

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Central Division

In Re:)	Bankr. Case No. 94-30016
)	
)	Adversary Case No. 94-3007
SHANNON PATRICK O'MALLEY)	
and CARMELITA O'MALLEY)	Chapter 7
)	
Debtors.)	
)	
JOHN S. LOVALD, TRUSTEE)	MEMORANDUM OF DECISION RE:
)	TRUSTEE'S COMPLAINT TO
)	RECOVER MONEY AND PROPERTY
Plaintiff,)	
vs.)	
)	
MARK BARNETT, AS ATTORNEY)	
GENERAL OF THE STATE OF SOUTH)	
DAKOTA, AS CUSTODIAN, SHANNON)	
P. O'MALLEY, JOHN O'MALLEY,)	
MARTY O'MALLEY, LARRY O'MALLEY,)	
and CARMELITA O'MALLEY)	
)	
Defendants.)	

The matter before the Court is Plaintiff Trustee John S. Lovald's complaint to recover money and property. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum of Decision and subsequent judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below more fully, the Court concludes that Debtors must turn over to Trustee Lovald most of the guns and a coin collection from their home in Winner and a 1987 golf cart because they are estate property under 11 U.S.C. § 541(a). The Court further concludes that the \$100,000.00 in restitution paid to the State of South Dakota by Debtor Shannon O'Malley was a preferential transfer that shall be voided under 11 U.S.C. § 547(b). Finally, the Court concludes that the purported transfer of 500 shares in Deer Park

Golf Club, Inc., that Debtor Shannon O'Malley made to Marty O'Malley in June 1991 shall be voided as a fraudulent transfer under 11 U.S.C. § 548(a)(1).

I.

SUMMARY OF THE ADVERSARY PROCEEDING AND ARGUMENTS.

Shannon O'Malley and his wife Carmelita filed a Chapter 7 petition on March 14, 1994. On their schedules, Debtors stated they owned one 1986 Yamaha golf cart valued at \$500.00 and two guns, a .410 H&R shotgun valued at \$50.00 and a .22 Savage [rifle] valued at \$50.00.¹ At the time of the petition, these guns were not listed specifically on Debtors' personal property insurance policy.²

In answer to the question on their statement of financial affairs of what property they hold for others, Debtors stated:

Household goods, furniture and appliances, gun cabinet, saddles, 1987 golf cart and guns - see Exhibits "A" and "B" attached, belonging to debtors' sons, Marty and John O'Malley, Phoenix, AZ, estimated value \$27,800.00.

Exhibit A listed property they said belongs to Marty O'Malley. It included furniture and a 1987 golf cart. The total stated value was \$4,360.00. Beneath a dividing line on that page was listed "Coin collection, estimated: \$10,000.00." This portion of Exhibit A did not identify clearly who purportedly owned these coins. Although the coins were not mentioned in Debtors' initial answer to

¹ Trustee Lovald has objected to the property exemptions Debtors have claimed. That matter will be resolved after this adversary proceeding.

² A rifle, Savage Model 6D, valued at \$75.00 is listed on the insurance binder. Shannon O'Malley testified that it was a different gun than his .22 Savage rifle valued at \$50.00.

the question, the value of the coins was included in their total value of property held for others.

Exhibit B listed guns and pistols valued at \$13,450.00. Exhibit B stated these items belonged to Marty and John O'Malley.

On August 2, 1994, Trustee Lovald filed a complaint against South Dakota Attorney General Mark W. Barnett, Debtors Shannon P. O'Malley and Carmelita O'Malley, John O'Malley, Marty O'Malley, and Larry O'Malley. Trustee Lovald sought the recovery, as a voidable preference under 11 U.S.C. § 547, of the restitution Shannon O'Malley had paid pre-petition to the State of South Dakota arising from criminal charges against him. Trustee Lovald also sought a turnover of certain guns, the coin collection, and one golf cart in Debtors' possession. Finally, Trustee Lovald sought the recovery of shares in Deer Park Golf Club, Inc., that Debtor Shannon O'Malley had transferred to Larry O'Malley, Marty O'Malley, and John O'Malley. Trustee Lovald contended certain transfers of Deer Park stock were voidable preferences made to these family members as insiders within one year of the filing of Debtors' petition, as governed by 11 U.S.C. § 547(b). Alternatively, Trustee Lovald contended the transfers of stock were a "sham" because Debtor Shannon O'Malley continued to exercise control over the Deer Park property.

Marty, Larry, and John O'Malley answered jointly on August 25, 1994. They denied that any of the restitution was estate property and affirmatively stated that the restitution paid to the State was in part theirs. Marty and John O'Malley claimed ownership of the

guns that Trustee Lovald wanted turned over. These three defendants also filed a cross-claim against Attorney General Barnett seeking a return of the restitution funds if the funds were not used as intended.

Attorney General Barnett answered Trustee Lovald's complaint and Defendants Larry, John, and Marty O'Malley's cross claim on August 30, 1994, with a general denial.

Debtors Shannon and Carmelita O'Malley answered on September 2, 1994. They too stated that the restitution funds did not belong to Shannon O'Malley. They argued that the money paid to the State was not restitution for the benefit of some unsecured creditors but instead claimed that the money was paid in response to the State's enforcement of its criminal statutes. They also stated that any Deer Park stock transferred to Larry, Marty, or John O'Malley was for security only. They admitted Larry, Marty, and John O'Malley are insiders but denied the transfers of stock were preferences.

The original trial date was rescheduled because Defendant-Debtor Shannon O'Malley suffered a heart attack. A second trial date was rescheduled because Defendant-Debtors' counsel became ill and had to be replaced.

A trial was held on June 7 and 8, 1995. Appearances included Trustee John S. Lovald, *pro se*, Rick Johnson for all the O'Malley Defendants, and Assistant Attorney General Janine Kern for Defendant Attorney General Barnett. Attorney Johnson clarified that the O'Malley Defendants were prepared to try only the precise

three counts brought by Plaintiff Trustee Lovald. On the record, Trustee Lovald reserved the right to have his complaint amended to conform to the evidence.

At trial, Defendants John and Larry O'Malley offered to transfer to Trustee Lovald the shares of Deer Park stock that Debtor Shannon O'Malley gave them in December 1993. They contended that the return of this stock would nullify any preference issue concerning the \$85,000.00 they gave Shannon for his restitution payment. They did not argue that the stock had been sold to them.

Defendant Marty O'Malley's position at trial was different from what he had stated in his answer. Marty O'Malley now contended that his father had sold him the Deer Park stock outright in 1993. He did not claim that he took the stock as security, as Defendants-Debtors Shannon and Carmelita O'Malley had stated.

Defendants-Debtors Shannon and Carmelita O'Malley' position also had changed by the time of trial. While in their answer they had stated that the Deer Park stock was transferred to John, Marty, and Larry as security, they now argued that the transfers to John and Larry were quasi gifts and that the transfers to Marty were sales.

The Court received written closing arguments. In his post-trial brief, Trustee Lovald stated he would waive relief under Count III [whether the stock transfers to Larry, John, and Marty O'Malley were voidable preferences], if he received full recovery under Count I [whether the restitution paid to the State of South

Dakota was a voidable preference]³. Trustee Lovald argued he is entitled to the full \$100,000.00 in restitution paid to the State. Trustee Lovald also argued that Debtors' possession of the guns and coin collection and the inclusion of these items on Debtors' insurance policies and financial statements are the best evidence of ownership. He challenged testimony offered by the O'Malley Defendants because it was unsupported by other objective evidence.

Similarly, Trustee Lovald argued that the testimony offered by the O'Malley Defendants that the coin collection belongs to a Loretta Cain is unsupported by other evidence. Trustee Lovald also argued that their testimony is contradicted by Shannon O'Malley's long-time possession of the coins.

