UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

In Re

JERRY CHARLES JOHNSON | Case No. 02-10652-MAM-7

Debtor.

JERRY CHARLES JOHNSON

Plaintiff,

v. | Adv. No. 02-1037

MARGARET (JOHNSON) EDDINS

Defendant.

ORDER AND JUDGMENT DETERMINING DEBT OF DEBTOR TO MARGARET EDDINS IS NOT DISCHARGEABLE AND AWARDING JUDGMENT TO PLAINTIFF ON FRAUDULENT TRANSFER CLAIM

Barry A. Friedman, Mobile, Alabama, Attorney for Plaintiff
James M. Orr, Mobile, Alabama, Attorney for Defendant

This matter is before the Court on the trial of an adversary proceeding involving Mr. Jerry Johnson's complaint that any debt he owes to his former wife, Margaret Eddins, under their divorce agreement, is dischargeable. The Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 157 and 1334 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2) and the Court has the authority to enter a final order. For the reasons indicated below, the Court finds that Johnson's debt to his former wife is not dischargeable; the Court further denies Eddins relief on her counterclaim for fraudulent transfer.

FACTS

Jerry Charles Johnson and Margaret (Johnson) Eddins were married in 1963. Their marriage lasted for seventeen years during which they had three children together. During the course of their marriage, Mr. Johnson was a full time employee of Scott Paper Company ("SPC"); Ms. Eddins alternated between working various non-skilled positions and working as a homemaker. Pursuant to an agreement drafted by an attorney representing both parties, a final judgment of divorce was entered by the Circuit Court of Baldwin County on November 25, 1980. The terms of the agreement relevant to this proceeding provided that neither party was entitled to alimony; however, Mr. Johnson was required to pay one half of his retirement benefits from SPC to Ms. Eddins when the benefits became due and payable.

After the divorce, Mr. Johnson continued working for SPC. He remarried in 1982 and had a son, Derek C. Johnson, from this second marriage shortly thereafter. SPC eliminated all its middle managers and production supervisors in 1995, including Mr. Johnson; in 1997, he began drawing monthly retirement benefits from SPC. Although the divorce agreement provided that Mr. Johnson would pay one half of his SPC retirement benefits to Ms. Eddins, he did not remit any payments to her.

Ms. Eddins filed an action against Mr. Johnson for failing to comply with the terms of their divorce agreement; the complaint was served on Mr. Johnson in February of 2000. Mr. Johnson testified that he sold his home a short time later - on June 21, 2000. He received about $175,000.00 from the sale and, after paying off his $50,000.00 mortgage, he received net proceeds of $125,000.00. Mr. Johnson split the $125,000.00 with his current wife, thereby retaining $62,500.00 for himself. After paying bills with his portion of the sale proceeds, Mr. Johnson testified that he had $38,000.00 left. Mr. Johnson chose to transfer the remaining

$38,000.00 to his son Derek, rather than pay Ms. Eddins her half of the SPC retirement benefits. Mr. Johnson testified that he gave the money to Derek as a college fund. However, on cross examination, when he was asked why he gave Ms. Eddins one half of his retirement in their divorce agreement but never paid her, Mr. Johnson stated "That's a good question. I never in my mind envisioned her getting one half of my retirement. I just wanted out."

Ms. Eddins received a $35,650.00 judgment against Mr. Johnson in the Circuit Court of Baldwin County on August 21, 2001; this amount represented her one half interest in Mr. Johnson's SPC retirement benefits. Ms. Eddins testified that Mr. Johnson subsequently appealed the judgment but his appeal was denied. She further testified that Mr. Johnson has not remitted any portion of the $35,650.00 judgment to her; instead, he filed a chapter 7 bankruptcy case.

Mr. Johnson filed a voluntary chapter 7 petition on February 7, 2002; the only debt he listed was Ms. Eddins' judgment against him for the value of her one half interest in his SPC retirement benefits.[1] In his schedules, Mr. Johnson lists a total monthly income of $2,465.00, which is derived from $1,430.00 of retirement pay combined with about $1,200.00 of income from his part time job at the Bedsole Farm. However, Mr. Johnson testified that he cannot be certain that his $1,200.00 a month income from his part time job will remain steady because of his health problems. He stated that he underwent colon surgery in March 2001 and he developed a large hernia as a result of the surgery; the hernia prevents him from performing physical labor.

Mr. Johnson lists a set of monthly expenditures totaling $2,300.00 in his schedules; these expenses include:

- $250.00 for electricity and heating fuel
- $50.00 for water and sewer costs

[1] In his petition, Mr. Johnson listed Ms. Eddins claim as $35,350.00; however, the judgment entered against him by the Circuit Court of Baldwin County was $35,650.00. The Court finds Ms. Eddins claim against Mr. Johnson to be $35,650.00.

