

UNITED STATES BANKRUPTCY COURT
 DISTRICT OF SOUTH DAKOTA
 Central Division

In re:)	Bankr. No. 97-30004
)	
KIRWAN RANCH, a South Dakota)	
partnership)	Chapter 7
Debtor.)	
)	
JOHN LOVALD, Trustee)	Adv. No. 99-3001
)	
Plaintiff,)	
)	
-vs-)	DECISION
)	
GERALD R. KIRWAN, JR. and)	
LEONA J. KIRWAN)	
)	
Defendants.)	

A trial on Plaintiff's complaint was held April 26, 2000. Appearances included Rick Johnson for Plaintiff and David A. Domina and Nora M. Kane for Defendants. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision and subsequent order and judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that Debtor's real property was fraudulently transferred pre-petition to Defendants Gerald and Leona Kirwan in December 1995 and that the transfer is, therefore, avoided under 11 U.S.C. § 544(b)(1) and applicable state law. The Court further concludes that under 11 U.S.C. § 550(a)(1) Defendants must return the value of the fraudulently transferred property to the bankruptcy estate.

I.

James T. and Shirley M. Kirwan and their sons, William P. Kirwan and James P. Kirwan (the "individual partners") formed the Kirwan Ranch partnership (the "Partnership"). The Partnership

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owned 1,551 acres of land in south central South Dakota that had been purchased from the Herzog family (the "Herzog" land). The Partnership was also a tenant in common with David L. Vanderwerf ("Vanderwerf") on 680 acres of land that had been purchased from the Matthews family (the "Matthews" land). The Herzog land was mortgaged to Commercial State Bank of Wagner, South Dakota. A mobile home on the Herzog land was separately mortgaged to Nebraska State Bank of Bristow. The note on the Herzog land was also guaranteed by the Farm Service Agency ("FSA") (formerly the Farmers Home Administration). The Matthews land was mortgaged to the First United Bank of O'Neill, Nebraska, an assignee of the Matthews family. Gerald R. Kirwan, Jr. ("Gerald Kirwan"), a first cousin of James T. Kirwan, had also guaranteed the note on the Matthews land.

Commercial State Bank, in addition to having the mortgage on the Herzog land, had provided the Partnership and two of the partners individually with operating credit or credit for the purchase of cattle.

The Partnership and its individual partners experienced financial difficulties beginning in 1993 when they suffered much higher than normal losses in their calf crop. Loan payments to Commercial State Bank for 1993 and 1994 were late. By the autumn of 1995, the Partnership had not yet made its April 1995 payments to Commercial State Bank. Under a refinancing pretext, some of the partners fraudulently obtained a quit claim deed from Vanderwerf on

the Matthews land and recorded the deed on September 6, 1995.¹ Around this time, the individual partners also consulted with a bankruptcy attorney in Sioux City to discuss their financial problems.

On October 3, 1995, the individual partners met with representatives of Commercial State Bank and FSA to discuss their delinquent loan status at the Bank. The partners indicated they would begin liquidating assets if a substitute lender was not found. To bring all the Partnership's operating and personalty loans current at that time would have required over \$250,000, but the Partnership and individual partners said they had liquid assets on hand (corn, hay, calves and cows) worth over \$750,000. A resolution was not reached at that time.

The Partnership's and the individual partners' financial woes continued into November 1995 when a check for \$23,464 for pasture rent to Terry Cone was returned for insufficient funds. The N.S.F. check eventually resulted in criminal charges against partner James P. Kirwan.² Real estate taxes for 1994 and payable in 1995 also went unpaid.

On December 12, 1995, without Vanderwerf's consent, the Partnership signed a Real Estate Contract to sell its Herzog land

¹ See *infra* p. 11 and 15 (additional facts regarding civil suit by Vanderwerf).

² James T. Kirwan's testimony indicated that Cone may have filed a separate civil suit regarding the unpaid pasture rent, also. However, he may have been referring only to the N.S.F. charges.

and Matthews land to Gerald Kirwan and Gerald's wife, Leona J. Kirwan ("Leona Kirwan"). The land was where Gerald Kirwan had been born and raised. The purchase price was \$710,000 (\$690,000 for the realty and another \$20,000 to pay the mobile home mortgage). Gerald Kirwan and James T. Kirwan negotiated the price. According to Gerald Kirwan, the price represented \$300 per acre plus another \$40,000 for the buildings on the land, which included two mobile homes and some out buildings.

Under the terms of the contract, the sale was to close fifteen days after Gerald Kirwan received financing; the financing was to be obtained by May 15, 1996. The \$690,000 for the realty was to be paid from three sources: \$1,000 cash; payment of the existing mortgages, which totaled around \$420,000; and 4.4 shares of stock in K+ Angus Ranch, Inc., a Nebraska corporation held solely by Gerald and Leona Kirwan. Based on K+ Angus Ranch's federal income tax returns and financial statements and the total shares issued by the corporation, the value of the 4.4 shares of K+ Angus Ranch was about \$270,000.

Two Notices of Contract were filed December 15, 1995.³ One covered the Herzog realty; the other, the Matthews property.

The Partnership realty (both the Matthews and Herzog land) was professionally appraised at \$890,000 on December 29, 1995. The appraisal was completed by James T. Payne for the First Western Bank of Atkison, Nebraska, to accommodate a mortgage to be given by

³ One notice was introduced as Defendants' Exhibit D. Both notices were part of the appraisal at Plaintiff's Exhibit 30.