The O'Malley Defendants relied on an earmarking theory for their argument that the restitution funds supplied by Larry and John O'Malley never became Shannon O'Malley's property and, therefore, could not be considered a preferential transfer. These Defendants relied on the testimony of family members, Connie Halvorson, and Loretta Cain and some documents drafted by the Defendants to support their claim that the guns, coin collection, golf cart, and other certain personalty are not estate property subject to turn over.

To their closing brief, the O'Malley Defendants attached an affidavit by Bryon E. Foreman, treasurer of the Winner Country Club, dated June 21, 1995. Trustee Lovald did not object to this

³ Any proposed settlement of a claim by the Trustee must be noticed to all creditors and approved by the Court before it is binding on the estate. F.R.Bankr.P. 9019(a).

additional evidence. Therefore, it has been received by the Court.

In his reply brief, Trustee Lovald moved that his complaint be amended to conform to the evidence that the \$5,000.00 bond that Shannon O'Malley gave to the State for his bond came from his personal funds and, therefore, also is subject to the preference claim with the other \$95,000.00. Defendants have not objected to this motion. Therefore, Plaintiff-Trustee's complaint shall be so amended.

Defendant Attorney General Barnett did not file a brief but noted that the questions before the Court are matters of credibility.

The Court makes the following findings and conclusions based on the evidence presented.

II.
TURNOVER OF ESTATE PROPERTY

FINDINGS OF FACT.

Gun Collection. Since 1984, Shannon O'Malley's insurance policy on personal property has included guns located in his Winner home. Shannon O'Malley prepared a letter with Ronald Waller, his insurance agent, on June 9, 1985. In the letter, Shannon O'Malley advised his insurance agent that the guns listed on his insurance policy belonged to his sons but that he (Shannon) would leave them on his policy and pay the premiums. Agent Waller acknowledged receipt of the letter.⁴ Neither Marty nor John O'Malley produced tangible evidence that they had reimbursed their father for these

⁴ Agent Waller's testimony was received by deposition. He died prior to trial.

premiums.

According to a financial statement signed and dated by Shannon O'Malley on June 25, 1986, he owned an insured gun collection valued at \$30,000.00. While Marty O'Malley testified that the collection listed on this financial statement was in Arizona, neither Marty nor Shannon O'Malley was able to identify and describe any gun collection Shannon O'Malley owned in Arizona. Marty and Shannon O'Malley failed to produce any insurance documents that indicated guns belonging to Shannon O'Malley, located somewhere other than Shannon O'Malley's Winner home, had been insured in 1986. Further, on this financial statement, real and personal property that were located in Arizona were described as being located in Arizona. There was no indication on the financial statement that the insured gun collection was located in Arizona. Finally, at his September 27, 1994 deposition, Shannon O'Malley did not state that in 1986 he possessed insured gun collections in both Winner, South Dakota and Arizona.

Jack Day, a long-time officer at Norwest Bank in Winner and its predecessor, Farmers State Bank of Winner, acknowledged receipt of the 1986 financial statement from Shannon O'Malley. Jack Day testified that he did not assist Shannon O'Malley in the preparation of the attachment to this financial statement, which listed Shannon and Carmelita O'Malley's real and personal property, values, and encumbrances.

The O'Malley Defendants presented the front page of a financial statement that bears Shannon O'Malley's name and is dated

June 16, 1992. Personal property, valued at \$20,000.00, was not described. The second page or reverse side of the financial statement was missing, all schedules to the statement were missing, and the statement was not signed. Because it was incomplete, this financial statement was not credible evidence that in 1992 Shannon O'Malley no longer included any insured gun collection in his personalty.

The O'Malley Defendants presented copies of three documents in which either Marty O'Malley or Shannon O'Malley offered to exchange various property for some guns through a trading club in Arizona. None of the offers described the guns or stated where they were located. Only one offer, dated October 28, 1987, stated that it involved Shannon O'Malley. Most important, each was dated after 1986. Therefore, Shannon O'Malley's June 25, 1986 financial statement could not have referred to the guns involved in any of these three offers.

Marty O'Malley testified that seven guns in his parents' house belong to him and his brother: two Browning .12 gauge shotguns, serial nos. 02442RT158 and 71V83375; a Remington rifle with scope, serial no. 6275682; a Winchester shotgun, serial no. 379727; a Browning shotgun, serial no. 04096RP161; a Browning shotgun, serial no. 341A47; and a Remington shotgun, serial no. 685649W. These were identified as gifts they had received as teenagers.

Marty O'Malley testified that the remaining guns listed in

Exhibit B,⁵ attached to his parents' statement of financial affairs, were his, including a Weatherby Ducks Unlimited 12 gauge shotgun. He stated from whom he had purchased each and the approximate year each was purchased.

Marty O'Malley did not offer any proof of purchase or other documentary evidence of ownership for these guns, including the Weatherby Ducks Unlimited shotgun. He did not testify where he got his funds to purchase any of these guns. Many of the guns were purchased during years in which Marty O'Malley said he did not make much money. Marty O'Malley blamed a 1990 flood of his offices in Arizona for a loss of records.

Connie Schwartz Halvorson, Marty O'Malley's former fiancé, testified that she had witnessed Marty purchasing many of these guns. She did not testify as to his source of funds. She said Marty stored the guns at his parents' house for security reasons. She could not explain why Shannon O'Malley insured them.

John O'Malley testified that he had three guns at his parents' home in Winner: a Browning Magnum 12 gauge automatic shotgun, serial number 04096RP161; a Browning side by side 12 gauge shotgun, serial number 341A47; and a Remington 870 16 gauge pump shotgun, serial number 685649W.⁶ All three guns were gifts from his parents.

⁵ Exhibit B is identical to a page in Trustee's Exhibit 1 except that Trustee's Exhibit 1 also includes a Savage rifle, model 6D (no serial number) that is not on Exhibit B.

⁶ John O'Malley's testimony was received by deposition pursuant to the litigants' agreement.

On June 28, 1994, Lewis Dirks, an investigator for Trustee Lovald, videotaped the guns and pistols in Shannon and Carmelita O'Malley's home and identified each. His findings corresponded with the list of guns in Trustee's Exhibit 1.

Coin Collection. At the § 341 meeting of creditors, Debtor Shannon O'Malley testified that a coin collection in his possession belonged to Marty O'Malley. He said that Marty brought the coins with him from Arizona to Winner and stored them in Debtors' garage with other personal property. Shannon O'Malley also stated Marty probably acquired the coins through a trade.

According to an AGREEMENT FOR THE EXCHANGE OF PROPERTY dated October 20, 1992 that the O'Malley Defendants produced, Marty O'Malley agreed to give two "fry factory french fry machines" valued at \$10,000.00 each to a Loretta Cain in exchange for "4 boxes of coins appraised value \$20,000." A handwritten note on the bottom states Marty O'Malley "will keep in a safe place and maintain coin collection until such time trade is completed." The handwritten note is not initialed or dated by either party. Attached to the AGREEMENT is a handwritten list of coins.

At trial, Shannon O'Malley testified that he had picked up the coins from Loretta Cain to facilitate a trade that Marty had made with her. He acknowledged that he had guaranteed Loretta Cain that she would not loose her coins. Shannon O'Malley admitted that at the § 341 meeting he did not testify truthfully about his or Loretta Cain's involvement with the coins. He said he did so because he did not want to involve Loretta Cain further.

Marty O'Malley's testimony mirrored his father's. He said the coins were part of an unconsummated trade between he (Marty) and Loretta Cain. He said his father was only the custodian of the coins.

Loretta Cain testified that she has been doing business with Shannon O'Malley for many years and that in August 1992 she also had made a deal with Shannon O'Malley for some stock in Go Unified, a corporation that Marty O'Malley and others had formed. She was unsure of the outcome of that deal.