- $150.00 for telephone charges
- $200.00 for home maintenance, repairs, and upkeep
- $350.00 for food
- $50.00 for laundry and dry cleaning
- $200.00 for transportation not including car payments
- $200.00 for recreation, clubs and entertainment, newspapers, and magazines
- $200.00 for charitable contributions
- $215.00 for automobile insurance

On cross examination, Mr. Johnson testified that he has an interest in three individual retirement accounts ("IRA's") with a total value of $24,000.00. The bulk of the $24,000.00 total value comes from $17,000.00 or $18,000.00 Mr. Johnson received from SPC when he was terminated from his job. He testified that he transferred the money into an IRA that will not disburse any payments to him until he is 62 or 65 years old.

When asked about his expenses on cross examination, Mr. Johnson testified that he does not have a water bill but that the $50.00 expenditure he listed under water should be attributed to heating fuel because it represented the amount he spent on his home gas tank each month. He testified that the $150.00 telephone charges represent charges for his local service, his long distance service, and his son Derek's cellular phone service. Mr. Johnson testified that his son Derek has an automobile that Derek purchased using the $38,000.00 Mr. Johnson transferred to him. Mr. Johnson stated that Derek did not use any of the $38,000.00 to pay for his (Derek's) automobile insurance, food, clothing, or cellular phone service though. Finally, Mr. Johnson testified that the $200.00 expenditure for recreation represents his expenses for golfing, fishing, and going to ball games.

On March 1, 2002 Mr. Johnson filed this adversary proceeding in which he alleges that he should not have to pay Ms. Eddins the $35,650.00 debt owed to her because it is a dischargeable debt that does not constitute alimony, maintenance, or child support. In her answer, Ms. Eddins denied that her claim against Mr. Johnson is dischargeable; she stated that

Mr. Johnson does have the ability to pay the $35,650.00 debt from income or property that is not reasonably necessary to be expended for the maintenance or support of Mr. Johnson or his dependents. Additionally, she filed a counterclaim against Mr. Johnson alleging that his transfer of $38,000.00 to his son Derek constituted a fraudulent transfer.

Ms. Eddins further stated in her answer that discharging Mr. Johnson's debt would not result in a benefit to Mr. Johnson that would outweigh the detrimental consequences to her, even though her precarious financial position may require her to file bankruptcy in the near future. She testified at trial that she owns a small trucking company from which she draws $2,400.00 a month. However, Ms. Eddins stated that the company's liabilities are currently greater than the value of its assets and it is operating at a loss. She testified that of the four trucks she originally purchased for the business, only two are currently operational. Ms. Eddins also makes a $730.00 monthly mortgage payment for the shop area she added to her home to enable her company to work on its trucks.

Apart from her business expenses, Ms. Eddins has personal monthly expenses of $962.00 for her home mortgage payment, $50.00 for her phone bill, $50.00 for her monthly automobile maintenance expenses on her 1990 Porshe, and a $200.00 tentative tithe amount to her church. She also claims expenses for her groceries, health insurance, medicine, and credit card payments but she did not give a specific monthly expense amount for these items. Ms. Eddins stated that presently her family members often give her money to supplement her income and she doubts that she will be able to subsist in her current financial condition unless Mr. Johnson is required to remit to her the $35,650.00 judgment he claims is dischargeable.

LAW

Under chapter 7, a debtor may generally discharge "all debts that arose before the date of the order for relief" 11 U.S.C. § 727(b); however, a debtor may not discharge certain marital debts under §§ 523(a)(5) and 523(a)(15). Section § 523(a)(5) states:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) does not discharge an individual debtor from any debt--
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> (5) to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with State or territorial law by a governmental unit, or property settlement agreement, but not to the extent that--
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> . . . .
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> (B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support.

11 U.S.C. § 523(a)(5). In other words, a debtor is not allowed to discharge a debt to a former spouse or child when the debt is for alimony, maintenance, or support of the debtor's former spouse or child *if the debt really is for alimony, maintenance, or support*. If the debt is merely called alimony, maintenance, or support but it is actually a property settlement, the debtor can discharge it, subject to the exceptions found in § 523(a)(15).

Section § 523(a)(15) states:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt--
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> . . . .
>
> > (15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with State or territorial law by a governmental unit unless--
> >
> > (A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or

> (B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor.

11 U.S.C. § 523(a)(15).

In his complaint that initiated this adversary proceeding, Mr. Johnson alleges that the $35,650.00 judgment rendered against him by the Circuit Court of Baldwin County is a dischargeable debt because it is properly characterized as a property settlement debt rather than a debt for alimony, maintenance, or child support. Ms. Eddins argues that the debt is properly characterized as a debt for alimony, maintenance, or child support; additionally, Ms. Eddins argues that even if the debt is characterized as a property settlement, it is not dischargeable. Ms. Eddins also counterclaims that Mr. Johnson fraudulently transferred $38,000.00 in proceeds from the sale of his home to his son Derek; if recovered, this amount would pay the debt to Ms. Eddins in its entirety.