Gerald Kirwan. Payne's value reflected \$695,600 for the real property and \$194,400 for improvements on the land. His appraised value averaged about \$399 per acre, including the improvements.

Payne's value was consistent with a valuation made by the individual partners in August 1995 in financial statements submitted to First National Bank of Omaha, a potential creditor, were on an attached balance sheet for the Partnership, they valued the improved Matthews and Herzog land at \$780,500 (\$350 per acre). Payne's value was also consistent with the value of \$780,500 given by the Partnership in a December 1, 1995 financial statement to the Commercial State Bank.

In this sale of realty, two of the three elements of consideration were never transferred from the buyers, Gerald and Leona Kirwan, to the seller, the Partnership. Gerald and Leona Kirwan did not transfer any of their own shares of K+ Angus Ranch to the Partnership, as the agreement provided. Instead, Gerald and Leona Kirwan authorized K+ to issue an additional 4.4 shares. K+ did not receive any consideration for these additional shares from Gerald and Leona Kirwan and K+ had not declared a dividend. More important, the 4.4 new shares were issued to the individual Kirwan Ranch partners, not to the Partnership as the contract provided. The transfer was made to the individual partners based on a written directive signed by the partners as individuals, not in a representative capacity for the Partnership. The directive was given to Boyd Strobe, an attorney who had worked for Gerald and Leona Kirwan for several years and who handled the real estate sale

for all the parties. The directive was made under the pretext that the Partnership would be dissolved. The Partnership did not receive any consideration from the individual partners when they took the K+ shares in their own names. The new shares were held by Attorney Strobe on the individuals' behalf beginning December 12, 1995. The Partnership was never dissolved.

The Partnership also did not receive the \$1,000 that Gerald and Leona Kirwan were supposed to pay under the Real Estate Contract. Instead, Gerald Kirwan had at least \$1,000 in a trust account with Attorney Strobe and after December 12, 1995 Attorney Strobe considered \$1,000 of these funds as held in trust for the individual partners. There was some testimony that the \$1,000 was eventually used to help pay James P. Kirwan's legal expenses associated with the bad check charge.

In lieu of a law suit by Vanderwerf over the quit claim deed that the Partnership had obtained from him on the Matthews land, Vanderwerf and William T. Kirwan and James T. Kirwan, acting on behalf of the Partnership, signed an agreement on December 29, 1995. This agreement stated that the quit claim deed for the Matthews property had been obtained for "accommodation services only" and that the deed would be returned to Vanderwerf if the Partnership did not obtain financing within 60 days. If financing was obtained by the Partnership, Vanderwerf was to be paid \$69,000 for his interest in the Matthews land. William T. and James T. Kirwan made this agreement with Vanderwerf although they both knew, but did not disclose to Vanderwerf, that the Partnership had

already contracted to sell the Matthews and Herzog land to Gerald and Leona Kirwan.⁴ Gerald Kirwan received notice of the agreement via a letter from Vanderwerf's attorney dated April 5, 1996. Vanderwerf, however, was never paid.

In late 1995, efforts by Commercial State Bank, the Partnership, and the individual partners to reach a compromise failed. Contrary to the Bank's request, the Partnership and individual partners did not cooperate in liquidating collateral and they declined pledging equity in the realty to secure more of the debt.

In shareholder minutes for K+ Angus Ranch dated January 1, 1996, neither the Partnership nor the individual Kirwan Ranch partners were noted as attending. There was no evidence that the Partnership or the individual Kirwan Ranch partners received notice of the meeting.

Commercial State Bank, in cooperation with FSA, the guarantor, started preparing to foreclose in early January 1996. On February 12, 1996, Gerald Kirwan visited the FSA office in Burke, South Dakota. He told them he was interested in purchasing the Partnership's real estate and leasing it back to the individual partners. Gerald Kirwan did not advise FSA that he already had signed a Real Estate Contract for all the Partnership's land.

Throughout the next few months, Commercial State Bank became increasingly concerned about the number and location of cattle that

⁴ See *infra* pp. 11 and 15 (additional facts regarding civil suit by Vanderwerf).

the Partnership and individual partners had secured to the Bank and others and whether all cattle proceeds had been appropriately accounted for. The Bank received little cooperation from the Kirwan Ranch partners. The Bank also learned of other debts against the Partnership and individual partners that were not being paid.

On March 18, 1996, Gerald Kirwan and James T. Kirwan formed a new corporation called Randall Ranch, Inc. When created, the corporation was without any known assets. The articles of incorporation were filed March 18, 1996. Ten thousand shares were issued to Gerald and Leona Kirwan on March 20, 1996.

In late March 1996, Attorney Strobe called Commercial State Bank to obtain abstracts. He was referred to the Bank's attorney. It was the Bank's understanding that the abstracts were needed because the Partnership was trying to find a substitute lender. By early April 1996, the Partnership and individual partners were over a year delinquent on all their notes with Commercial State Bank.

On April 1, 1996, Gerald and Leona Kirwan sold a total of 3,800 shares of Randall Ranch stock to the individual Kirwan Ranch partners for a total of \$270,000, the exact balance that Gerald and Leona Kirwan owed for the land purchased from the Partnership. The partners were to make ten annual payments with interest beginning December 15, 1996. Gerald and Leona Kirwan took as security the 4.4 shares of K+ Angus Ranch stock that were now held by the individual Kirwan Ranch partners and all the shares of Randall Ranch stock that they were selling. The new shareholders agreed to

let Attorney Strobe hold the certificates. Randall Ranch still had no known assets at the time of this stock sale.