Loretta Cain said she inherited the coins from her husband in 1989. On direct examination, she stated that Shannon O'Malley had picked up the coins from her and that "Shan was going to keep it [the coin collection] until an agreement was made with Marty." When asked on direct what the trade was for, she replied, "Well, we were started out with the fryers but we decided to wait to see for a better chance of better things to do with it." Thus, she implied that the trade with Marty O'Malley for the fryer machines was off. On cross examination, her testimony changed. She then said that she had made the fryer machine agreement with Marty O'Malley *before* Shannon O'Malley picked up the coins.

None of these witnesses was able to give a clear date of when Shannon O'Malley took possession of the coins. The coins are not insured by either Marty O'Malley or Shannon O'Malley. Prior to trial, Loretta Cain did not cooperate with Trustee Lovald's informal discovery request.

Based on a transaction involving Go Unified stock, Loretta

Cain originally was one of the parties on the restitution list attached to a draft plea agreement involving Shannon O'Malley's criminal charges. Her name was removed from the final plea agreement because the State had determined that she had been paid or refunded the \$2,500.00 she was owed.

Other Personalty. As noted above, Debtors stated in their schedules that they held a golf cart belonging to Marty O'Malley. Marty O'Malley testified that he uses this cart when he is in Winner. He further stated that his mother uses it when he is not in Winner. Marty O'Malley testified that he reimburses his father in cash for the rental space for his golf cart at the country club in Winner. Insurance Agent Ronald Waller stated Shannon O'Malley's personal property insurance policy lists two golf carts.

In his affidavit, Bryon Foreman, treasurer of the Winner Country Club, stated that Shannon O'Malley and Marty O'Malley each have stored one golf cart at the Winner Country Club since 1990 and that rent charges have been paid by cash or check. He did not state who paid the rent.

Shannon O'Malley and Marty O'Malley testified that various personalty, including some furniture, a Hammond organ, and two saddles that were stored in Debtors' garage in Winner belonged to Marty. They and Connie Halvorson testified that Marty stored this property there when he sold his Winner home and moved into an apartment in the mid 1980's and when Marty moved from Valentine back to Arizona in the summer of 1991. Marty O'Malley and Connie Halvorson also testified that the refrigerator in Debtors' home

belongs to Marty O'Malley. It was placed there when Debtors' refrigerator quit working.

Marty O'Malley and Shannon O'Malley testified that the saddles were gifts or bequeaths that Marty O'Malley received from his maternal grandfather. They also testified that the Hammond organ was a childhood gift to Marty. Finally, Shannon O'Malley testified that a pool table in his home was a childhood gift to his children.

APPLICABLE STATUTE AND RELATED CASE LAW.

Property of a bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case." 11 U.S.C. § 541(a)(1). Congress intended the provision to be broad. *Patterson v. Shumate*, 112 S.Ct. 2242, 2246 (1992); *Sosne v. Gant (In re Gant)*, 178 B.R. 169, 172 (Bankr. E.D. Mo. 1995).

The scope of the paragraph is broad. It includes all kinds of property, including tangible and intangible property, causes of action . . . and all other forms of property specified in Section 70(a) of the Bankruptcy Act [I]t includes as property of the estate all property of the debtor, even that needed for a fresh start.

S.Rep. No. 989, 95th Cong., 2d Sess. 823, *reprinted in* 1978 U.S.Code Cong. & Ad.News 5787, 5868; H.R.Rep. No. 595, 95th Cong., 1st Sess. 367-68 (1977), *reprinted in* 1978 U.S. Code Cong. & Ad.News. 6322-24 (cited in *Samore v. Graham (In re Graham)*, 725 F.2d 1268, 1270 (8th Cir. 1984), abrogated by *Patterson*, 112 S.Ct. 2242); *Whetzal v. Alderson*, 32 F.3d 1302, 1303 (8th Cir. 1994).

Section 542(a) of Title 11 governs turnover of estate property. It provides that a person, other than a custodian, in

possession of property that the trustee may use, sell, or lease under 11 U.S.C. § 363 shall deliver that property to the trustee. The only exception is if the property is of "inconsequential value or benefit to the estate." 11 U.S.C. § 542(a) (in applicable part).

CONCLUSIONS OF LAW.

Turnover of Certain Guns. The Court concludes that all but six of the guns listed on Exhibit B of Debtors' statement of financial affairs are estate property that must be turned over to Trustee Lovald. Shannon O'Malley's and Marty O'Malley's testimony that Marty owned most of the guns in Shannon and Carmelita O'Malley's Winner home was self-serving and not credible. See *In re Schmitt Farm Partnership*, 161 B.R. 429, 433 (N.D. Ill. 1993) (unrebutted but noncredible testimony need not be given any weight by the court). Further, their testimony was not supported by any objective, documentary evidence.

Marty O'Malley was able to give a history of most of the guns. Connie Halvorson's testimony supported his testimony. John O'Malley testified that he owned three of the guns. However, the O'Malley Defendants offered no objective evidence of ownership. All the testimony was self-serving. There were no sales slips. There was no testimony from any gun seller. The guns have never been in Marty O'Malley's possession, even when he lived in Winner. None of the defendants could offer any proof that Marty reimbursed his parents for the insurance premiums. There was no evidence of the source of funds Marty used to purchase the guns, especially the ones he supposedly bought when he worked at Shannon O'Malley's

supper club in Winner. Most important, Shannon O'Malley listed the guns on his insurance policy and a 1986 financial statement. Shannon O'Malley's letter to his insurance agent offered little probative value as to true ownership of the guns, since Shannon O'Malley authored it. See *Langford v. Issenhuth*, 134 N.W. 889 (S.D.1912) (self-serving declaration in memorandum not corroboration of other evidence offered by same party). In essence, their version of who owns the guns appears to change as circumstances dictate.

In addition to the guns Debtors have declared exempt⁷, six guns will be excluded from the estate: the two Browning .12 gauge shotguns, serial nos. 02442RT158 and 71V83375; a Remington rifle with scope, serial no. 6275682; a Winchester shotgun, serial no. 379727; a Browning shotgun, serial no. 04096RP161; a Browning shotgun, serial no. 341A47; and a Remington shotgun, serial no. 685649W. The testimony of John and Marty O'Malley that these guns were gifts to them from their parents was believable.

Turnover of the Coin Collection. The Court also concludes that the coin collection is estate property that must be turned over to Trustee Lovald.

The testimony of Shannon O'Malley and Marty O'Malley regarding the coin collection lacked credibility. Their testimony at trial, that Loretta Cain still owned the coins, was contrary to Debtors' schedules, which indicated Marty owned the coins, and Shannon

⁷ The guns declared exempt are still subject to a final hearing on the Trustee's objection to exemptions.

O'Malley's testimony at the § 341 meeting, where he said Marty owned the coins. Further, Shannon O'Malley has had possession of the coins for a substantial period of time, he has made many other trades with Loretta Cain, and he guaranteed to protect her on her coin trade.

Loretta Cain's testimony about the coin trade was contradictory. At first she said the agreement was made with Marty O'Malley after Shannon O'Malley picked up the coins. Later she testified that she made the agreement with Marty O'Malley before Shannon O'Malley picked up the coins. Most noteworthy, however, is her testimony that the initial deal for the french fry machines went by the wayside and that she had decided to wait for something better. She thereby implied that the french fry machine trade had been or would be substituted for another deal. Further, the testimony of Loretta Cain was self-serving in that she would get the coins back if her and the O'Malleys' story was believed. Her testimony also becomes questionable when it is coupled with the fact that her claim against Shannon O'Malley for a sale of unregistered securities went away -- with no explanation -- before the plea agreement between the State and Shannon O'Malley was finalized.

When all this evidence is considered, the Court concludes that the coin collection is estate property that must be turned over to Trustee Lovald. To hold otherwise would ignore Shannon O'Malley's changing stories about who owned the coins and his involvement with the coin trade. Further, based on Loretta Cain's testimony, the

Court is persuaded that the agreement to trade the coins for two french fry machines was abandoned and replaced by some other deal that involved Shannon O'Malley, as evidenced by his continued possession of the coins and his guarantee to Loretta Cain that he would protect her interest in any deal involving the coins. Loretta Cain can file a claim against the estate based on this guarantee.