The Court must consider the following issues to make its determination on the dischargeability of Mr. Johnson's $35,650.00 debt to Ms. Eddins:

1. Is the judgment properly characterized as a property settlement debt or a debt for alimony, maintenance, or support?

2. If it is characterized as either a property settlement debt or a debt for alimony, maintenance, or support, is it dischargeable?

3. Does Ms. Eddins have an independent right to bring a fraudulent transfer action under §§ 544(b) or 548(a)(1)?

4. Did Mr. Johnson fraudulently transfer $38,000.00 from the proceeds of the sale of his home to his son Derek?

5. If so, from whom can Ms. Eddins recover?

1.

Is the Judgment Properly Characterized as a Property Settlement Debt or a Debt for Alimony, Maintenance, or Support?

The nature of Mr. Johnson's $35,650.00 debt to his former wife, Ms. Eddins, is an important consideration under the Bankruptcy Code because it will determine if his debt is dischargeable. A finding that his debt is dischargeable would relieve Mr. Johnson of any obligation to pay Ms. Eddins on her judgment. The debt springs from a judgment rendered against Mr. Johnson by the Circuit Court of Baldwin County on the issue of Mr. Johnson's obligation to pay Ms. Eddins one half of his SPC retirement benefits pursuant to a divorce agreement signed by both parties. Although the circuit court ordered Mr. Johnson to pay $35,650.00 to Ms. Eddins, it did not characterize the debt; therefore, this Court must determine the nature of the debt. Ms. Eddins is "the party seeking to hold the debt nondischargeable;" therefore, she "has the burden of proving by a preponderance of the evidence that the parties intended the obligation as support." *Cummings v. Cummings*, 244 F.3d 1263, 1265 (11th Cir. 2001) (quoting *In re Sampson*, 997 F.2d 717, 723 (10th Cir. 1993).

The determination of whether a debt arising from a divorce agreement is a debt in the nature of alimony, maintenance, or support or a debt in the nature of a property settlement is governed by § 523(a)(5) of the Bankruptcy Code. The statute itself does not provide any test for courts to use when characterizing the debt; however, the Eleventh Circuit Court of Appeals has held that bankruptcy courts should make a "simple inquiry" into whether the obligation required by a divorce agreement is in the nature of alimony, maintenance, or support. *Harrell v. Sharp*, 754 F.2d 902 (11th Cir. 1985). In *Harrell*, the court held that:

> The language used by Congress in § 523(a)(5) requires bankruptcy courts to determine nothing more than whether the support label accurately reflects that the obligation at issue is 'actually in the nature of alimony, maintenance, or support.' The statutory language suggests a simple inquiry as to whether the obligation can legitimately be characterized as support, that is, whether it is in the *nature* of support. The language does not suggest a precise inquiry into financial circumstances to determine precise levels of need or support; nor does the statutory language contemplate an ongoing assessment of need as circumstances change.

Id. at 906.

Although courts should conduct only a "simple inquiry," they should not limit the inquiry solely to the label used by the parties because "it is likely that neither the parties nor the divorce court contemplated the effect of a subsequent bankruptcy when the obligation arose." *Cummings* at 1265 (quoting *In re Gianakas*, 917 F.2d 759, 762 (3rd Cir. 1990)). Instead, courts must look to the "touchstone for dischargeability under § 523(a)(5)," which is the intent of the parties at the time the divorce agreement was made. *Id*. at 1266 (citing to *In re Sampson* at 723).

Mr. Johnson and Ms. Eddins entered into a divorce agreement on November 24, 1980; under its terms, the agreement became effective on November 25, 1980, the day on which the Circuit Court of Baldwin County granted the parties a divorce. The provisions of the agreement relevant to this proceeding provide that neither party would pay alimony but that Mr. Johnson would pay Ms. Eddins one half of his SPC retirement benefits when those benefits became due and payable. The provision in the agreement stating that neither party was entitled to alimony was found under the section titled "Alimony;" the provision requiring Mr. Johnson to pay Ms. Eddins one half of his benefits is found under the section titled "Property Division."

Although courts have found that the provisions in a divorce agreement are not entirely dispositive when making a determination of the nature of a divorce agreement provision, the statements in the agreement between Mr. Johnson and Ms. Eddins are the clearest indication of the parties' intent. The statements are clear and their location under the respective section titles of "Alimony" and "Property Division" indicated to both parties the nature of the obligations. In their testimony, Mr. Johnson and Ms. Eddins disagreed regarding the intent of the agreement. The Court observed their testimony and found them equally credible when testifying about their intent when making the divorce agreement. The Court finds unhelpful the parties' testimony recollecting their intent 22 years ago when the agreement was made; rather the Court finds the

agreement to be the only clear indication of their intent. Ms. Eddins carried the burden to prove by a preponderance of the evidence that the parties intended the obligation as support; she could not do so. Accordingly, under the "simple inquiry" analysis used by the Eleventh Circuit Court of Appeals, the Court finds that the parties' intended the provision in the divorce agreement entitling Ms. Eddins to one half of Mr. Johnson's SPC retirement benefits to be in the nature of a property settlement.