On April 3, 1996, John E. Harmelink, an attorney for the Partnership and the individual partners, advised Commercial State Bank's counsel that they would be bringing in funds sufficient to allow a release of the mortgage on the Herzog land. Through another party that day, the Bank learned that Gerald Kirwan had purchased the Matthews and Herzog land from the Partnership.

Formal mediation through the State of South Dakota was held April 9, 1996. The individual partners, Attorney Harmelink, Attorney Strobe, and Gerald Kirwan were among the attendees. Gerald Kirwan advised those present that he was in the process of buying the Partnership land. Attorney Harmelink stated that if an agreement on the personalty debt could not be reached, his clients would file a Chapter 7 bankruptcy.

Negotiations continued over the next several days. As happened in December 1995, a formal agreement was not reached.

A Warranty Deed from the Partnership to Gerald and Leona Kirwan covering the Partnership realty dated December 12, 1995 was recorded April 15, 1996. With \$440,000 in financing that Gerald Kirwan obtained from First Western Bank of Atkinson, Nebraska, they paid all the mortgages and taxes on the Matthews and Herzog property and some associated costs. To secure the note on April 26, 1996, First Western Bank took a mortgage on the Herzog

and Matthews land.⁵ Commercial State Bank released its mortgage on the Herzog land on April 22, 1996. Gerald and Leona Kirwan's mortgage to First Western Bank was recorded May 6, 1996.

After they had contracted to sell 3,800 shares of Randall Ranch stock to the individual Kirwan Ranch partners, Gerald and Leona Kirwan transferred the Matthews and Herzog land to Randall Ranch by deed dated June 4, 1996.⁶ The stated consideration was \$690,000. Randall Ranch's directors and shareholders "consented" to the purchase on June 4, 1996. The directors and shareholders also consented that day to Randall Ranch assuming the note that Gerald and Leona Kirwan had given on the land debt, to giving a mortgage on the property, and to holding Gerald and Leona Kirwan harmless and reimbursing them for any payments made or damages and costs incurred. The deed from Gerald and Leona Kirwan to Randall Ranch was recorded June 10, 1996. First United Bank of O'Neill's satisfaction of the mortgage on the Matthews property was recorded on June 21, 1996.

These transfers put all the equity in the Matthews and Herzog land that the Partnership once had into Randall Ranch. Assuming no subsequent encumbrances, this equity was around \$270,000, based on Gerald Kirwan's and James T. Kirwan's valuation of the property in

⁵ First Western Bank assigned the mortgage to First Dakota National Bank of Yankton, South Dakota.

⁶ On June 6, 1996, Randall Ranch was certified as a farm under South Dakota's 1974 Family Farm Act. The documentation for the certification reflected Gerald and Leona Kirwan's jointly held 6,200 shares, James T. and Shirley Kirwan's jointly held 1,900 shares, and James P. and William P. Kirwan's 950 shares each.

December 1995, or about \$480,000 if Payne's appraisal in December 1995 is used. Since Randall Ranch has 10,000 shares outstanding, the value of the 3,800 shares sold to the individual partners was worth at most \$102,600 (38% of \$270,000) after Randall Ranch received the Matthews and Herzog land, not the full \$270,000 since Gerald and Leona Kirwan retained 62% of the issued stock.

Amid all these transfers, on May 16, 1996, Vanderwerf and his parents filed suit in state court against the individual Kirwan Ranch partners, Gerald and Leona Kirwan, and First Trust National Association, the mortgagee at that time. The state court granted summary judgment to Gerald and Leona Kirwan and First Trust. It concluded that Gerald and Leona Kirwan were bona fide purchasers who were without notice of Vanderwerf's interest in the Matthews property at the time of the purchase. The court also concluded that First Trust had a valid mortgage.

On June 27, 1996, Commercial State Bank commenced its foreclosure action. The Bank and its counsel, James T. Kirwan, James P. Kirwan, Gerald Kirwan, and Attorneys Harmelink and Strobe met again on July 25, 1996. At this meeting, the Bank formally learned that the Partnership had sold its real property to Gerald Kirwan and Leona Kirwan for \$710,000. The Bank also was told that the real property was now in the name of Randall Ranch, that Gerald and Leona Kirwan had a majority interest in Randall Ranch, and that a portion of their interest in Randall Ranch had been sold back to James T., William P., and James P. Kirwan. The Bank inquired where the equity in the Matthews and Herzog land had gone, but did not

receive a satisfactory explanation. By that date, all the parties agreed that a liquidation of all remaining personalty would not yield sufficient proceeds to pay all the notes held by Commercial State Bank and other lenders.

Over the next few months, Commercial State Bank tried to locate all their secured cattle and cattle sale proceeds. Hearings in the state court foreclosures were set to begin in mid January 1997.

On December 18, 1996, Gerald and Leona Kirwan and the individual Kirwan Ranch partners executed Settlement Agreements. The Agreements provided that all the K+ Angus Ranch stock went back to Gerald and Leona Kirwan unencumbered and that 3,800 shares of Randall Ranch stock went to the individual Kirwan Ranch partners unencumbered. As a result of this Settlement, Randall Ranch now held all the equity in the Partnership's real property, Gerald and Leona Kirwan retained 62% interest in Randall Ranch, and the individual partners obtained a 38% interest in Randall Ranch. All this happened without the Partnership receiving any consideration for the equity from Gerald and Leona Kirwan, Randall Ranch, or the individual Kirwan Ranch partners.