Turnover of Other Personalty. Determining true ownership of the 1987 golf cart is difficult. While all testimony received at trial was self-serving, the post-trial affidavit of Bryon Foreman states that one golf cart stored at his country club by the O'Malleys is considered to be Marty O'Malley's. In contrast, Debtors' personal property insurance binder, the only documentary, objective evidence of ownership presented, indicates Debtors own the cart. Further, Defendants were unable to produce any documentary evidence of when or how Marty purchased the cart or that he ever reimbursed his parents for the rental space. That family members treated the cart as Marty O'Malley's is not conclusive evidence of ownership. Consequently, in the absence of any documentary evidence of purchase or ownership by Marty O'Malley and it appearing that Debtors insured the golf cart as their own, the Court concludes that the 1987 golf cart in Winner belongs to Debtors and must be turned over to Trustee Lovald.

The Court concludes that certain other personalty at issue, including furniture stored in Debtors' garage, a refrigerator in Debtors' Winner home, a Hammond organ, a pool table in Debtors'

Winner home, and two saddles, belong to Marty or John O'Malley. The O'Malleys' testimony that Marty or John received this property as gifts was reasonable. There was no objective evidence to the contrary. This property need not be turned over to Trustee Lovald.

III.
VOIDABLE TRANSFERS

FINDINGS OF FACT.

Shannon P. O'Malley had business interests in Winner, South Dakota and Arizona. Some involved his son Marty O'Malley. In the late 1970's and early 1980's, Marty O'Malley and his then fiancé, Connie Schwartz, managed a restaurant and lounge in Winner that Shannon O'Malley owned. Later, Marty O'Malley became Shannon O'Malley's pilot for business travel. During the 1980's Marty O'Malley's involvement in his father's business deals increased, especially those in Arizona. Marty O'Malley did not make much money until the mid to late 1980's.

Marty O'Malley and Shannon O'Malley both had stock in The Equitas Group ("Equitas"). A PURCHASE AGREEMENT dated December 22, 1990, and signed by Shannon and Marty O'Malley, states that each will have half ownership in 300,000 shares in "Equitas" stock, the stock will be issued in Shannon's name only, and Shannon will have "full control" over the shares. The PURCHASE AGREEMENT also states that "Marty O'Malley will have one-half interest in anything [the stock] is sold or traded for." The PURCHASE AGREEMENT has never been a public document evidencing any ownership interest Marty O'Malley may have had in the 300,000 shares of Equitas stock.

Marty O'Malley showed his attorney in Arizona, Arthur F.

Schaffer, Jr., a copy of the PURCHASE AGREEMENT in 1991.⁸ Attorney Schaffer did not give the O'Malleys an opinion on whether the PURCHASE AGREEMENT was lawful or binding on third parties. Attorney Schaffer said it was a "typical" transaction between Marty O'Malley and Shannon O'Malley. He further stated that Marty O'Malley and his father often represented themselves to him as partners in their business deals.

On March 1, 1991, Shannon O'Malley purchased from Charlene Faust all 1,000 outstanding shares of Deer Park Golf Club, Inc., an S corporation under federal tax laws. Deer Park was the only golf course and country club in Valentine, Nebraska. It held a liquor license. The CONTRACT FOR SALE OF STOCK indicated Shannon O'Malley was the sole buyer. The purchase price was \$240,000.00. Shannon O'Malley borrowed \$150,000.00 from a bank and gave Charlene Faust a note for \$50,000.00. The remaining balance of \$40,000.00 was paid with 145,500 shares in Equitas.

Paragraph 8, "Warranties by Buyer," of the CONTRACT FOR SALE stated Shannon O'Malley is the owner of the 145,500 shares of Equitas being transferred. Exhibit B of the CONTRACT FOR SALE acknowledged that Marty O'Malley also had stock in Equitas but it further stated that the stock Shannon O'Malley was transferring in consideration for the Deer Park stock was owned by Shannon O'Malley only. The certificate for the 145,500 shares of Equitas that were transferred to Charlene Faust was held in Shannon O'Malley's name.

⁸ Attorney Schaffer's testimony was received by deposition pursuant to the litigants' agreement.

The meeting minutes for Deer Park shareholders on March 1, 1991 also stated that Shannon O'Malley was the sole buyer.

On March 6, 1991, Shannon O'Malley applied to the Nebraska Liquor Control Commission to have Deer Park's liquor license renewed. The application indicated only Shannon O'Malley was a stockholder in Deer Park. The Deer Park stock certificate and the CONTRACT FOR SALE OF STOCK, which indicated Shannon O'Malley was the sole buyer, were appended to the application.

According to copies of stock certificates that were put in evidence,⁹ by the end of 1991 Deer Park had issued five stock certificates. The first certificate, dated April 18, 1986, was for 1,000 shares. This was the original certificate issued to Charlene Faust, the person who later sold these shares to Shannon O'Malley. The certificate was received and signed by her.

The second certificate was issued to Shannon O'Malley for 1,000 shares pursuant to the transfer from Charlene Faust. It is dated March 1, 1991. It was received and signed by Shannon O'Malley.

The third stock certificate for Deer Park was issued to Marty O'Malley for 500 shares transferred from Shannon O'Malley. It is dated June 30, 1991 but has not been received or signed by Marty O'Malley. Shannon O'Malley said he delivered this certificate to Marty when Marty moved from Phoenix to Valentine in the summer of 1991. Shannon and Marty O'Malley contended at trial that Marty

⁹ No other corporate records or minute books were put into evidence.

acquired these 500 shares based on the transfer to Charlene Faust of the 145,500 shares of Equitas that were held in Shannon O'Malley's name but which Marty and Shannon O'Malley claimed they both owned under their December 22, 1990 PURCHASE AGREEMENT. Shannon O'Malley also testified that the CONTRACT FOR SALE OF STOCK stated that Marty O'Malley had an interest in the Equitas stock transferred to Charlene Faust. To the contrary, as noted above, Paragraph 8 and Exhibit B of the *CONTRACT FOR SALE OF STOCK* indicate that only Shannon O'Malley was transferring Equitas stock in consideration for Charlene Faust's Deer Park stock.

Shannon O'Malley had another certificate issued to himself (certificate number four) for 500 shares. It also is dated June 30, 1991, but has not been received or signed by Shannon O'Malley. This certificate would reflect the balance Shannon O'Malley would own if Marty O'Malley acquired one-half of the original 1,000 shares issued.

The fifth certificate reflects Shannon O'Malley's sale of 100 shares to a Robert Fritz on September 25, 1991. The certificate has not been received and signed by Robert Fritz.

Deer Park's 1991 federal income tax return indicated only Charlene Faust and Shannon O'Malley were shareholders in 1991. Schedule D from Shannon and Carmelita O'Malley's 1991 federal personal income tax return set forth the transfer of Deer Park stock to Robert Fritz but not to Marty O'Malley. Deer Park's 1992 federal income tax return stated Shannon O'Malley owned ninety percent and Robert Fritz owned ten percent of Deer Park.

John Michalek, Deer Park's manager, acknowledged that Marty O'Malley had worked at Deer Park during the summer of 1991 and had taken an active role in the business.

On February 21, 1993, Shannon O'Malley transferred 90 shares of Deere Park stock to Marty O'Malley. Consideration for this transfer was \$35,000.00. Corporate records include a stock certificate (number 7) issued to Marty O'Malley that is dated February 21, 1993 but is not signed as received by Marty. The O'Malley Defendants produced a cashier's check receipt dated February 17, 1993 for \$35,000.00 from Marty O'Malley to Shannon O'Malley. These Defendants produced another cashier's check receipt dated February 17, 1993 where Marty O'Malley got \$35,000.00 from Go Unified, the corporation that Marty O'Malley and others had formed. Marty O'Malley testified that he purchased these 90 shares so that he would have the controlling interest in Deer Park over his brother John if their father died.