2.

If it is Characterized as Either a Property Settlement Debt or a Debt for Alimony, Maintenance, or Support, is it Dischargeable?

The Court has found that Mr. Johnson's $35,650.00 debt to his former spouse, Ms. Eddins, is a property settlement debt. Debts to a former spouse that are in the nature of a property settlement are generally dischargeable under § 727(b), which states:

> (b) Except as provided in section 523 of this title, a discharge under subsection (a) of this section discharges the debtor from all debts that arose before the date of the order for relief . . .

11 U.S.C. § 727(b). As stated in § 727(b), debts that are dischargeable under chapter 7 are subject to the exceptions listed in §523, including § 523(a)(15), which states:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt--
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> . . . .
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> (15) not of the kind described in paragraph (5) that is incurred by the debtor in the course of a divorce or separation or in connection with a separation agreement, divorce decree or other order of a court of record, a determination made in accordance with State or territorial law by a governmental unit unless--
>
> (A) the debtor does not have the ability to pay such debt from income or property of the debtor not reasonably necessary to be expended for the maintenance or support of the debtor or a dependent of the debtor and, if the debtor is engaged in a business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business; or
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> (B) discharging such debt would result in a benefit to the debtor that outweighs the detrimental consequences to a spouse, former spouse, or child of the debtor.

11 U.S.C. § 523(a)(15).

The majority of courts have held that "§523(a)(15) sets up a shifting burden of proof: the non-debtor spouse bears the initial burden of showing that §523(a)(15) is applicable to the debt in question, whereupon the burden shifts to the debtor to prove that he falls within either of the two exceptions to dischargeability." *In re Cameron*, 243 B.R. 117, 121 (Bankr. M.D. Ala. 1999) (citations omitted). The Court has previously found that the judgment against Mr. Johnson stemmed from a property settlement provision in the parties' divorce agreement; therefore, Ms. Eddins has met her initial burden. Accordingly, the burden now shifts to Mr. Johnson to prove that he falls within one of §523(a)(15)'s two exceptions.

Section § 523(a)(15) contains two exceptions to the general dischargeability provision in § 727(b). They are 1) the ability to pay exception under § 523(a)(15)(A) and 2) the balancing test exception under § 523(a)(15)(B). Mr. Johnson bears the burden of proving that he meets one of these exceptions in order to have his debt to Ms. Eddins discharged. The Court will begin with the ability to pay exception. "In order to resolve disputes under the ability to pay exception . . . most courts rely on the 'disposable income test' of §1325(b)(2) . . . because that section's language essentially mirrors the language of § 523(a)(15)(A)." *In re Cameron* at 122 (citations omitted). Section § 1325(b)(2) states:

> (2) For purposes of this subsection, "disposable income" means income which is received by the debtor and which is not reasonably necessary to be expended--
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> (A) for the maintenance or support of the debtor or a dependent of the debtor, including charitable contributions (that meet the definition of "charitable contribution" under section 548(d)(3)) to a qualified religious or charitable entity or organization (as that term is defined in section 548(d)(4)) in an amount not to exceed 15 percent of the gross income of the debtor for the year in which the contributions are made; and
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> (B) if the debtor is engaged in business, for the payment of expenditures necessary for the continuation, preservation, and operation of such business.

11 U.S.C. § 1325(b)(2).

When applying the disposable income test, "the bankruptcy court is to subtract the debtor's budgeted expenses, assuming they are reasonably necessary, from [d]ebtor's income and determine if there is any money left." *In re Cameron* at 122. "A debtor's ability to pay is to be measured on the date of trial, not on the date that the debtor filed his petition." *In re Cameron* at 125 (citations omitted). In his amended schedules, Mr. Johnson claims $2,300.00 of monthly expenses; the Court finds that certain of these claimed expenses are not reasonably necessary. When Mr. Johnson filed his petition, he listed his 18 year old son Derek as a dependent but as of the date of the trial on November 13, 2002, Derek was 19 years old - the age of majority in Alabama. Therefore, Mr. Johnson can no longer claim Derek as a dependent; any expenses claimed by Mr. Johnson in his schedules that are attributable to Derek must be subtracted because they are not "reasonably necessary" under § 1325(b)(2).