In mid December 1996, Commercial Bank received some funds to apply against its remaining operating and cattle purchase notes. The funds came from some cattle sale proceeds that had been held in escrow and that was eventually divided by the competing secured creditors. Continued efforts to settle the Partnership's and individual partners' remaining debt were unsuccessful.

On January 13, 1997, the individual Kirwan Ranch partners borrowed a total of \$85,000 from Gerald and Leona Kirwan. As security for the loan, Gerald and Leona Kirwan took a lien back on all the individual partners' shares in Randall Ranch. Some of the borrowed funds were used to buy life insurance policies for the individual partners and their spouses and some were used to pay fees to Attorney Harmelink for his pre-petition legal work for the individual partners and the Partnership.

The Partnership filed a Chapter 12 petition on January 17, 1997. It was a companion case to Chapter 12 cases commenced by each of its partners.⁷ In these companion cases, the individual partners claimed their minority interest in Randall Ranch as a homestead that was encumbered by Gerald Kirwan's lien. No party in interest timely objected to the homestead exemption claim. Thus, the individual partners' liquidation analyses yielded little, if anything, for their unsecured creditors under 11 U.S.C. § 1225(a)(4).⁸

In its case, the Partnership scheduled no real property. Its scheduled personalty included several vehicles and some farm machinery and equipment valued at \$49,575. Its scheduled

⁷ *In re James T. and Shirley M. Kirwan*, Bankr. No. 97-30003; *In re James P. Kirwan*, Bankr. No. 97-30006; and *In re William P. Kirwan*, Bankr. No. 97-30005.

⁸ In their plan, James T. and Leona Kirwan valued their 19% interest in Randall Ranch at \$51,300. In their plans, James P. Kirwan and William T. Kirwan valued their respective 9.5% interests at \$26,250. The individual partners thus valued Randall Ranch's equity at \$270,000 (based on James T. and Leona Kirwan's schedules) or \$276,316 (based on their sons' schedules).

personalty did not include any claims against Gerald and Leona Kirwan for the consideration owed for the Matthews and Herzog land or any claim against the individual partners for their taking of the \$1,000 down payment and the K+ Angus Ranch stock directly from Gerald and Leona Kirwan without consideration to the Partnership. The Partnership listed two secured creditors, Commercial State Bank and John Deere Credit. For unsecured creditors, the Partnership listed Vanderwerf for \$69,0000, his parents at \$0.00, and an accountant for \$4,641. The Partnership stated that it sustained a loss of \$121,571 in 1995 and another loss of an unknown amount in 1996. It did not acknowledge any payments to creditors within 90 days. Instead, under the question of "Repossessions, foreclosures, and returns," the Partnership stated that in 1996: Gerald Kirwan had paid a mortgage lien of \$270,000⁹; Commercial State Bank had received \$12,000 after a sale of some cows and yearlings; John Deere Credit had taken back \$71,200 in equipment and tractors; and the Partnership had voluntarily turned over 115 cows to Spencer State Bank. The Partnership also disclosed that Attorney Strobe's firm held \$13,000 in livestock sale proceeds. The Partnership did not disclose any pre-bankruptcy debt counseling by Attorney Strobe.

On January 16, 1997, Randall Ranch gave a mortgage to First Western Bank on all its realty to secure debts up to \$1,500,000, which had been or could be advanced for the benefit of Gerald and Leona Kirwan, K+ Angus Ranch, Randall Ranch, and K & K Farming,

⁹ The Court presumes this number is incorrect since the mortgages on the Matthews and Herzog property exceeded \$420,000.

Inc., another corporation held by Gerald and Leona Kirwan. The mortgage was recorded January 23, 1997. Gerald and Leona Kirwan's note has not been formally assigned to Randall Ranch.

The Partnership converted from a Chapter 12 case to a Chapter 7 case on April 18, 1997. On May 30, 1997, the Partnership's objection to an amended proof of claim filed by Vanderwerf and his parents was sustained since no response was received from the Vanderwerfs.

In the companion Chapter 12 cases, Vanderwerf and his parents obtained relief from the automatic stay on July 17, 1997 to continue the state court litigation against the individual Kirwan Ranch partners, except James P. Kirwan. The relief from stay order was affirmed on appeal. On December 5, 1997, the state court concluded that the Kirwan Ranch partners had fraudulently obtained the Matthews property from Vanderwerf. Vanderwerf obtained judgment against James T. Kirwan, William P. Kirwan, and Shirley M. Kirwan for \$83,300, plus pre-judgment interest. *See Vanderwerf v. Kirwan*, civ. no. 96-31, slip op. (Sixth Judicial Circuit, S.D. December 5, 1997). Vanderwerf then commenced fraud-based non dischargeability complaints against these partners before this Court, but the complaints were dismissed because they were filed untimely.

On September 2, 1997, Commercial State Bank sought and later obtained an abandonment of the remaining secured assets of the Partnership's bankruptcy estate, including the \$13,000 in cattle proceeds held by Attorney Strope.