On March 24, 1993, Shannon O'Malley was indicted by the State of South Dakota for selling unregistered securities. Stocks from several corporations were involved, including Equitas and Go Unified. Under a plea agreement, Shannon O'Malley plead guilty to two felony counts of selling unregistered securities. A ten-year jail term would be suspended if Shannon O'Malley paid \$162,000.00 to the State in restitution for persons involved in the securities transfers. When the judgment was entered, \$100,000.00 of the \$162,000.00 was to be paid.

Shannon O'Malley raised the initial \$100,000.00 in restitution

from family members. He had a \$10,000.00 cashier's check on hand from funds he had gotten in April 1993 when he sold Marty O'Malley some Deer Park stock or from when he (Shannon) refinanced his home. He obtained \$60,000.00 from his son John and \$25,000.00 from his brother Larry. John and Larry each gave Shannon O'Malley a cashier's check made out to themselves and Shannon O'Malley. The cashier's checks were dated December 3, 1993. The final \$5,000.00 of the required \$100,000.00 was from the bond Shannon O'Malley had posted with the State.

Corporate records indicate that on December 3, 1993, Carmelita O'Malley as Secretary and Shannon O'Malley as President, issued a stock certificate giving John O'Malley 155 shares in Deer Park and Larry O'Malley 65 shares in Deer Park (certificates 11 and 12). Shannon O'Malley did not discuss the stock transfers with Larry and John before making them. Shannon O'Malley made the transfers when he realized he no longer could hold stock in Deer Park without jeopardizing Deer Park's liquor license. Shannon O'Malley described the transfers as gifts or sales. The transfers were treated as sales in the corporate records. Copies of the certificates were not delivered to either Larry or John until later in December 1993 or after the first of 1994. Neither certificate has been signed or dated upon receipt.

In early December 1993, Shannon O'Malley got another \$35,000.00 from Marty O'Malley in exchange for another 90 shares in Deer Park. This transfer is acknowledged on certificate 10. The certificate states the transfer of stock was made December 3, 1993.

The certificate has not been signed and dated as received by Marty. The O'Malley Defendants produced a cashier's check dated December 7, 1993 from Marty O'Malley to Shannon O'Malley. Marty O'Malley said he used funds from a loan repayment for the \$35,000.00 he gave to his father. Shannon O'Malley could not explain how he spent this \$35,000.00.

Pursuant to the plea agreement on December 15, 1993, Shannon O'Malley paid the State \$95,000.00 of the restitution. The remaining \$5,000.00 of the initial \$100,000.00 was paid December 16, 1993 when Shannon O'Malley's bond was released.

Two Judgments of Conviction and Orders Suspending Sentence were entered by the state court on March 8, 1994. They ordered Shannon O'Malley to make restitution payments totaling \$162,000.00 to individuals who purchased from him unregistered securities in several corporations, including Equitas and Go Unified. Attachments to the Judgments of Conviction set forth the names of those entitled to restitution. The list included Ardie B. Cook, Vernon Seger, and Al[y]ce Singer, persons who Debtors later scheduled as unsecured creditors in their Chapter 7 case.

Jeffrey G. Hurd, one of Debtor Shannon O'Malley's criminal defense attorneys, testified about the plea agreement and his firm's involvement in relaying the restitution funds to the State.

By letter dated January 10, 1994, Shannon O'Malley advised Deer Park's and his personal accountant, Lewis Johnson, of the 1991 and 1993 transfers of stock in Deer Park he had made. In the letter, Shannon O'Malley advised his accountant that his and Deer

Park's tax returns are in error because they do not recognize the June 1991 transfer of Deer Park stock to Marty O'Malley, the February and December 1993 transfers to Marty O'Malley, and the December 1993 transfers to John and Larry O'Malley. Shannon O'Malley also told his accountant that he must have forgotten to notify him of these changes earlier. Finally, Shannon O'Malley told his accountant that as of December 1993 he no longer owns any Deer Park stock but that he continues as president.

An attachment to the letter lists the consideration for the transfers in 1993 and states that all sales were cash. Based on this information, Marty O'Malley paid \$388.89 per share for the 180 shares he purchased in 1993. John O'Malley paid \$387.10 per share for the 155 shares sold to him in 1993. Larry O'Malley paid \$384.61 per share for the 65 shares sold to him in 1993.

If it is accepted that Marty acquired 500 of the original 1,000 shares based on his one-half interest in the Equitas stock that was transferred to Charlene Faust, then Shannon O'Malley would have paid \$440.00 per share and Marty O'Malley would have paid \$40.00. These figures are calculated by adding the consideration each purportedly gave and dividing by 500. Shannon O'Malley gave consideration totaling \$220,000.00: \$150,000.00 from a bank loan plus \$50,000.00 in a note to Charlene Faust, plus one-half interest in the Equitas stock, with an apparent value not exceeding \$20,000.00. Marty O'Malley purportedly gave the remaining \$20,000.00 of the \$240,000.00 purchase price based on his one-half interest in the Equitas stock. There is no evidence that Marty

O'Malley was a co-signor on the bank note or the note to Charlene Faust. Therefore, if the June 1991 transfer of 500 shares to Marty is valid, Marty would have paid only \$20,000.00 in consideration for one-half interest in Deer Park while his father paid \$220,000.00 for the other half interest.

Shannon and Carmelita O'Malley's joint federal income tax return for 1993 treated the 1993 transfers of Deer Park stock to Larry, John, and Marty O'Malley as sales, not gifts or pledges of security. John and Larry O'Malley also treated the Deer Park stock transfers to them as sales on their 1993 personal federal income tax returns.

CPA Lewis Johnson testified that he prepared all of Deer Park's tax returns. He acknowledged receiving Debtor Shannon O'Malley's January 10, 1994 letter. He said he then amended the necessary returns for Deer Park and the O'Malleys in October 1994. He stated that the stock transfers in 1991 and 1993 invalidated the S corporation election after 1991 so that Deer Park had to be refiled as a "C" corporation. CPA Lewis did not prepare the Deer Park stock certificates.

On March 24, 1994, Deer Park again filed a liquor license application with the Nebraska Liquor Control Commission. This application stated Marty O'Malley owned 680 shares, John O'Malley owned 155 shares, Larry O'Malley owned 65 shares, and Robert Fritz owned 100 shares. Shannon O'Malley no longer was listed as a stockholder.

In late 1994 and early 1995, the State of South Dakota

distributed some of the restitution that Shannon O'Malley had paid. Three of Debtors' scheduled creditors received funds: Vernon Seger received \$7,257.00; the estate of Alyce Singer received \$4,839.00; and Ardie Cook received \$1,506.08. The restitution account retains a balance of a little over \$100,000.00.

APPLICABLE STATUTES AND RELATED CASE LAW.

Avoidance of a Transfer to an Insider Under § 547(b). Under 11 U.S.C. § 547(b), a trustee may avoid a transfer to an insider that occurred within one year of the petition date if the transfer was for a debt that preceded the transfer, the debtor was insolvent at the time of the 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). It is designed to prevent the debtor from favoring one creditor over others by transferring property shortly before filing for bankruptcy. *Beiger v. I.R.S.*, 496 U.S. 53, 58 (1990). 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). The trustee bears the burden of proof on each element of a preference under § 547(b). 11 U.S.C. § 547(g). The burden is by a preponderance of the evidence. *In re Hogg*, 76 B.R. 735, 743 (Bankr. D.S.D. 1987).

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 property¹⁰

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. Farmers Home Administration (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 a creditor on a simple contract cannot acquire a judicial lien that is superior to the interest of the transferee." If the transfer is not perfected when made or within ten days after the transfer, then for the purpose of applying § 547(b), the transfer is considered to have been made immediately before the date of the filing of the petition.

