

UNITED STATES BANKRUPTCY COURT  
DISTRICT OF SOUTH DAKOTA  
Southern Division

In Re:	)	
	)	Bankr. No. 91-40439
	)	Chapter 7
PATRICIA H. GRIDLEY	)	Adversary No. 93-4049
SS# [REDACTED]-6709	)	
	)	
Debtor.	)	
	)	
JAMES A. CRAIG, Trustee,	)	MEMORANDUM OF DECISION RE:
	)	MOTIONS FOR SUMMARY
Plaintiff,	)	JUDGMENT ON § 547 COMPLAINT
vs.	)	
	)	
NANCY MARTZ O'BRIEN, DOROTHY	)	
HYDE, as special administratrix	)	
for the estate of Robert T.	)	
Hyde, CATHERINE HYDE NICHOLS,	)	
and MARTHA HYDE BROWN,	)	
	)	
Defendants.	)	

The matter before the Court is the preference action brought by Trustee James A. Craig. This is a core proceeding over which this Court has jurisdiction pursuant to 28 U.S.C. § 157(b)(2). The parties submitted the case on cross motions for summary judgment and briefs and the matter was taken under advisement in conjunction with Adversary No. 93-4046, which is related to the same Chapter 7 bankruptcy case captioned above.<sup>1</sup> Appearances included Edward J. Leahy for Plaintiff and Steven W. Sanford for Defendants. As set forth below, the Court concludes that the state court surcharge

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<sup>1</sup> A separate decision in adversary proceeding number 93-4046, is being entered at the same time as this Memorandum of Decision.

Order entered against Debtor Patricia Gridley that deprived her of certain benefits in the Hadleigh D. Hyde Trust is not a voidable preference under 11 U.S.C. § 547. This Memorandum of Decision and subsequent judgment shall constitute findings of fact and conclusions of law pursuant to F.R.Bankr.P. 7052.

I.

John N. Gridley, Jr. (Jack Gridley) and Patricia Gridley were husband and wife. Patricia Gridley was the sister of Defendants Nancy Martz O'Brien and Robert T. Hyde. Patricia Gridley was an aunt to Defendants Catherine Hyde Nichols and Martha Hyde Brown.

Patricia Gridley and Robert Hyde were co-trustees of the Hadleigh D. Hyde Trust. Beneficiaries of the Trust were Patricia Gridley, Robert Hyde, Nancy O'Brien, Catherine Nichols, and Martha Brown. Trust assets included farm land, stocks, securities, and other interest-bearing investments.

The co-trustees entered into a management agreement with Jack Gridley on October 17, 1980 whereby Jack Gridley became the agent for the real property. The agreement gave Jack Gridley exclusive control over the farms and their production but he was not authorized to hold or manage money. The other investments were handled by a brokerage firm.

Upon the motion of co-trustee Patricia Gridley, the Hadleigh D. Hyde Trust was submitted to state court administration by Order entered March 28, 1988. On June 24, 1988, Nancy O'Brien filed an objection to the inventory of the Trust submitted by co-trustee Patricia Gridley and sought an accounting by Patricia Gridley and

the management agent, Jack Gridley. By memorandum of decision entered September 30, 1988, the state court concluded that: Jack Gridley, after becoming an agent for the Trust, opened a commodities trading account; Patricia Gridley transferred Trust funds to Jack Gridley for him to trade in the commodities account; Jack Gridley's and the Trust's funds became co-mingled; the Trust lost \$29,232.00 on these transactions; Jack Gridley willfully violated his management agreement; Patricia Gridley intentionally breached her trust; and Patricia Gridley was liable for agent Jack Gridley's unauthorized acts, the commissions he received, and some accountant's fees. The state court delayed entry of formal findings and conclusions pending resolution of a request for attorney's fees and costs by the movant, Nancy O'Brien.

By Findings and Conclusions and Order entered May 22, 1989, the state court surcharged Patricia Gridley \$61,205.48, plus interest, from her beneficial interest in the Hadleigh D. Hyde Trust for the losses the Trust incurred due to the unauthorized transactions involving Jack Gridley.

On July 5, 1989, Patricia Gridley appealed the decision to the South Dakota Supreme Court. The Supreme Court affirmed in part and reversed in part. Upon remand, the state court entered an Order on September 7, 1990 that surcharged Patricia Gridley's beneficial interest in the Hadleigh D. Hyde Trust for \$76,543.02, plus interest after May 8, 1989.

A Final Decree of Distribution for the Hadleigh D. Hyde Trust was entered in state court on October 30, 1990. By March 1991, all

Defendants had received their allotted distribution from the Trust. Patricia Gridley received nothing.