On December 9, 1998, in *Vanderwerf v. Kirwan*, 586 N.W.2d 858 (S.D. 1998), the South Dakota Supreme Court affirmed the lower court's decision that in April 1996 Gerald and Leona Kirwan were bona fide purchasers without notice of Vanderwerf's interest in the Matthews property. The opinion, like the lower court decision, did not specifically address whether the transfer had been for reasonable consideration. Further, the opinion was entered before Gerald and Leona Kirwan's later conveyance of the Matthews and Herzog property to Randall Ranch, Gerald and Leona Kirwan's re-taking of the K+ Angus Ranch stock from the individual Kirwan Ranch partners, the individual partners' taking of an interest in Randall Ranch, and Gerald and Leona Kirwan's retaking of a secured interest in the individual partners' Randall Ranch stock.

On January 15, 1999, the trustee for the Partnership's Chapter 7 case, John S. Lovald, commenced this adversary proceeding against Gerald and Leona Kirwan. He alleged that the transfer of the Matthews and Herzog land to them was voidable because it was for less than a reasonably equivalent value and because the transfer was made with an actual intent to defraud creditors. In the alternative, the Trustee alleged that the Partnership's transfer of the K+ Angus Ranch stock to Gerald and Leona Kirwan on December 18, 1996 under the Settlement Agreement was a preferential transfer. Trustee Lovald's complaint survived Gerald and Leona Kirwans' withdrawal of reference motion and their summary judgment motion and a trial was held.

II.
FRAUDULENT TRANSFERS

A Chapter 7 trustee, as a conduit, may invoke under 11 U.S.C. § 544(b)(1) a state-law-based fraudulent conveyance action in bankruptcy. *Ries v. Wintz Properties, Inc., (In re Wintz Co.)*, 230 B.R. 848, 859 (B.A.P. 8th Cir. 1999). The trustee must step into the shoes of an actual unsecured creditor who could bring such an action absent the pending bankruptcy. *Id.* In this case, the parties have not disputed that this unsecured creditor exists.¹⁰ For a fraudulent conveyance action in this District, a trustee may invoke South Dakota's Uniform Fraudulent Transfer Act, S.D.C.L. ch. 54-8A ("UFTA")¹¹.

Under the UFTA, Trustee Lovald bears the burden of proof by a preponderance of the evidence. *Prairie Lakes Health Care System, Inc. v. Wookey*, 583 N.W.2d 405, 411-14 (S.D. 1998). He must show that the Partnership transferred property with an actual intent to hinder, delay, or defraud a creditor, S.D.C.L. § 54-8A-4(a)(1), or that the Partnership transferred property without receiving a

¹⁰ After this action was commenced by the Trustee, Gerald and Leona Kirwan filed a summary judgment motion on the grounds that the state court decisions precluded recovery from them by the Trustee in a subsequent action. The motion was denied for the reasons stated in the Court's decision entered January 12, 2000, including that Trustee Lovald was not a party in privity with Vanderwerf, a plaintiff in the state court action. Moreover, Vanderwerf is not the Partnership's only unsecured creditor into whose shoes the Trustee may step to utilize § 544(b)(1).

¹¹ The UFTA at S.D.C.L. ch. 54-8A was preceded by S.D.C.L. ch. 54-8. Portions of that chapter remain, although somewhat subsumed by ch. 54-8A. Section 54-8-1 renders intentionally fraudulent transfers "void as against all creditors[.]"

"reasonably equivalent value in exchange for the transfer" and the Partnership was insolvent at the time of the transfer or became insolvent as a result of the transfer. S.D.C.L. § 54-8A-5(a).¹² Whether a conveyance was fraudulent is a question of fact, not law. *Piner v. Jensen*, 519 N.W.2d 337, 339 (S.D. 1994).

III.
ACTUAL FRAUD.

Actual fraud under § 54-8A-4(b) may be established by circumstantial evidence. *Andrews v. Reynolds*, 409 N.W.2d 128, 130 (S.D. 1987) (citing *Kary v. Kary* 318 N.W.2d 334, 338 (S.D. 1982)). A close relationship between the parties of a conveyance justifies heightened scrutiny of the transfer for indicia of fraud. *Andrews*, 409 N.W.2d at 130 (cites therein). Indicia of fraud, or factors, that may be considered include:

- (1) The transfer or obligation was to an insider;
- (2) The debtor retained possession or control of property transferred after the transfer;
- (3) The transfer or obligation was disclosed or concealed;
- (4) Before the transfer was made or the obligation was incurred, the debtor had been sued or threatened with suit;
- (5) The transfer was of substantially all the debtor's assets;
- (6) The debtor absconded;

¹² The statute of limitations for a suit under S.D.C.L. § 54-8A-5(b) ran before Trustee Lovald commenced this action. S.D.C.L. § 54-8A-9(c). He is within the four-year allowance for actions under §§ 54-8A-4(a)(1), 4(a)(2), or 5(a).

- (7) The debtor removed or concealed assets;
- (8) The value of the consideration received by the debtor was reasonably equivalent to the value of the asset transferred or the amount of the obligation incurred;
- (9) The debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;
- (10) The transfer occurred shortly before or shortly after a substantial debt was incurred; and
- (11) The debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor.

S.D.C.L. § 54-8A-4(b).

The Court concludes that the transfer of the Partnership's real property in December 1995 was made with an actual intent to defraud the Partnership's existing creditors. There are several indicia of fraud.