Section 547(c) sets forth several exceptions to the avoidable preference rule. For example, a transfer may not be avoided as a preference by the trustee if the transfer was a contemporaneous exchange for new value. 11 U.S.C. § 547(c)(1). "New value" includes money or money's worth in goods and services in a

¹⁰ "Property" and "interests in property," in the absence of federal law, are defined by state law. *Barnhill*, 112 S.Ct. at 1389.

transaction that is neither void nor voidable by the debtor or trustee under any applicable law. The creditor bears the burden of proving that an exception to the preference provision applies. 11 U.S.C. § 547(g).

Avoidance of a Transfer to a Non Insider Under § 547(b). A transfer to any party may be avoided by the trustee under § 547(b) if the same elements discussed above are met except that the transferee need not be an insider and the transfer must have been made within ninety days of the petition. For transfers on or within ninety days, the debtor is presumed to be insolvent. 11 U.S.C. § 547(f).

Avoidance of a Fraudulent Transfer Under § 548(a). Section 548(a) of the Bankruptcy Code allows a trustee to avoid transfers infected by either actual fraud or constructive fraud. *BFP v. Resolution Trust Corp.*, 114 S.Ct. 1757, 1760 (1994). The trustee must show each element of such voidable transfers by a preponderance of the evidence. *Brown v. Third National Bank (In re Sherman)*, 67 F.3d 1348, 1353 (8th Cir. 1995). If the trustee makes a *prima facie* case, the burden of going forward with evidence may shift to the debtor or creditor involved in the transfer to prove some "legitimate supervening purpose" for the transfer at issue. *Acequila, Inc. v. Clinton (In re Acequila, Inc.)*, 34 F.3d 800, 806 (9th Cir. 1994); *First National Bank in Anoka v. Minnesota Utility Contracting, Inc. (In re Minnesota Utility Contracting, Inc.)*, 110 B.R. 414, 418-20 (D. Minn. 1990).

Under § 548(a)(1), a trustee may avoid a transfer if the

debtor transferred property within one year of his petition and if the debtor made the transfer with the actual intent to hinder, delay, or defraud present or future creditors. Because actual proof to hinder, delay, or defraud rarely is established by direct evidence, fraudulent intent may be inferred from the circumstances surrounding the transfer. *Sherman*, 67 F.3d at 1353. To determine whether circumstantial evidence establishes fraudulent intent, courts look to see whether any "badges of fraud" are present. *Id.*

The presence of a single badge of fraud is not sufficient to establish actual fraudulent intent; however, "the confluence of several can constitute conclusive evidence of actual intent to defraud, absent 'significantly clear' evidence of a legitimate supervening purpose."

Id. (quoting *Max Sugarman Funeral Home, Inc. v. A.D.B. Investors*, 926 F.2d 1248, 1254-55 (1st Cir. 1991) (quote therein omitted)).

The badges of fraud to consider include whether:

- (1) the transfer or obligation was to an insider;
- (2) the debtor retained possession or control of the property transferred after the transfer;
- (3) the transfer or obligation was disclosed or concealed;
- (4) before the transfer was made or 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;
- (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.

Id. at 1354 (citing Mo.Rev.Stat. § 428.024(2); S.D.C.L. § 54-8A-4(b)).¹¹

CONCLUSIONS OF LAW.

Debtor Shannon O'Malley made several transfers within one year of his petition that must be considered: (1) the transfer of 155 shares of Deer Park stock to John O'Malley in December 1993; (2) the transfer of 65 shares of Deer Park stock to Larry O'Malley in December 1993; (3) the transfer of 90 shares of Deer Park stock to Marty O'Malley in December 1993; and (4) the transfer of \$100,000.00 in restitution to the State of South Dakota on December 15 and 16, 1993. Of these four transfers, only the latter transaction is a preference voidable by the Trustee.¹²

The Court concludes that Debtor Shannon O'Malley's transfers of Deer Park stock to Larry, Marty, and John O'Malley in December 1993 are *not* voidable preferences. Instead, these transfers were sales of stock. Although Larry's and John's original agreement to provide restitution money for Shannon O'Malley did not contemplate

¹¹ These badges of fraud, which originated in the common law, are set forth in the Uniform Fraudulent Transfer Act. Both Missouri, the state from which the *Sherman* decision arose, and South Dakota have adopted it.

¹² Trustee Lovald has not sought recovery of the Deer Park stock that was transferred in December 1993 on the grounds that the original certificates have not been delivered to Larry, Marty, or John O'Malley. See S.D.C.L. § 57A-8-309.

a sale of stock, Shannon O'Malley intended their deals to be sales on December 3, 1993 when he transferred the stock certificates to them. Larry and John O'Malley also soon considered the deals to be sales when they acknowledged the transfers on their 1993 federal income tax returns. While a meeting of minds may not have occurred on the same day, the transfers of stock were recorded in corporate records at approximately the same time as John and Larry O'Malley produced their cashier's checks and John and Larry O'Malley acknowledged the transfers for the restitution money within a month or so thereafter. That time frame creates a substantially contemporaneous exchange under § 547(c)(1). Further, the consideration each gave for his shares was reasonable when compared to other sales of Deer Park stock by Shannon O'Malley that year. Finally, the transfers also were recognized timely in Shannon and Carmelita O'Malley's and Deer Park's tax returns for 1993 and 1994. Therefore, under §547(c)(1), these transfers are excepted from the voidable preference provision of § 547(b).

Debtor Shannon O'Malley's transfer of the \$100,000.00 in restitution is a voidable preference. The elements of § 547(b) are present. All \$100,000.00 was Debtor Shannon O'Malley's personal property when the transfers to the state were made on December 15 and 16, 1993. Debtors' personal funds were used for the \$5,000.00 in bond money and the \$10,000.00 cashier's check that was applied toward the restitution. The remaining \$85,000.00 became part of Shannon O'Malley's personalty when he exchanged the money from John and Larry O'Malley for his Deer Park stock in early

December 1993. Shannon O'Malley's transfers of the \$100,000.00 in restitution to the State on December 15 and 16, 1993 was within ninety days of the March 14, 1994 petition date.¹³ The transfers were for the benefit of the creditors listed on the attachment to the Judgment of Conviction and would have given those creditors preferential treatment over Debtors' other creditors. Finally, Debtor Shannon O'Malley was insolvent at the time based on the presumption provided by 11 U.S.C. § 547(f). There was no evidence to the contrary.

The O'Malleys Defendants' earmarking theory fails because the funds supplied by John O'Malley and Larry O'Malley became Shannon O'Malley's property when Shannon O'Malley transferred Deer Park stock to them in early December. This changed the original nature of their agreements from a loan or gift to a sale. Shannon O'Malley no longer held the funds in "trust" or in a "fiduciary capacity" for payment of the restitution to creditors. *McCuskey v. National Bank of Waterloo (In re Bohlen Enterprises, Inc.)*, 859 F.2d 561, 555-56 (8th Cir. 1988). Further, a diminution of the estate occurred when the Deer Park stock was transferred. *Id.* at 566. No equitable principles dictate an application of the earmarking doctrine in this case. *Id.* at 567. Voiding this transfer will not produce an "unjust enrichment" to Debtors or others. *Id.*; see also *Buckley v. Jeld-Wen, Inc. (In re Interior*

¹³ That the restitution funds passed through Shannon O'Malley's criminal attorney's trust account has no relevancy. The law firm was not a necessary party to this action. See F.R.Bankr.P. 7019 and F.R.Civ.P. 19.

Wood Products Co.), 986 F.2d 228, 231-32 (8th Cir. 1993) (earmarking doctrine is not applicable where one creditor is not substituted for another).