Patricia Gridley held fifteen percent of the stock in Pana Development Company. The corporation's assets were approximately \$5,000,000.00. She transferred her stock in the Pana Development Company to her children on July 14, 1989, two months after the state court entered its original surcharge order regarding the Hadleigh D. Hyde Trust. On July 14, 1989, after the transfer of the stock, Patricia Gridley had the following assets:

cash	\$	12,039.57
money market fund		4,750.98
life insurance (cash value)		3,400.00
condominium (net after sale costs)		120,000.00
stocks		84,538.25
jewelry		10,000.00
other personalty		<u>70,000.00</u>
Total:		\$304,728.80

Her creditors included Hand County State Bank for \$213,566.41, who had a secured interest in the condominium, and First Interstate Bank for \$7,959.76, who had a secured interest in some publicly traded stock, and Accountant Richard A. Fait, who had an unsecured claim for \$1,332.42. These liabilities totaled \$222,858.59. Her assets exceeded her liabilities by \$81,870.21.

On November 7, 1989, Patricia Gridley acquired a loan from Valley Bank for \$38,536.48 with interest at 10%. The note was due November 7, 1990. The funds used were to pay interest on Patricia and Jack Gridley's note to the Hand County State Bank that was secured by their condominium and to pay principal and interest on

Jack Gridley's unsecured note to Hand County State Bank. In December 1989, Patricia Gridley paid her loan to First Interstate Bank with proceeds from a sale of some of the stock that was pledged as collateral. The unsold stock was returned to her by First Interstate Bank. On March 30, 1990, Valley Bank paid Hand County State Bank \$198,583.54 (\$190,000.00 principal plus \$8,583.54 interest) for the condominium loan and took an assignment.

On September 7, 1990, when the final state court surcharge order was entered regarding the Hadleigh D. Hyde Trust, Debtor's assets had decreased to approximately \$294,728.80, since the stock pledged to First Interstate Bank had been sold. Her liabilities, all to Hand County State Bank, totaled approximately \$237,220.02, plus some accrued interest. Therefore, her assets still exceeded her liabilities.

Debtor filed a Chapter 7 petition on June 17, 1991. She died on June 19, 1991.

Trustee James T. Craig was appointed interim trustee for the bankruptcy estate on June 17, 1991 and became the trustee on July 19, 1991. Trustee Craig commenced a preference action under 11 U.S.C. § 547 against Defendants, the Hadleigh D. Hyde Trust beneficiaries (excluding Debtor Patricia Gridley), on July 16, 1993. He alleges Defendants are insiders of Debtor Patricia Gridley and that the transfer of Debtor's share of the Hadleigh D. Hyde Trust assets to them pursuant to the state court surcharge order was a voidable preference.

Defendants filed a joint answer on August 24, 1993. They admit receiving in-kind distributions from the Trust as stated in the complaint but deny the distributions were a preference under § 547.

Defendant Robert Hyde died thereafter. By Order entered February 22, 1994, Dorothy Hyde, his surviving spouse, was substituted for Defendant Robert T. Hyde as a special administratrix of his estate.

Trial of the matter was rescheduled several times.<sup>2</sup> The case and related adversary proceedings were reassigned to the undersigned on June 9, 1994. A pre-trial conference was held June 23, 1994. By Order entered June 23, 1994, the Court directed each party to file a motion for summary judgment and a brief in support of their respective motions by August 8, 1994. Responses were accepted until August 22, 1994. A trial in related adversary number 93-4046 was held in late September 1994 and both matters were taken under advisement.

## II.

Under 11 U.S.C. § 547(b), a trustee may avoid a transfer to an insider<sup>3</sup> that occurred within one year of the petition date if the transfer benefitted the creditor, the transfer was for a debt that preceded the transfer, the debtor was insolvent at the time of the

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<sup>2</sup> The Hon. Peder K. Ecker, presiding.

<sup>3</sup> It is not disputed that Defendants are insiders as to Debtor, as defined by 11 U.S.C. § 101(31)(A)(i).

transfer, and the transfer enabled the creditor to receive more than it would have under a Chapter 7 liquidation. *Buckley v. Jeld-Wen, Inc. (In re Interior Wood Products Co.)*, 986 F.2d 228, 230 (8th Cir. 1993). The trustee bears the burden of proof on each element of a preference under § 547(b). 11 U.S.C. § 547(g). The purpose of § 547(b) is to restore the bankruptcy estate to its pre-preferential transfer condition. *Halverson v. Le Sueur State Bank (In re Willaert)*, 944 F.2d 463, 464 (8th Cir. 1991).

What constitutes a transfer and when a transfer is complete is a question of federal law. *Barnhill v. Johnson*, 112 S.Ct. 1386, 1389 (1992) (cite therein). Under 11 U.S.C. § 101(54), a "transfer" is defined as

every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property<sup>4</sup> . . . .