First, the transfer was to an insider, Gerald Kirwan, and his wife, Leona Kirwan. S.D.C.L. §§ 54-8A-1(7)(iii)(B) and (11) and 54-8A-4(b)(1). Gerald Kirwan was a first cousin of the Partnership's partner, James T. Kirwan. The Partnership had earlier financial dealings with Gerald Kirwan beginning when Gerald Kirwan became a guarantor on the note for the Matthews property. Further, Gerald Kirwan had a personal interest in much of the subject realty because it had previously been in his family for many years. Second, the individual partners continued to operate the ranch land after the sale, though now under the guise of Randall Ranch. S.D.C.L. § 54-8A-4(b)(2). Partners James T. and James P. Kirwan and their families continued to reside on the

property before and after the transfer. A daughter of James T. and Shirley Kirwan lived in one mobile home on the place rent free. Moreover, there was little documentary evidence that formal employer-employee relations were maintained between Randall Ranch and James T. and James P. Kirwan or that Gerald Kirwan has continued to supplement the present operation's income. While the loose compensation arrangement between Randall Ranch and James T. Kirwan and James P. Kirwan was described by James T. Kirwan as "profit sharing," the arrangement served only to insure that James T. Kirwan and James P. Kirwan made their minimal Chapter 12 plan payments and to shield from creditors any disposable income from the ranch operation.

In mid May 1996, Gerald Kirwan exhibited that he controlled the Partnership realty by advising Commercial State Bank that the cattle and machinery belonging to either the Partnership or the individual partners needed to be removed from the land. At a meeting of the Partnership and partners' creditors on May 23, 1996, Attorney Strobe indicated that his client, Gerald Kirwan, had invested more in his relatives' operation than he had planned and Attorney Strobe encouraged an auction of remaining assets with an escrow of funds. On November 30, 1996, Gerald Kirwan again expressed that he controlled the Randall Ranch realty when, by letter dated that day, he informed James P. Kirwan that James P. and his sons needed to remove their cattle from the place by December 15. Considered in isolation, these instances would indicate that Gerald Kirwan had a business-only relationship with

the individual partners and that he was now running the ranch. These instances of personal control mean little, however, in the bigger picture, where the purchase price for the ranch land was too low, where equity in the land well-protected Gerald and Leona from any personal liability on the note they gave, where Gerald and Leona Kirwan returned a 38% interest in Randall Ranch to the individual partners, and where all the Kirwans obtained, through Randall Ranch, an interest in the equity of the Partnerships' real property without paying for it.

The third indicia of actual fraud is that the transfer, though formally disclosed by the filing of a notice in December 1995, was not disclosed or acknowledged in late 1995 through early April 1996 by the Partnership, the individual partners, Gerald Kirwan, and their counsel during informal and formal mediation with Commercial State Bank and other creditors. S.D.C.L. § 54-8A-4(b)(3). In February 1996, Gerald Kirwan told FSA that he was "interested" in taking over the realty when in fact he already had. On April 3, 1996, Attorney Harmelink said his clients would bring sufficient funds to Commercial State Bank to pay the Herzog land mortgage in full; there was no understanding between the Bank and Attorney Harmelink that the Partnership had sold the real property to Gerald and Leona Kirwan. Only later, on April 3, 1996, did the Bank learn through another party that Gerald Kirwan may have purchased the land. At the formal mediation meeting on April 9, 1996, Gerald Kirwan was known to the creditors in attendance only as a party who was in the process of purchasing the land and taking over the debt

on it. Even a week later, April 15, 1996, Commercial State Bank still understood that there would be equity in the realty to cover its unsecured claims against the Partnership and individual partners. The record indicates that it was not until April 19, 1996 that the Bank may have become fully aware that a sale of the realty to Gerald and Leona Kirwan had already taken place. And it was not until a subsequent meeting on July 25, 1996 that the specific sale terms were disclosed.

Fourth, the Partnership was under financial pressure from Vanderwerf, Cone, Commercial State Bank, and other creditors when the transfer took place. S.D.C.L. § 54-8A-4(b)(4). Formal legal action by Vanderwerf and a foreclosure or other liquidation action by Commercial State Bank all clearly loomed in December 1995; Cone was already seeking legal remedy for the unpaid pasture rent.

Fifth, the transfer essentially removed the Partnership's only unencumbered asset -- the equity of at least \$270,000 or as much as \$480,000 in its realty. S.D.C.L. § 54-8A-4(b)(5). The Partnership's remaining cattle and farm machinery and equipment were heavily encumbered. By late 1995 and early 1996, disputes had already arisen among creditors regarding who had priority to what personalty or their proceeds.

Sixth, the sale of the Partnership realty to Gerald and Leona Kirwan was not for reasonable consideration. S.D.C.L. § 54-8A-4(b)(8). Foremost, the Partnership never actually received any consideration for the equity in the real property. The \$1,000 down payment that was in Attorney Strobe's trust account for Gerald

Kirwan was, according to James T. Kirwan and Attorney Strobe, utilized by partner James P. Kirwan to address the bad check charges against him; the \$1,000 was never treated as Partnership property. The K+ Angus Ranch stock also was never transferred to the Partnership. Further, while Gerald and Leona Kirwan gave a note to pay the existing mortgages and real estate taxes due on the land, they placed a new mortgage on the property. The large amount of equity in the land insured that the mortgagee was over secured and that Gerald and Leona Kirwan were insulated from any personal exposure. Later, Randall Ranch agreed to hold them harmless on this debt. Thus, for nothing but signatures by Gerald and Leona Kirwan on a note that was over secured by the property they obtained, the Partnership gave Gerald and Leona Kirwan real property with equity of at least \$270,000 or as much as \$480,000.