The Court also is satisfied that a restitution payment may be subject to a trustee's avoidance action. See *Babitzke v. Mantelli (In re Mantelli)*, 149 B.R. 154, 156 (9th Cir. BAP 1993) (citing *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 557-60 (1990)); *Zimmerman v. Itano Farms, Inc. (In re Currey)*, 144 B.R. 490 (Bankr. D. Id. 1992); *Becker V. Sacramento County (In re Hackney)*, 83 B.R. 20 (Bankr. N.D. Ca. 1988); *Bakst v. Atlantic National Bank (In re Kayajanian)*, 27 B.R. 711 (Bankr. S.D. Fla. 1983). Further, "new value" under 547(a)(2) was not created for the estate because Debtor Shannon O'Malley avoided jail by paying the restitution. *Babitzke*, 149 B.R. at 157-58.

Larry, John, and Marty O'Malley's cross claim against Attorney General Barnett must fail based on this same conclusion. Larry and John O'Malley lost any interest they had in the restitution money when they exchanged their contributions for Deer Park stock from Shannon O'Malley. Therefore, these O'Malleys are not entitled to a return of the restitution funds Shannon O'Malley paid to the state through the Attorney General's office.

There are two other transfers at issue in this case that must be addressed by the Court because the parties have tried them by implied, if not express, consent: Shannon O'Malley's transfer of 90 shares of Deer Park stock to Marty O'Malley on February 21, 1993 and Shannon O'Malley's transfer of 500 shares of Deer Park stock to

Marty O'Malley purportedly on June 30, 1991.

Under F.R.Civ.P. 15(b) [F.R.Bankr.P. 7015], "when issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings." An amendment of a complaint is to be granted liberally "where necessary to bring about the furtherance of justice and where the adverse party will not be prejudiced." *McLaurin v. Prater*, 30 F.3d 982, 985 (8th Cir. 1994) (quoting *Corsica Livestock Sales v. Sumitomo Bank of California*, 726 F.2d 374, 377 (8th Cir. 1983)). Implied consent can be found where evidence on the issue specifically was introduced and where no objection to that introduction was made. *Corsica Livestock Sales*, 726 F.2d at 377. However, a court is not required to amend a complaint at trial on the basis of some evidence that would be relevant to the new claim if the same evidence also was relevant to a claim originally pled. *Gamma-10 Plastics, Inc. v. American President Lines, Ltd.*, 32 F.3d. 1244, 1256 (8th Cir. 1994). "The introduction of such evidence does 'not provide the defendant any notice' that the implied claim was being tried." *Id.* (quoting therein *Pariser v. Christian Health Care Systems, Inc.*, 816 F.2d 1248, 1253 (8th Cir. 1987)).

In this adversary proceeding, Trustee Lovald first raised the suspicious nature of Shannon O'Malley's transfers of Deer Park stock in Count III of his complaint. Most important, both parties introduced testimony and exhibits regarding Shannon O'Malley's transfers of Deer Park stock to Marty O'Malley in June 1991 and

February 1993. The O'Malley Defendants even called John Michalek, Deer Park's present manager, to relay his opinion on Marty's involvement with the golf course in the summer of 1991. This evidence was not relevant to the Trustee's other claims. The only related objection by the O'Malley Defendants was to questions regarding Marty O'Malley's present net worth and assets -- matters not material to the alleged 1991 transfer. Finally, both parties addressed the June 1991 and February 1993 transfers in their closing briefs. Accordingly, the validity of Shannon O'Malley's purported transfers of stock to Marty O'Malley in June 1991 and February 1993 was tried by implied consent and Plaintiff-Trustee's complaint shall be deemed amended to conform to this evidence.

Just like Shannon O'Malley's transfers of Deer Park stock to Larry, John, and Marty O'Malley in December 1993, the Court concludes that the February 1993 transfer of 90 shares from Shannon O'Malley to Marty O'Malley was a bona fide sale that the Trustee cannot avoid. The consideration Marty O'Malley gave for these 90 shares is reasonable when compared to Shannon O'Malley's other sales in December 1993 to Marty, Larry, and John O'Malley. The cashier's check that Marty O'Malley gave his father for the 90 shares was credible evidence that Marty O'Malley gave adequate consideration for these shares on or near the date the stock certificate was issued.

The transfer of 500 shares from Shannon O'Malley to Marty O'Malley, however, will be voided by the Court. There is no credible evidence that Marty O'Malley obtained a legitimate

interest in Deer Park when Charlene Faust sold it in 1991. As discussed below, all the objective evidence points to the contrary and leads the Court to conclude that Shannon O'Malley was the sole purchaser of Deer Park in 1991, that Marty O'Malley did not give valuable consideration for the 500 shares that Shannon transferred to him, and that the transfer occurred after Shannon O'Malley was indicted on March 14, 1994. Debtor Shannon O'Malley's attempt to put the majority interest of Deer Park in Marty O'Malley's hands was a fraudulent act to keep the asset in the family but away from Debtors' creditors and shall be voided under § 548(a)(1).

First, the PURCHASE AGREEMENT between Marty O'Malley and Shannon O'Malley regarding ownership of the 300,000 shares of Equitas stock is not binding on third parties when considering its impact on Deer Park stock ownership. The PURCHASE AGREEMENT was never made a lien or other encumbrance of record on the Deer Park corporate records so as to put anyone on notice that Marty O'Malley claimed an interest in the original 1,000 shares issued to Shannon O'Malley. See, e.g., S.D.C.L. §§ 57A-8-304.

Second, there is no documentary evidence that Marty O'Malley ever owned the \$75,000.00 in furniture and "appraised precious gemstones" that the PURCHASE AGREEMENT lists as his consideration for the one-half interest. Further, there is no objective evidence that Marty O'Malley actually transferred this \$75,000.00 worth of property to Shannon O'Malley or the seller of the Equitas stock.

Third, prior to his criminal conviction and this bankruptcy action, Shannon O'Malley was responsible for many documents that

said he was the sole purchaser of Deer Park in 1991:

(1) The CONTRACT FOR SALE OF [Deer Park] STOCK is between Shannon O'Malley and Charlene Faust only. The CONTRACT FOR SALE OF STOCK states Shannon O'Malley is the sole owner of the 145,500 share of Equitas stock being transferred. An attachment to the CONTRACT FOR SALE OF STOCK states Shannon O'Malley and his son Marty own more than 145,500 share but it does not state that Marty has any interest in the 145,500 shares being transferred to Charlene Faust. The CONTRACT FOR SALE OF STOCK is not ambiguous; there is no need to resort to parol evidence to interpret the contract. *Van Dyke v. Coburn Enterprises, Inc.*, 873 F.2d 1094, 1102 (8th Cir. 1989); *Farmers Mutual Hail Insurance Co. v. Fox Turkey Farms*, 301 F.2d 697, 699 (8th Cir. 1962); *Jensen v. Pure Plant Food International, Ltd.*, 274 N.W.2d 261, 263-64 (S.D. 1979).¹⁴

(2) Deer Park corporate meeting minutes dated March 1, 1991 indicate Shannon O'Malley is the sole stockholder.¹⁵

(3) A 1991 liquor license application indicates Shannon O'Malley is the sole owner of Deer Park stock.

(4) A 1992 liquor license renewal application states there has been no change in ownership from the original application.

(5) Shannon and Carmelita O'Malley's personal federal income tax return for 1991 does not acknowledge any transfer of 500 shares of Deer Park stock to Marty O'Malley.

¹⁴ The parol evidence rule does not dictate that Shannon and Marty O'Malley's December 22, 1990 PURCHASE AGREEMENT be excluded. The PURCHASE AGREEMENT may stand as a contemporaneous contract that does not cover the same ground as the CONTRACT FOR SALE OF STOCK between Shannon O'Malley and Charlene Faust. *Farmers Mutual Hail Insurance Co. v. Fox Turkey Farms*, 301 F.2d 697, 699-700 (8th Cir. 1962). However, by its own terms, the CONTRACT FOR SALE OF STOCK was not modified by the PURCHASE AGREEMENT. The PURCHASE AGREEMENT was not made a part of the CONTRACT FOR SALE OF STOCK.