Mr. Johnson indicated in his schedules, as well as in his testimony at trial, that three people are currently living in his home - Mr. Johnson, Mrs. Johnson, and their son Derek. Therefore, the Court will subtract one third of the amount Mr. Johnson listed for expenses attributable to all three individuals unless the testimony given at trial indicated a different amount that should be attributed to Derek. The following chart will illustrate Mr. Johnson's "reasonably necessary" expenditures that are affected by subtracting the value attributable to Derek:

Expenditure	**Amount Claimed**	**Amount Attributable to Derek**	**Amount Reasonably Necessary**

Telephone	$150.00	$87.33 ($56.00 cellphone + $31.33 residential line)	$62.67
Food	$350.00	$116.66	$233.33
Electricity & Fuel	$250.00	$83.33	$166.67
Home Maintenance	$200.00	$66.66	$133.34
Laundry	$50.00	$16.66	$33.34
Transportation (not including car payments)	$200.00	$66.66	$133.34
Car Insurance	$215.00	$100.00	$115.00
Clothing	$250.00	$83.33	$166.67
Total	**$1,665.00**	**$620.63**	**$1,044.36**

Based on the above chart, the Court finds that $620.33 of the monthly expenditures claimed by Mr. Johnson are not "reasonably necessary" because that amount is attributable to Mr. Johnson's son Derek, who is not a dependent of Mr. Johnson. On his schedules, Mr. Johnson listed total monthly expenses of $2,300.00; after subtracting the $620.63 in expenses attributable to Derek, the Court finds that Mr. Johnson has reasonably necessary monthly expenses of $1,679.37 a month. Therefore, Mr. Johnson's excess income per month is $785.63. If Mr. Johnson paid this amount each month to Ms. Eddins, it would take him a little over 45 months to pay her $35.650.00, the entire amount he owes under the judgment. Accordingly, the Court finds that Mr. Johnson has not met his burden to show that he does not have the ability to pay the debt he owes to Ms. Eddins. However, even though Mr. Johnson did not meet the requirements of § 523(a)(15)(A), his debt may still be dischargeable if he meets the requirements of § 523(a)(15)(B).

Mr. Johnson may discharge his debt to Ms. Eddins even though he has the ability to pay it if he can prove that discharging the debt would result in a benefit to him that outweighs the detrimental consequences to Ms. Eddins. 11 U.S.C. § 523(a)(15)(B). To determine if Mr. Johnson meets the requirements of § 523(a)(15)(B), the Court must conduct a "balancing test" and "weigh the benefit to [Mr. Johnson] of a discharge against the detrimental consequences that [Ms. Eddins] would suffer were the debt discharged." *In re Tersen*, 234 B.R. 189, 194 (Bankr. M.D. Fla. 1999). Mr. Johnson bears the burden of proof here, just as he did under the ability to pay exception. *In re Cameron* at 121.

Mr. Johnson testified that discharging the $35,650.00 debt he owes to Ms. Eddins would benefit him because his monthly retirement benefits from SPC will soon drop from a gross amount of $1,580.00 a month to $546.00 per month. However, he also testified that the difference between those amounts will be made up by Social Security. Mr. Johnson further testified that he has health problems preventing him from working a 40 hour week and therefore, he cannot be certain that his approximately $1,200.00 a month income from his part time job will remain steady. Mr. Johnson testified that his only outstanding debt is the $35,650.00 debt to Ms. Eddins.

By contrast, Ms. Eddins testified that she is heavily in debt due to her small trucking business, which is operating at a loss. Ms. Eddins stated that she hopes her business operations will improve and turn a profit within the next 5 or 6 years but that the poor condition of her trucks would hinder her efforts. She also testified that she has about $20,000.00 of personal credit card debt which she incurred by using credit cards to support herself. Finally, Ms. Eddins testified that she does not believe she will survive financially unless Mr. Johnson pays her the $35,650.00 judgment he owes to her.

Although Mr. Johnson testified that he is unsure if his $2,465.00 in monthly income will remain steady, Mr. Johnson apparently has enough income to pay various bills for his 19 year old son Derek, even though Mr. Johnson is not obligated to pay any of Derek's bills. Moreover, Mr. Johnson stated that he gave Derek $38,000.00 to help him pay for his college expenses - which included buying a new car, among other things. While the Court appreciates Mr. Johnson's interest in helping his son Derek, Mr. Johnson cannot do so at Ms. Eddins' expense. Accordingly, the Court finds that Mr. Johnson did not meet his burden of proving that discharging the debt he owes to Ms. Eddins would result in a benefit to him that outweighs the detrimental consequences to Ms. Eddins.

Mr. Johnson did not meet his burden of proof to show that his debt to Ms. Eddins should be discharged under either of the exceptions in § 523(a)(15). The Court finds that his $35,650.00 debt to Ms. Eddins is not dischargeable under chapter 7 of the Bankruptcy Code. The Court must now consider if Mr. Johnson's $38,000.00 transfer to his son Derek is a fraudulent conveyance from which Ms. Eddins can recover her $35,650.00 judgment.

3.

Does Ms. Eddins Have an Independent Right to Bring an Fraudulent Transfer Action Under §§ 544(b) or 548(a)(1)?