Further, the weight of the evidence, based on Payne's appraisal, is that the land was worth \$890,000 -- significantly more than the total purchase price provided in the sale agreement between the Partnership and Gerald and Leona Kirwan. Thus, even if the Partnership had been paid the agreed compensation, the agreed price was much too low for the equity the land held. Gerald and Leona Kirwan's evidence of a lower value was self-serving and not significantly supported by any independent evidence. The evidence that the neighboring Connot property recently sold for \$350 an acre carried little weight because there was no independent comparison of the properties nor a professional assessment of present land values compared to values in 1995.

Seventh, the Partnership was insolvent when the transfer was made on December 15, 1995.¹³ S.D.C.L. § 54-8A-4(b)(9). The Partnership was not generally meeting its debts as they became due, as shown most particularly by the Partnership's failure to timely pay Commercial State Bank, pasture rent to Terry Cone, and real estate taxes in the fall of 1995 and its efforts in late 1995 to negotiate with creditors. S.D.C.L. § 54-8A-2(b). Other indicia of insolvency around December 1995 included the partners' talk of liquidation with Commercial State Bank and the Partnership's acknowledgment in its bankruptcy schedules that the operation lost \$121,571 in 1995.

Moreover, even if the Partnership had not been insolvent before its real property was sold, the land transfer itself rendered the Partnership insolvent. S.D.C.L. § 54-8A-2(c). All the individual partners, Gerald Kirwan, and active creditors acknowledged during negotiations in the spring of 1996 that the only equity available, from the Partnership's or partners' assets, to pay unsecured claims was in the Partnership's real property. Once that equity was taken from the Partnership in December 1995 without consideration, the Partnership's and individual partners' assets totaled less than the Partnership's liabilities. There was no evidence that the value of the Partnership's and partners'

¹³ At trial, the parties did not appear to contest that a "transfer," as defined by either S.D.C.L. § 54-8A-1(12) or 11 U.S.C. § 101(54), took place on December 15, 1995, when notice of the December 12, 1995 land sale agreement was formally given to subsequent purchasers or creditors. See S.D.C.L. § 54-8A-6.

personal property sufficiently increased between December 1995 and April 1996 to replace the large loss of equity from the Partnership's real property in December 1995.

Finally, the last factor indicating actual fraud in the sale of the Partnership's real property was the prevailing lack of arms-length dealings between insiders Gerald and Leona Kirwan, the individual partners, and the newly created Randall Ranch. S.D.C.L. § 54-8A-4(b)(11). Through these machinations of selling the land to Gerald and Leona Kirwan with K+ Angus Ranch stock as part of the consideration, transferring the K+ Angus Ranch stock to the individual partners rather than to the Partnership, creating Randall Ranch to take title to the land and selling the individual partners stock in it, Gerald and Leona Kirwan receiving a security interest in the K+ Angus Ranch stock when they sold the Randall Ranch stock to the individual partners, and all the Kirwans entering into the December 1996 Settlement Agreement, the individual partners re-obtained a substantial interest in the real property that their Partnership once held. Then they re-encumbered this interest with Gerald Kirwan before filing bankruptcy to minimize any equity that would have to be reflected in plan payments under § 1225(a)(4). While it is true that the real property is now owned by a corporation in which the individual partners have only a minority interest, the majority interest is held by an insider. Further, the present arrangement -- with the individual partners as only "employees" of Randall Ranch -- allows the individual partners to shelter from their unsecured creditors any disposable income produced by the ranch during the terms of

their Chapter 12 plans.

The lack of an arms length transaction between Gerald and Leona Kirwan and the Partnership and its partners when the Partnership's land was sold is also shown by the parties' use of one attorney, Boyd Strobe, to handle the sale and the several related corporate/shareholder matters and most of the subsequent transfers and related matters, including the encumbrance of the Randall Ranch stock by Gerald and Leona Kirwan just before the Partnership and partners filed bankruptcy. Attorney Strobe made little effort to distinguish whose interest he was representing during these times; thus, there appeared to be a merging of interests.

Finally, the lack of an arms length transaction is shown by Gerald and Leona Kirwan's decision not to require title insurance or the usual warranties of title under the December 12, 1995 Real Estate Contract. Title insurance was not obtained until April 1, 1996 when Gerald Kirwan arranged financing.

III.
CONSTRUCTIVE FRAUD.

Under S.D.C.L. § 54-8A-5(a), a transfer may be deemed fraudulent as to a debtor's existing creditors even if the transfer was made without a specific intent to defraud. This "constructive" fraud may be found when a transfer is made without the debtor receiving a reasonably equivalent value in exchange for the transfer and the debtor was insolvent when the transfer was made or became insolvent as a result of the transfer. Section 54-8A-2 defines insolvency. It provides that a debtor is presumptively

insolvent if the debtor is generally not paying his debts as they become due. S.D.C.L. § 54-8A-2(b). Further, a partnership is insolvent if its liabilities exceed its assets and its partners' equity. S.D.C.L. § 54-8A-2(c).

As the Court concluded above, the Partnership did not receive a reasonable sum for its realty in December 1995. The purchase price was too low based on a contemporaneous, professional appraisal. More important, the Partnership did not even receive the consideration that Gerald and Leona Kirwan were obligated to pay under the December 12, 1995 Real Estate Contract. Second, the Partnership was insolvent in December 1995 when the transfer was made because it was not meeting its obligations as they became due. In addition, the Partnership's debts exceeded its assets after the transfer was made and the individual parties had no assets above their own liabilities to contribute. Thus, the record clearly establishes both elements of a constructively fraudulent transfer under § 54-8A-5(a).