¹⁵ If Marty O'Malley was a half-owner and active principal of Deer Park from the spring of 1991 as he and his father claim, then it also could be argued that Marty O'Malley waived that interest when he and his father failed to acknowledge Marty's interest in Deer Park's March 1991 corporate minutes, 1991 and 1992 applications to the Nebraska Liquor Control Commission, and 1991 and 1992 federal income tax returns. See *Hammerquist v. Warburton*, 458 N.W.2d 773, 778 (S.D. 1990). The information set forth on the applications and tax returns was inconsistent with any interest now claimed by Marty O'Malley. *Id.* Marty O'Malley has not argued that Deer Park's minutes, applications, or returns were prepared without his full knowledge of material facts. *Id.*

(6) Deer Park's original federal income tax return for 1991 indicates Shannon O'Malley was the sole stockholder in 1991.

(7) Deer Park's original federal income tax return for 1992 indicates Shannon O'Malley and Robert Fritz were the only stockholders in 1992.

Fourth, Shannon O'Malley did not advise his and Deer Park's accountant of any 1991 or 1993 transfers of Deer Park stock to family members until early in 1994.

Fifth, all the stock certificates that set forth 1991 or 1993 transfers to Marty, John, or Larry O'Malley appear to have made at the same time. The corporate records were in the exclusive possession and control of Shannon O'Malley. None of the certificates for these transfers has been acknowledged as received by these transferees.

Sixth, if the transfer of 500 shares to Marty O'Malley in 1991 was legitimate, Marty would have received those shares for consideration equal to only \$40.00 per share. The average consideration paid per share for all other transfers of Deer Park stock in 1991 and 1993 is \$350.15.

Finally, Shannon O'Malley is not a credible witness on matters involving Deer Park and Equitas stock: He has felony convictions for selling unregistered securities. See F.R.Evid. 609(a). These convictions involved Equitas and Go Unified stock, among others. His testimony in this case (from his schedules, to the § 341 meeting, to his answer, and to the trial) has been inconsistent, and his answers to questions at the trial were often incomplete and evasive. Marty O'Malley's testimony regarding his interest in Deer Park also is not credible. He too changed his story about the Deer

Park stock from the time of his answer to the date of trial. He too gave answers that were often incomplete and evasive. Therefore, the Court, with its opportunity to observe these witnesses' demeanor and manner of testifying, is not obligated to accept their testimony as true, even those portions that are not rebutted by other testimony or exhibits. See *Iola State Bank v. Coberly (In re Coberly)*, 20 B.R. 557, 560 (Bankr. D. Kan. 1982); *Crilly v. Morris*, 19 N.W.2d 836, 840 (S.D. 1945).

Moreover, if Shannon O'Malley's and Marty O'Malley's testimony were believed, then Debtors and Marty O'Malley would be admitting that Debtors filed false federal personal income tax returns in 1991 and 1992, that Shannon O'Malley filed false applications in 1991 and 1992 with the Nebraska Liquor Control Commission, and that Shannon O'Malley did not set forth truthfully the buyer's warranties in the CONTRACT FOR SALE with Charlene Faust. All these prior acts and documents are, in essence, admissions contrary to Debtors' and Marty O'Malley's positions at trial. See *Auto-Owners Insurance Co. v. Jensen*, 667 F.2d 714, 722 (8th Cir. 1981); *Harmon v. Christy Lumber Co.*, 402 N.W.2d 690, 692 (S.D. 1987). The Court will not permit the O'Malleys to now minimize or obviate these prior, public representations that they made regarding Deer Park ownership. See *Maitland v. University of Minnesota*, 43 F.2d 357, 364 (8th Cir. 1994) (estoppel is an equitable doctrine to be given effect when necessary to accomplish justice); *Federal Land Bank of Omaha v. Houck*, 4 N.W.2d 213, 218-19 (S.D. 1942) (doctrine of quasi or equitable estoppel applies where it would be unconscionable to

allow a person to maintain a position inconsistent with a prior position from which he benefitted). Debtors and Marty O'Malley offered no explanations for these inconsistent prior positions. See *Kennedy v. First State Bank of Wall*, 149 N.W. 168, 170 (S.D. 1914); *Sweeney v. Hewett*, 148 N.W. 503, 504 (S.D. 1914).

The Trustee has proved all elements of § 548(a)(1) by a preponderance of the evidence. As the objective evidence discussed above establishes, the transfer of 500 shares of Deer Park stock from Shannon O'Malley to Marty O'Malley was made within one year of the March 14, 1994 petition date, not in June 1991, as Debtors and Marty O'Malley claim. Finally, Shannon O'Malley made the transfer with an actual intent to defraud his present creditors as shown by several badges of fraud that are present:

(1) Shannon O'Malley transferred the stock to his son Marty O'Malley, an insider as defined by 11 U.S.C. § 101(31)(a);

(2) Shannon O'Malley has retained possession and control of Deer Park. He remained President of the corporation, as set forth in his January 10, 1994 letter to his accountant, after all the stock transfers. There is no evidence that Marty O'Malley presently plays an active role at Deer Park;

(3) Shannon O'Malley did not disclose the transfer timely, even to his and Deer Park's accountant;

(4) In 1993, when Shannon O'Malley transferred the stock, he was under indictment for selling unregistered securities. His conviction could jeopardize Deer Park's liquor license if he continued to be the majority stockholder of record;

(5) As discussed above, Shannon O'Malley did not receive adequate consideration for the 500 shares of Deer Park that he transferred to Marty O'Malley;

(6) Shannon O'Malley transferred the 500 shares to Marty O'Malley shortly before or shortly after he (Shannon) negotiated a plea agreement on the criminal charges against him. The plea agreement required a substantial cash outlay by Shannon O'Malley.

These badges of fraud, coupled with the Court's conclusion that Shannon O'Malley's and Marty O'Malley's testimony on the Deer Park stock transfers was not credible, convinces the Court that Debtor Shannon O'Malley's transfer of 500 shares of Deer Park stock to Marty O'Malley is voidable as a fraudulent transfer under § 548(a)(1). *Sherman*, 67 F.3d at 1355.

Trustee Lovald shall prepare an appropriate proposed judgment. The proposed judgment shall include a dismissal of the cross claim against Attorney General Barnett.

Dated this 1st day of December, 1995.

BY THE COURT:

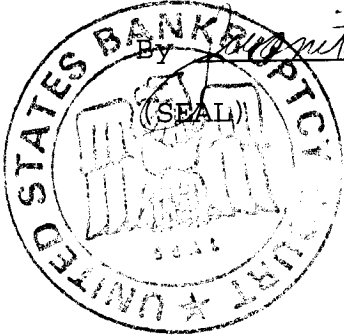


Irvin N. Hoyt
Chief Bankruptcy Judge

ATTEST:

CHARLES L. NAIL, JR., CLERK

By *Charles L. Nail, Jr.*
Deputy Clerk



NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

DEC 01 1995

Clerk
U.S. Bankruptcy Court, District of S.D.

CERTIFICATE OF SERVICE

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to those creditors and other parties in interest identified on the attached service list.

U.S. Bankruptcy Clerk
District of South Dakota

By: *CL*
Date: 12-1-95

Case: 94-03007 Form id: 122 Ntc Date: 12/01/95 Off: 3 Page : 1
Total notices mailed: 6

Plaintiff Lovald, John S. Box 66, Pierre, SD 57501

Defendant O'Malley, Shannon P. 1012 Lamro, PO Box 724, Winner, SD 57580

Defendant O'Malley, Carmelita Loray 1012 Lamro, Box 724, Winner, SD 57580

Aty Johnson, Rick PO Box 149, Gregory, SD 57533

Aty Kern, Janine Assistant Attorney General, 500 E. Capitol, Pierre, SD 57501

Intereste U.S. Trustee, Shrivvers Square, Suite 502, 230 S. Phillips Avenue, Sioux Falls, SD 57102