Under §§ 544(b) and 548(a)(1), the trustee may bring an action to avoid certain transfers of an interest that the debtor has in property. The trustee in this case is not seeking to avoid the alleged fraudulent transfer by Mr. Johnson; rather, Ms. Eddins, a creditor, is bringing the action. The nearly identical language in §§ 544(b) and 548(a)(1) only explicitly grants the trustee power to bring this type of action; therefore, the Court must address Ms. Eddins' right to bring this action against Mr. Johnson.

The language used in both §§ 544(b) and 548(a)(1) states simply that "[t]he trustee" may use either section to bring a fraudulent transfer action; it does not explicitly prohibit other parties from using either section. Therefore, "the question thus becomes whether it is a proper inference that the trustee is the only party empowered to invoke [either] provision." *Hartford Underwriters Insurance Co. v. Union Planters Bank, N.A.*, 530 U.S. 1, 6 (2000). The Court finds that only the trustee, or a party acting in the trustee's stead, may seek avoidance under either section §§ 544(b) or 548(a)(1).[2]

The United States Supreme Court recently analyzed language analogous to that of §§ 544(b) and 548(a)(1) in a case arising under § 506. *Hartford Underwriters*, 530 U.S. 1 (2000). Like the fraudulent transfer code provisions at issue here, § 506 empowers "[t]he trustee" to seek recovery; also similar to the fraudulent transfer code provisions, § 506 does not explicitly prohibit other parties from using it. 11 U.S.C. § 506. The Supreme Court had "little difficulty" finding that the trustee is the only party empowered to seek recovery under § 506 because the language is so plain in specifying who may use that section. *Hartford Underwriters* at 6.

In a footnote that is very important for this case, the *Hartford Underwriters* Court observed that "the practice of some courts of allowing creditors or creditors' committees a derivative right to bring avoidance actions when the trustee refuses to do so, even though the applicable Code provisions . . . mention only the trustee" was not applicable in its case because the "petitioner did not ask the trustee to pursue payment under § 506(c) and did not seek permission from the Bankruptcy Court to take such action in the trustee's stead." *Id.* at 13 n.5 Instead, the "petitioner asserted an independent right to use § 506(c)," which is what the Supreme Court rejected. *Id.*

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[2] Debtors in possession may also seek recovery under either section as they are explicitly given that right under § 1107.

Relying heavily on *Hartford Underwriters*, the Third Circuit Court of Appeals extended the Supreme Court's reasoning to prohibit a creditor's committee from even bringing a derivative suit in the trustee's stead under § 544. *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 304 F.3d 316 (3rd Cir. 2002). However, that opinion was vacated after a majority of the active judges on the Third Circuit Court of Appeals, who are not recused, voted for a rehearing en banc. *Official Committee of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 2002 WL 31554591 (3rd Cir. 2002).

Subsequent to the *Cybergenics* opinion, the 2nd Circuit Court of Appeals held that creditors of a debtor may bring a derivative action to avoid a fraudulent transfer under §548. *In re Housecraft*, 310 F.3d 64 (2nd Cir. 2002). In *Housecraft*, the trustee was a named plaintiff along with a secured creditor. 310 F.3d at 70-71. The *Housecraft* court recognized the significance of the trustee's participation in the case; it stated "[t]he Trustee's participation as a party is also significant because . . . [the creditor] is not replacing the Trustee as a claimant; it is simply assisting him with the litigation." *Id.* at 71. This Court finds the *Housecraft* reasoning persuasive and finds that a creditor or creditor's committee is empowered to seek avoidance under §§ 544(b) and 548(a)(1) in the form of a derivative action.

The trustee is not named as a party in this case. Ms. Eddins did not seek the trustee's participation in her fraudulent transfer action against Mr. Johnson nor did she seek the Court's permission to act in the trustee's stead. In *Hartford Underwriters*, the United States Supreme Court prohibited a creditor from asserting an independent right to use § 506(c), a section that contains language analogous to §§ 544(b) and 548(a)(1). 530 U.S. at 13 n.5. Accordingly, this Court finds that Ms. Eddins does not have an independent right to bring an avoidance action under §§ 544(b) or 548(a)(1). This rule makes sense. Creditors should not be pursuing claims

against debtors that are for the benefit of all creditors without the trustee's consent or the Court's permission.

If Ms. Eddins were to gain the trustee's participation in her case or receive permission from the Court to bring a derivative action in the trustee's stead, the Court finds that Ms. Eddins would then have the right to bring an avoidance action for fraudulent transfer under §§ 544(b) or 548(a)(1). However, at this time, she has not fulfilled the requirements necessary to bring the action, so the plaintiff must be awarded judgment in his favor.

4.

Did Mr. Johnson Fraudulently Transfer $38,000.00 from the Proceeds of the Sale of His Home to His Son Derek?