VI.
SUBSEQUENT TRANSFERS

The Court does not reach the question of whether the subsequent transfer of K+ Angus Ranch stock back to Gerald and Leona Kirwan was preferential or fraudulent. The same is true for the creation of Randall Ranch, the sale of Randall Ranch stock by Gerald and Leona Kirwan, and the transfer of the Matthews and Herzog property to Randall Ranch. To analyze whether all these transfers were fraudulent or preferential, the Court would have to presume that the Partnership actually received the K+ Angus Ranch

stock from Gerald and Leona Kirwan or that the Partnership purchased an interest in Randall Ranch. It did neither. Moreover, each of these transfers followed the fraudulent transfer in December 1995 of the Partnership's real property to Gerald and Leona Kirwan, which is now voided by this decision.

V.
REMEDY.

Since the Trustee has demonstrated under § 544(b) and applicable state law that a fraudulent conveyance of the Partnership's real property to Gerald and Leona Kirwan occurred, the Court must next look to 11 U.S.C. § 550(a) to determine the extent of the what the Trustee may recover. *Acequia, Inc. v. Clinton (In re Acequia, Inc.)*, 34 F.3d 800, 809-10 (9th Cir. 1994); *Decker v. Voisenat (In re Serrato)*, 214 B.R. 219, 231-32 (Bankr. N.D. Cal. 1997) (state law limitation of recovery amount on fraudulent transfer did not control; § 550 of Bankruptcy Code does). Under § 550(a), the Court, in its discretion, may order that the Trustee shall recover either the property transferred or its value. *Kaler v. McLaren (In re McLaren)*, 236 B.R. 882, 903 (Bankr. D.N.D. 1999).

State law, by defining an "asset" at S.D.C.L. § 54-8A-1(2), identifies the property that can be the subject of a fraudulent transfer. In this case, it is the real property of the Partnership that was *not* encumbered by a valid lien at the time of the transfer. S.D.C.L. §§ 54-8A-1(2)(i) (limiting asset to unencumbered property) and § 54-8A-1(12) (limiting transfer to an asset). Thus,

only that portion of the real property that was not mortgaged in December 1995 by Commercial State Bank (on the Herzog land), the First United Bank of O'Neill (the assignee of the mortgage on the Matthews realty), and the Nebraska State Bank (on one modular home) and that portion that was not encumbered by real estate taxes is considered the property that was fraudulently transferred to Gerald and Leona Kirwan.

Since all the realty was not fraudulently transferred, the better remedy under § 550(a) is to require the value of that portion that was fraudulently transferred to be returned to the bankruptcy estate. This remedy is also the better choice since all the property has been subsequently encumbered.

The value to be returned to the bankruptcy estate is the present value of the property. The present value of the land is used since it reflects what would be in the bankruptcy estate if the property were still there. *Feltman v. Warmus (In re American Way Service Corp.)*, 229 B.R. 496, 530-31 & n. 114 (Bankr. S.D. Fla. 1999); *Serrato*, 214 B.R. at 232. Only this sum can restore the Partnership's "financial condition to the state it would have been had the transfer not occurred." *Serrato*, 214 B.R. at 232 (quoting *Reiber v. Baker (In re Baker)*, 17 B.R. 392, 395 (Bankr. W.D.N.Y. 1982.))

The Trustee failed to establish that present value of the land at trial. The record only established, by the testimony of Payne and James T. Kirwan, that the value of land in that area has appreciated since 1995. Thus, the only value available is the

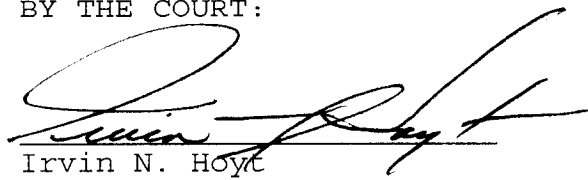
\$890,000 established by Payne in 1995 less the taxes and mortgages that existed on December 15, 1995. The best evidence is that the mortgages and taxes in December 1995 totaled \$406,855.48, a figure calculated by Gerald Kirwan. While interest on the mortgages likely accrued and additional taxes may have become due before the sale closed in April 1996, it is the mortgage and tax figures on the transfer date of December 15, 1995 that are relevant. Thus, the value to be returned to the bankruptcy estate is \$483,144.52 (known present value of the land less encumbrances and taxes on December 15, 1995).

Finally, the Trustee shall recover the \$483,144.52 from Gerald and Leona Kirwan since they are the initial transferees of the subject property. 11 U.S.C. § 550(a)(1). They exercised dominion and control over the property upon receiving it from the Partnership. *Luker v. Reeves (In re Reeves)*, 65 F.3d 670, 676 (8th Cir. 1995).

Counsel for the Trustee shall prepare an appropriate order and a judgment.

Dated this 19 day of June, 2000.

BY THE COURT:



Irvin N. Hoyt
Bankruptcy Judge

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
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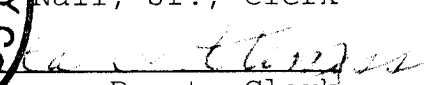
JUN 19 2000

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota



(SEAL)

ATTEST
Charles L. Nail, Jr., Clerk


Deputy Clerk

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list.

JUN 19 2000

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By AC

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