The definition is broad but the Court must "look to the real substance of the interests transferred, not to whether those interests are referred to as 'legal title' or 'equitable interest.'" *Carlson v. FmHA (In re Newcomb)*, 744 F.2d 621, 626 (8th Cir. 1984). A transfer is *made* under § 547(e)(2) when it is effective between the transferor and transferee or when it is perfected. See *Barnhill*, 112 S.Ct. at 1391. Under 11 U.S.C. § 547(e)(1)(B), a transfer of personal property is *perfected* "when

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<sup>4</sup> "Property" and "interests in property," in the absence of federal law, are defined by state law. *Barnhill*, 112 S.Ct. at 1389.

a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee."

A complaint seeking the avoidance of a preference must be brought by the trustee within the earlier of "two years after the appointment of a trustee under section 702" or before the case is closed or dismissed. 11 U.S.C. § 546(a).

### III.

*Timeliness of the Complaint.* Trustee Craig's complaint was timely because it was filed on July 16, 1993, within two years of the date he was appointed the case trustee under § 702. Although Trustee Craig initially was an interim trustee under 11 U.S.C. § 701 for a few weeks, he did not become a trustee under § 702 until after the § 341 meeting on July 19, 1991 when the creditors did not elect a trustee. The weight of authority adopts this reasoning and commences the two-year period for filing a preference action when the interim trustee becomes the permanent trustee under § 702(d), not when the interim trustee is appointed under § 701. *Kroh v. T.R.M. Manufacturing (In re Conco Building Supplies, Inc.)*, 102 B.R. 190, 191-92 (9th Cir. BAP 1989); *Spence v. Panco (In re Surf & Sand Construction, Inc.)*, 138 B.R. 454, 457 (Bankr. D. Del. 1992); and *Hunter v. Hansen (In re Hansen)*, 114 B.R. 927, 929 (Bankr. N.D. Ohio 1990) (survey of cases therein); see also *Maurice Sporting Goods, Inc. v. Maxway Corp. (In re Maxway Corp.)*, 27 F.3d 980, 984 (4th Cir. 1994).

*Date of the Transfer.* Upon consideration of the facts presented and in light of §§ 547(e)(1)(B) and 547(e)(2), this Court



concludes that the transfer of Debtor's interest in the Trust occurred September 7, 1990 when the Amended Surcharge Order was entered. The entry of that Order, which was not appealed, essentially divested Patricia Gridley of \$76,543.02 of her beneficial interest in the Trust. Further, a judgment lien creditor could not have levied on that portion of her beneficial interest in the Trust after that date to attain a higher priority to it than Defendants. Since September 7, 1990 is within one year of Debtor's petition on June 17, 1991, the transfer may be scrutinized further as an avoidable preference under § 547(b).

*Debtor's solvency at the time of the transfer.* Debtor was not insolvent on September 7, 1990. Her transfer of the Pana Development Company stock did not render her insolvent, despite what a January 16, 1991 affidavit signed by her states. While her assets decreased and her liabilities increased after she transferred the Pana Development Corporation stock to her children in July 1989, the transfer did not render her insolvent. Her assets exceeded her liabilities well into 1990 or 1991 when the only new debts she incurred was the growing interest on her Valley Bank notes. Her bankruptcy attorney even considered her solvent in April 1991 when they talked about whether she should file a petition.

Although Plaintiff relies on Patricia Gridley's affidavit of January 16, 1991 for establishing Patricia Gridley's insolvency when her interest in the Hadleigh D. Hyde Trust was transferred, this Court found in companion Adversary No. 93-4046 that the

affidavit was not an accurate, dispositive statement of her financial condition on July 14, 1989 or thereafter. The Court will not make a contrary finding here, especially whether Trustee Craig is a Plaintiff in both proceedings. The findings and conclusions of *Craig v. Gridley, et. al (In re Patricia H. Gridley)*, Adversary No. 93-4046 (Bankr. D.S.D. March 24, 1995), are incorporated herein by reference.

The transfer may not be avoided under 11 U.S.C. § 547(b) because Debtor was not insolvent when the state court entered its amended surcharge order on September 7, 1990. Defendants' Motion for Summary Judgment shall be granted. Within ten days of entry of this Memorandum of Decision, Defendants shall submit to the Court a proposed Judgment. No costs shall be awarded to any party.

Dated this \_\_\_\_\_ day of March, 1995.

BY THE COURT:

\_\_\_\_\_  
Irvin N. Hoyt  
Chief Bankruptcy Judge

ATTEST:

PATRICIA MERRITT, CLERK

By \_\_\_\_\_  
Deputy Clerk  
(SEAL)