Although the Court has found that Ms. Eddins has no authority at present to bring this suit, she may be able to cure the deficiency in a motion for amendment of the pleadings or new trial under Fed. R. Bankr. P. 9023. If she can, the parties would presumably offer the same evidence (perhaps with supplementation). But the facts presented to date cannot change. If the matter is brought to the Court again in a proper posture, the Court does not want to retry the same case. The expense to the litigants would be too much in view of their strained financial positions. Therefore, the Court is offering to the parties its view of the application of the law to the facts.

Under § 548(a)(1), the trustee can avoid a transfer by the debtor of an interest in property if the transfer took place on or within one year before the debtor filed his petition; under § 544(b), the trustee can avoid a transfer by the debtor of an interest in property if the transfer is voidable under applicable law. Courts have held that "applicable law" includes state law, *In re Nextwave Personal Communications, Inc.*, 200 F.3d 43, 49 (2nd Cir. 1999); therefore, under § 544(b), the trustee may be able to avoid a transfer by the debtor of an interest in property even

though the transfer took place greater than one year before the debtor filed his petition. The Court will begin its analysis with § 548(a)(1).

Section § 548(a)(1) states:

> (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--
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> (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
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> (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;
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> (II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or
>
> (III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. § 548(a)(1).

Mr. Johnson testified that he sold his home for $175,000.00 on June 21, 2000, approximately 3 to 4 months after he was served with a complaint in an action Ms. Eddins filed in the Circuit Court of Baldwin County to enforce a provision in her divorce agreement requiring Mr. Johnson to pay her half of his SPC retirement benefits. After paying off the $50,000.00 mortgage on his home, Mr. Johnson received a net amount of $125,000.00. Mr. Johnson stated that he split this amount with his current wife, thereby receiving $62,500.00 himself.

Rather than paying Ms. Eddins one half of his retirement benefits, Mr. Johnson testified that he paid certain bills with his $62,500.00 portion of the proceeds and gave the remaining amount, $38,000.00, to his son Derek. When Mr. Johnson was asked on cross examination why

he gave Ms. Eddins one half of his retirement in their divorce agreement but never paid her, he stated "That's a good question. I never in my mind envisioned her getting one half of my retirement. I just wanted out."

The Court finds that Mr. Johnson's testimony clearly indicates that he actually intended to "hinder, delay, or defraud" Ms. Eddins by not paying her one half of his retirement benefits. Mr. Johnson sought to at least hinder and delay Ms. Eddins by selling his home and using the proceeds to pay his creditors before finally transferring the remaining $38,000.00 to his son Derek rather than paying Ms. Eddins. However, Mr. Johnson's fraudulent transfer took place in the summer of 2000 and he did not file his chapter 7 petition until February 7, 2002 - well beyond the one year "look back"period of § 548(a)(1). Therefore, Ms. Eddins cannot avoid Mr. Johnson's fraudulent transfer under § 548(a)(1).

The Court has found that Mr. Johnson's fraudulent transfer took place outside of the one year period before he filed his petition; therefore, § 548(a)(1) is not applicable to the transfer. However, Section § 544(b) is applicable because it looks back further than one year.

Section § 544(b) states:

> (b)(1) Except as provided in paragraph (2), the trustee may 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 that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

11 U.S.C. § 544(b). Courts have held that "applicable law" includes state law, *In re Nextwave Personal Communications, Inc.*, 200 F.3d 43, 49 (2nd Cir. 1999); therefore, the Court must look to Alabama state law to determine if Mr. Johnson's transfer to his son Derek is a voidable fraudulent transfer. Alabama Code § 8-9A-4(a) governs this transaction and it has a six year "look back" period under Ala. Code § 8-9A-9(2). Mr. Johnson transferred the money in the summer of 2000, therefore, the transfer falls well within § 8-9A-9(2)'s six year "look back"

period. Accordingly, the Court will apply § 8-9A-4(a) to Mr. Johnson's transfer to determine if it was a fraudulent conveyance under Alabama state law.

Alabama Code § 8-9A-4(a) states:

> (a) A transfer made by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made, if the debtor made the transfer with actual intent to hinder, delay or defraud any creditor of the debtor.

Ala. Code § 8-9A-4(a). Section § 8-9A-4(a)'s language is nearly identical to the language of Bankruptcy Code § 548(a)(1) under which the Court found Mr. Johnson committed a fraudulent transfer that was not actionable only because the transfer was outside of that section's one year "look back" period. Mr. Johnson's fraudulent transfer is actionable under § 8-9A-4(a) though, because it has a longer "look back" period.

Alabama Code § 8-9A-4(b) lists eleven nonexclusive factors for the Court to consider in making its determination regarding Mr. Johnson's intent when he transferred $38,000.00 to his son Derek. These factors are commonly known as "badges of fraud" and they include: whether the debtor transferred to an insider, whether the debtor retained possession or control of the property transferred, whether the transfer was disclosed or concealed, whether the transfer was made after the debtor had been sued or threatened with suit, whether the transfer was substantially all of the debtor's assets, whether the debtor removed or concealed assets, whether the debtor received reasonably equivalent value for the transfer, whether the debtor was insolvent or became insolvent shortly after the transfer, and whether the transfer took place shortly before or after the debtor incurred a substantial debt. Ala. Code § 8-9A-4(b).

