finally, pursuant to 11 U.S.C. § 548(a)(1)(B)(ii)(I), it appears, based on his own testimony, that the Debtor was insolvent on the date the transfer was made. The most telling testimony the Debtor offered in that regard was his statement that his CPA told him he was "a walking bankrupt situation because he was borrowing from friends and borrowing from Peter to pay Paul." The Debtor also testified that he needed the stream of income from his son and

daughter-in-law to fund his plan and, more importantly, to have enough money to live on. Even if the Debtor was not insolvent at the time of the transfer, he believed he would become insolvent as a result of the default judgment Great States was on the verge of obtaining against him in the Florida action.

10. For all of the reasons stated above, the Trustee has prevailed under 11 U.S.C. §§ 548(a)(1)(A) and (B). Thus, the sale of the Henderson County Property to Marc and Lynn Connelly should be set aside and the Property should be brought back into the Estate for the purposes of administration by the Trustee. In that regard, the court affirms its order dated April 2, 2004, approving the sale of the Property for Two Hundred and Fifty Thousand Dollars ($250,000.00) to Beverly and Dan Allen, free and clear of all liens.

It is therefore **ORDERED** that:

1. The October 26, 2001, transfer of the Henderson County Property to Marc and Lynn Connelly is set aside as a fraudulent conveyance pursuant to 11 U.S.C. §§ 548(a)(1)(A) and (B), and the Property is to be brought back into the Debtor's Estate for administration by the Trustee.

2. The order dated April 2, 2004, approving the sale of the Property for Two Hundred and Fifty Thousand Dollars ($250,000.00) to Beverly and Dan Allen, free and clear of all liens, is affirmed.

George R Hodges

Dated as of date entered

George R. Hodges
United States Bankruptcy Judge