Mr. Johnson testified that he transferred $38,000.00, quite a large sum relative to his current income, to his son Derek, an insider, as a gift and therefore received nothing in return. Moreover, the transfer took place shortly after Mr. Johnson was served with a complaint in an action Ms. Eddins filed against him to recover the debt he owed her under their divorce

agreement. Finally, Mr. Johnson stated in court that even though he signed the divorce agreement giving Ms. Eddins one half of his SPC retirement benefits, he never envisioned her getting it. The Court finds that the evidence presented and the testimony given clearly indicate that under § 8-9A-4(a) Mr. Johnson actually intended to fraudulently transfer $38,000.00 to his son Derek in an attempt to hinder and delay Ms. Eddins. Accordingly, the Court would find that Ms. Eddins could successfully avoid Mr. Johnson's $38,000.00 transfer to his son Derek, if Ms. Eddins had the right to bring a § 544(b) action. The Court has found that she does not have the right to bring such an action at this time though.

4.

If So, From Whom Can Ms. Eddins Recover?

The Court has found that Mr. Johnson's $38,000.00 transfer to his son Derek could be avoided as a fraudulent transfer pursuant to state law grounds under § 544(b) if Ms. Eddins had the right to bring such an action. Under the Bankruptcy Code, "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 . . . ." *In re Acequia*, 34 F.3d 800, 809 (9th Cir. 1994). If Ms. Eddins stepped into the shoes of the trustee and demonstrated her right to recover under § 544(b); she would then have to establish the amount of her recovery under § 550, which states:

> (a) Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from--
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> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
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> (2) any immediate or mediate transferee of such initial transferee.

11 U.S.C. § 550(a). Ms. Eddins has a $35,650.00 judgment against Mr. Johnson pursuant to a state court action. She is the only creditor listed in Mr. Johnson's schedules; therefore, if she can bring the $38,000.00 fraudulent transfer back into Mr. Johnson's estate under § 550, she can recover her entire $35,650.00 judgment.

Section § 550(a) allows Ms. Eddins to recover the $38,000.00 fraudulent transfer from the initial transferee for whose benefit the transfer was made; it does not allow Ms. Eddins to recover the $38,000.00 from Mr. Johnson directly. Mr. Johnson testified that he made the transfer for the benefit of his son Derek, who was the initial transferee. Accordingly, Ms. Eddins has a cause of action against Derek under § 550(a) to recover the $38,000.00 fraudulent transfer. However, Ms. Eddins did not list Derek as a party in her answer or counterclaim; therefore, the Court cannot enter a judgment against Derek.

The Court finds that although Ms. Eddins could have demonstrated her right to recover the $38,000.00 fraudulent transfer under § 544(b) and established the amount of her recovery as $35,650.00 under §550(a), she cannot recover against either Mr. Johnson or his son Derek Johnson because she does not have the right to bring an avoidance action. Additionally, even if Ms. Eddins had the right to bring an avoidance action, she could not bring the fraudulent transfer back into Mr. Johnson's estate because she did not name Derek Johnson, the transferee, as a party.

CONCLUSION

The Court finds as follows:

1. Ms. Eddins' $35,650.00 judgment against her former husband, Mr. Johnson, is properly characterized as a property settlement.

2. Mr. Johnson's $35,650.00 debt to Ms. Eddins is generally dischargeable under chapter 7, subject to the exceptions to discharge listed in § 523.

3. Mr. Johnson's $35,650.00 debt to Ms. Eddins is nondischargeable because he did not meet his burden to prove that it should be discharged under § 523(a)(15).

4. Ms. Eddins does not have an independent right to bring an action to avoid a fraudulent transfer under §§ 544(b) or 548(a)(1).

5. If Ms. Eddins did have the right to bring an action to avoid a fraudulent transfer by Mr. Johnson, the Court would find that Mr. Johnson fraudulently transferred $38,000.00 from the sale of his home to his son Derek.

6. If the Court found that Mr. Johnson fraudulently transferred $38,000.00 to his son Derek, Ms. Eddins could not recover the $38,000.00 fraudulent transfer directly from Mr. Johnson's son, Derek Johnson, because he is not listed as a party at this time.

IT IS ORDERED and ADJUDGED that:

1. Defendant, Margaret Eddins, is awarded a judgment against Jerry Johnson, plaintiff, declaring that the plaintiff's debt to defendant as established in the Circuit Court of Baldwin County judgment of $35,650.00 is not discharged by 11 U.S.C. § 727.

2. Margaret Eddins, defendant, shall take nothing from Jerry Johnson, plaintiff, on her counterclaim for fraudulent transfer.

Dated: December 9, 2002

/s/ Margaret A. Mahoney
MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE