IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

Central Division

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In re	:	Bankruptcy No. 78-00743 78-00744
EDWIN R. HEAPS, ELAINE M. HEAPS,	:	
Bankrupts.	:	
NANN NOVINSKI-DURANDO, Trustee,	:	MEMORANDUM DECISION AND ORDER
Plaintiff,	:	
vs.		
EDWIN R. HEAPS, ELAINE M. HEAPS, MELVYN R. HEAPS,		
Defendant		

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Nann Novinski-Durando, Salt Lake City, Utah, plaintiff. Pete N. Vlahos and Ronald W. Perkins, Vlahos and Knowlton, Ogden, Utah, for defendants. Heard June 27, 1979.

This action was brought to recover title to real property located at 1549 West 70th South, West Jordan, Salt Lake County, Utah (the property). The trustee alleges that the transfer of the property to defendant Melvyn R. Heaps (Melvyn) was fraudulent under section 67d(2)(a) or (c) of the Bankruptcy Act, former 11 U.S.C. §107d(2)(a) or (c).

FACTS

On March 15, 1978, Edwin R. and Elaine M. Heaps (the bankrupts) conveyed, by quitclaim deed, all rights, title and interest in the property to their son, Melvyn. The quitclaim deed was recorded in Utah on May 30, 1978. On August 10, 1978, the bankrupts filed their petitions in bankruptcy.

The terms of the transfer of the property by the bankrupts to Melvyn were as follows:

1) Melvyn assumed payment of the first mortgage (approximately $25,000.00 remaining to be paid);

2) Melvyn was to pay the property taxes if the bankrupts were unable to do so;

3) The bankrupts were to continue to maintain the property;

4) The bankrupts were to continue making payments on the second and third mortgages;

5) The bankrupts were to have the right to live on the property for the remainder of their lives.

Edwin Heaps testified that these terms had been embodied in a written agreement; however, the written agreement was not produced for the Court's consideration.

At the time of the transfer, the balance owing on the first mortgage was $24,619.56. The combined balance owing on the second and third mortgages was in excess of $10,600.00. The value of the property at the time of the transfer was estimated at trial to have been $62,000.00.

At the time of the transfer, the bankrupts owed approximately $10,760.00 in unsecured debts. About $5,400.00 of that amount was due to their co-signature on a note owed by a second son, Allen, who, on May 18, 1978, filed a petition in bankruptcy. Another $2,468.00, approximately, of the unsecured debt was due to a debt of $10,468.01, of which about $8,000.00 was secured by the bankrupts' automobiles. Edwin Heaps testified at trial that after the transfer of the property, he and his wife had not sufficient remaining property which could be sold to meet their aggregate obligations.

No debts were incurred by the bankrupts after the transfer in question although during the summer of 1978, the bankrupts, according to testimony of Elaine Heaps, were unable to pay their bills. At the time of the transfer, the bankrupts had no idea that Allen would file for bankruptcy, leaving them with responsibility to pay his debt. Payment on the co-signed note was first demanded of the bankrupts sometime in the middle of the summer of 1978, subsequent to the transfer in question. This demand for payment first prompted the thought of filing for bankruptcy.

ISSUES

The transfer is attacked as fraudulent under section

67d(2)(a) or (c) of the Bankruptcy Act, former 11 U.S.C. §107d(2)(a) or (c). Section 67d(2)(c) requires proof of an intent or a belief by the debtor that he will, after the transfer, incur debts beyond his ability to pay as such debts mature. The issue on this claim is, therefore, whether or not the bankrupts had such an intent or belief.

The trustee's principal ground for setting aside the transfer is, however, the claim under section 67d(2)(a). This section initially requires that the allegedly fraudulent transfer occur within a year prior to the filing of the bankruptcy petition and that creditors exist at the time of the transfer. The facts show that these requirements have been met. The remaining issues to be resolved under the section 67d(2)(a) claim, then, are whether or not the bankrupts were, at the time of the transfer, insolvent, or rendered insolvent thereby, and whether or not fair consideration was paid to them by their son Melvyn.

THE SECTION 67(d)(2)(c) CLAIM

The trustee alleged in her trial memorandum that the bankrupts had the intent to, or the belief that they would, incur debts beyond their ability to pay as such debts matured. However, no evidence was presented by the trustee at trial directly on this issue. The Court must, therefore, resolve the issue from the other facts of the case and the inferences to be drawn from them.

The salient facts are that the bankrupts incurred no debts after the transfer in question although during the summer of 1978 they were unable to pay existing obligations. Elaine Heaps testified that this inability arose because of the waiting period for receipt of initial social security/disability retirement benefits. Edwin Heaps testified that he had begun disability retirement in late April of 1978 upon the order of his doctor, although at the time of the March 15, 1978 transfer to Melvyn, he had been uncertain that he would have to do so. Elaine Heaps' testimony indicated that with the

combination of her own salaried income and Edwin Heaps' prospective benefits, they anticipated having, after the transfer in question and after Edwin Heaps' retirement, more expendable income than they had had before these events occured. This was due to the assumption of payment by Melvyn of the first mortgage on the transferred property and the assumption of most of the monthly payments on the $10,468.00 obligation by a disability insurer.

Further, the bankrupts did not contemplate bankruptcy until after they learned that they would have to pay the note defaulted upon by Allen. They learned of their responsibility to pay this obligation, as well as of Allen's bankruptcy, several months after the March 15, 1978 conveyance. Moreover, though the actual date of the transfer, in accordance with section 67d(5), must be deemed to have been May 30, 1978, the date the deed was recorded, the facts indicate that the bankrupts, even at that time, did not intend to or believe that they would incur debts beyond their ability to pay as such debts matured. The Court concludes that the defendants prevail upon the trustee's section 67(d)(2)(c) claim.

THE SECTION 67d(2)(a) CLAIM

In order to meet the requirements of section 67d(2)(a), insolvency and a lack of fair consideration must be proved. As previously noted, the other requirements of section 67d(2)(a) are indisputedly present.

Insolvency

Insolvency, under section 67d(1)(d) of the Bankruptcy Act, is deemed to have occurred when the present fair value of the debtor's property is not sufficient to pay his debts. According to Farmers Bank of Clinton, Missouri v. Julian 383 F.2d 314 (8th Cir.), cert. denied, 389 U.S. 1021 (1967), this is a "balance sheet" test. In Julian, the court held that the test of insolvency within the meaning of the Bankruptcy Act was whether liabilities exceeded assets, not whether the debtor was able to meet current obligations.

Edwin Heaps admitted at trial that after the transfer of the property to Melvyn, he and his wife had not

sufficient property left which could be sold to pay all of their obligations. As the Court must apply the "balance sheet" test for insolvency, the defendants' argument that the bankrupts were, at the time of the transfer, able to meet current obligations, is irrelevant.

Whether or not the bankrupts' obligation arising from the co-signature of Allen's loan should be considered "contingent" is also immaterial. "Debts" under section 67d(1)(d) is defined by section 1(14) of the Bankruptcy Act, generally, as any debt provable in bankruptcy. Section 63(8) expressly includes contingent debts among those debts provable in bankruptcy.

Finally, although section 67d(1)(d) does not state whether property fraudulently transferred is to be excluded from the aggregate of the debtor's salable property for purposes of adjudging solvency or insolvency, the language ". . . or will thereby be rendered insolvent . . ." of section 67d(2)(a) appears to answer this question in the affirmative. This result is supported in 4 COLLIER ON BANKRUPTCY §67.32, at 499 (14th ed. 1978): "Section 67d is clear that insolvency resulting from the <u>transfer under attack</u> is sufficient in every case where insolvency is at all material under the subdivision."

The trustee has met her burden of persuasion on the issue of the bankrupts' insolvency. The transfer of the property rendered the bankrupts, by their own admission, insolvent within the meaning of the Bankruptcy Act.

<u>Fair Consideration</u>

Section 67d(1)(e)(1) of the Bankruptcy Act requires two elements for a finding of fair consideration: (1) a good faith transfer; and (2) receipt by the transferor of a "fair equivalent" for the transferred property. A lack of good faith has not been alleged, but whether or not the bankrupts received a "fair equivalent" for the transferred property has been brought squarely in issue.

The federal cases dealing with the issue of fair consideration, or a "fair equivalent," are not numerous. Schafer v. Hammond, 456 F.2d 15 (10th Cir. 1972), does, however, provide a benchmark on this issue. The Schafer court, in deciding a claim under section 67d(2)(a) of the Bankruptcy Act, held that a conveyance of real property valued at $18,000.00 for a consideration of $10,000.00 was not for fair consideration. Thus, on the Schafer facts, 56 percent of the value of real property was insufficient to constitute a "fair equivalent" within the meaning of section 67d(1)(e)(1).

In her trial memorandum, the trustee cites Kindom Uranium Corporation v. Vance, 269 F.2d 104 (10th Cir. 1959) in support of her contention that fair consideration was not paid in the case at bar. The court in Vance, however, concluded that shares with no established value plus satisfaction of an antecedent debt, the existence of which was questionable, amounted to a consideration essentially without substance and, hence, not fair consideration. Since in Vance, no consideration was paid, it is of little aid in determining fair consideration within the context of the facts before the Court. Here, whether or not Melvyn's agreement to pay the first mortgage on the bankrupts' home is a fair consideration or "fair equivalent," it represents, nonetheless, a substantial amount.

The trustee makes reference to several state court fraudulent conveyance cases in support of her case as well. In Zuniga v. Evans, 87 Utah 198, 48 P.2d 513 (1935), the Court held that fair consideration had not been paid where there was only a recital of $10.00 consideration in the conveying instrument and where the trial court reasonably disbelieved testimony concerning additional consideration paid. The trustee's reliance on Zuniga is misplaced.

The trial court disbelieved all testimony concerning additional consideration; it did not, as the trustee appears to have concluded, hold, in effect, that $2,375.00 was not fair consideration for land worth $3,550.00.

Cooper v. Cooper, 22 Tenn. App. 473, 124 S.W.2d 264 (1938), is cited by the trustee for the proposition that an agreement to pay a $320.00 judgment, to care for the grantor for the remainder of her life and to pay her funeral expenses was not fair consideration for land valued at $750.00. The $320.00 judgment, however, was against one of the grantor's sons. Payment of the judgment, therefore, accrued to the benefit of a third party, not to the benefit of the grantor. Further, although the deed in question specified that the grantor was to be able to spend her remaining years on the land transferred, two tracts of land were listed on the deed. The facts showed that the grantor continued to live on one of the tracts, but it was the other tract of land which the court valued at $750.00. No valuation was made as to the tract upon which the grantor continued to live.

The court in Cooper did not expound upon its reasons for finding that a fair consideration had not been paid; the court may have disregarded the payment of the $320.00 judgment because the benefit did not, in fact, accrue to the grantor. Similarly, the court may have disregarded the grantee's promise to care for the grantor for the rest of her life, at least in relation to the $750.00 property, as the grantor was clearly not living on that tract.

The trustee uses Cooper to bolster her contention that an executory promise cannot be considered a "fair equivalent" for transferred property. For the reasons stated above, however, the case provides, at most, questionable support for this contention. The trustee cites additional support in 4 COLLIERS ON BANKRUPTCY §67.33, at 512 (14th ed. 1978). The treatise, however, also cites cases holding the opposite,

noting that if the transferee is solvent and his promise is enforceable, "[i]t seems doubtful that a transfer to him in exchange for his promise should be held to be necessarily and automatically without fair consideration, especially where the promise has been partially or totally fulfilled in good faith and the creditors have profited by a reduction of their debtor's obligations." Id. at 513.

The trustee takes the position that Melvyn's promises will not be of benefit to the creditors of the bankrupts. It would seem, however, that the creditors of the bankrupts would derive some benefit from Melvyn's promise to pay the first mortgage on the property in that, if fulfilled, it reduces the amount of debt the bankrupts must pay. According to the trial testimony, Melvyn has already, in fact, partially fulfilled his promise to pay. The question of whether or not an executory promise can be a "fair equivalent" would appear then, to be a question determined by the facts of each case.

Of the trustee's other cited state cases, only Hulsether v. Sanders, 54 S.D. 412, 223 N.W. 335 (1929), addresses directly the issue of fair consideration. In Hulsether, a town lot had been conveyed to the grantor's son. The son agreed to pay the $6,000.00 mortgage on the property and to support the grantor for the remainder of his life. The land at issue was valued at $15,000.00. The transfer involved was held to be made without fair consideration. It was also held that the transfer had been made with a fraudulent intent.

Hulsether involved facts similar to the case at bar. Hulsether, however, involved fraudulent intent. Here, the trustee has proved no such intent. Had there been no finding of fraudulent intent in Hulsether, the result there might have been different. Therefore, its precedential value is questionable.

The inconclusiveness of the plaintiff's cases is mirrored by the cases relied upon by the defendants.

The defendants cite Utah Assets Corporation v. Dooley Brothers, 92 Utah 577, 70 P.2d 738 (1937), and Given v. Lambeth

10 Utah 2d 287, 351 P.2d 959 (1960), in support of their case. Dooley Brothers held that a conveyance of property valued at approximately $12,500.00 was made for fair consideration where a $10,000.00 debt was satisfied in return. The court stated that an exact equivalent was not required, only a fair equivalent, i.e., the price for which a willing seller would sell and a willing buyer would buy.

The consideration paid in Dooley Brothers amounted to 80 percent of the property's fair market value. For Dooley Brothers to be of aid to the defendants, Melvyn's consideration to the bankrupts must reasonably be deemed to approach that degree of equivalence. The only ascertained consideration in the case at bar is the approximately $25,000.00 Melvyn has agreed to pay the bankrupts in terms of making the payments on the property's first mortgage. The value of the property at issue was $62,000.00 at the time of the transfer to Melvyn. Clearly, there exists here no corresponding degree of equivalence with the facts in Dooley Brothers.

The defendants cite Given v. Lambeth, supra, at least in part, for the proposition that the love and affection a parent has for his children is adequate consideration, absent a fraudulent intent, to support a conveyance to a child. Part of the consideration in Given, however, was the services of the transferees in helping their father operate a family sheep business. No value was place by the Court on these services, nor was a value placed on the properties conveyed in Given. In any event, defendants' contention concerning love and affection of a parent for his children would seem inapplicable to the case at bar. The bankrupts did not transfer the property at issue because of their love and affection for Melvyn. They transferred their home to him to ensure that if Edwin R. Heaps had to retire for reasons of disability, they would not lose their home. Given, hence, is of scant value in determining whether or not a "fair equivalent" has been paid in the case at bar.

Defendants' other cases deal with the issue of fraudulent intent, an issue not addressed at trial by the trustee.

In summary, the cases and authority cited by both sides shed some light on the issue of "fair consideration" or a "fair equivalent." However, with the exception of Kindom Uranium Corporation v. Vance, supra, the trustee's and defendants' cases deal with state fraudulent conveyance law. As the case at bar falls under the Bankruptcy Act, it raises questions of federal law. State cases then, provide guidance only insofar as their reasoning is persuasive and their interpretation of fraudulent conveyances is identical with the federal standard. Because of this, Schafer v. Hammond, supra, is the only case of direct precedential significance to this proceeding. The question remaining, therefore, is whether or not the consideration paid by Melvyn to the bankrupts for the property at issue meets the Schafer standard.

At trial, the value of the property at the time of transfer to Melvyn was estimated to have been $62,000.00. The trustee's witness based his estimate upon the value of similar homes in the area surrounding the property at issue, deducting from that value the amount of appreciation which statistically should have occured between the time of the transfer to Melvyn and the time of the witness' appraisal. Cross-examination of the trustee's witness revealed that the property might have been worth as little as $54,000.00 at the time of the transfer in the "worst case". The preponderance of the evidence supports the higher figure. The Court finds that the fair market value of the property at the time of the transfer to Melvyn was $62,000.00

Whether or not the bankrupts were paid a "fair equivalent", though, depends upon the extent of the bankrupts' ownership of the property at the time of the transfer. The equity, in other words, of the bankrupts must be determined by subtracting the amount remaining to be paid on all mortgages from $62,000.00. In making this calculation, the Court must

ignore the first mortgage on the property, as that amount represents, ostensibly, Melvyn's consideration to the bankrupts. Assuming, arguendo, that Melvyn was legally bound by his agreement with the bankrupts to pay the first mortgage, only the amount remaining to be paid on the second and third mortgages, something in excess of $10,600.00 at the time of the transfer, should be subtracted from the $62,000.00 market value.

Subtracting the amount still owed on the second and third mortgages at the time of the transfer to Melvyn, the bankrupts may be deemed to have had an equity at transfer of approximately $51,000.00. Melvyn's consideration of about $25,000.00 was, then, less than 50 percent of the bankrupts' equity. It will be recalled, however, that the Schafer court did not accept as a "fair equivalent" a consideration of 56 percent of the value of the property transferred. On the present facts, the Court accepts the Schafer standard and concludes that unless Melvyn gave consideration beyond his agreement to pay the first mortgage of approximately $25,000.00, Melvyn's consideration for the transfer was not a "fair equivalent".

As additional consideration, the defendants contend that they retained a life estate in the transferred property. The defendants' position stems from Melvyn's agreement to allow them to live on the property for the remainder of their lives. The defendants contend, in effect, that a value should be placed upon this "right" of the bankrupts and that the value affixed should be added to Melvyn's consideration of $25,000.00. The position of the defendants is, however, not well-founded.

A bankrupt's interest in property is to be determined by the law of the state where the property is situate. See In Re Ved Elva, Inc., 260 F. Supp. 978 (D.N.J. 1966). Although, apparently, no Utah case has directly treated the requirements for the creation of a life estate, there exists

case law in other states which does treat the subject. In Cassina v. Jones, 340 P.2d 482 (Okla. 1959), it was held that a life estate can be created only by a deed, a will, a lease, or a written contract. In Cannon v. Harris, 166 P.2d 998 (Kan. 1946), the court held that a parol agreement allowing the plaintiff to live on certain property as long as she lived did not create a life estate in her, but rather, something less than a life estate. It was further held that the plaintiff had no power to dispose of such an interest, and that, were she to cease living on the property, her right to do so would similarly cease.

The record in the case at bar contains only a copy of the bankrupts' quitclaim deed to Melvyn. The deed contains no reservation of a life estate. While trial testimony indicated that the agreement between the bankrupts and Melvyn had been embodied in written form contemporaneously with the deed, the written agreement, as previously stated, has never been produced. As no convincing evidence has been introduced to support the allegation of a written agreement, the Court concludes that the "reservation" of a life estate in the bankrupts was, at most, an oral one. As such, the rule in Cannon, which decision appears to follow the common law rule, applies here. Whatever remained of the bankrupts' interest in the transferred property was something less than a life estate, being incapable of disposition by the bankrupts, unprotected by recordation, ill defined and undocumented. The value of such an interest on the evidence before the Court is nil.

Melvyn's consideration of $25,000.00 must, therefore, stand or fall of its own weight. It is clear from Schafer that without more, it must fall.

CONCLUSION

The Court finds that Melvyn's consideration for the property at issue was, at most, approximately $25,000.00

which is less than 50 percent of the value of the bankrupts' equity in the property transferred to Melvyn. In light of Schafer, Melvyn's consideration was not a "fair equivalent" within the meaning of Section 67d(1)(e)(1) of the Bankruptcy Act. Thus, the transfer was fraudulent under Section 67d(2)(a), and the trustee is entitled to recover the property. Accordingly, the transfer must be set aside and the property must be included in the estate of the bankrupts subject to valid mortgages thereon, and, in accordance with Section 67d(6) of the Bankruptcy Act, subject to repayment to Melvyn of such amounts as he has, to date, paid on the first mortgage on the property.

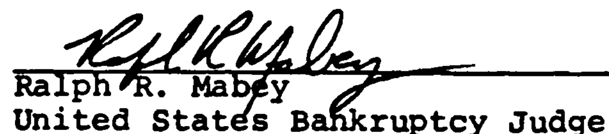
ORDER

1. The foregoing constitutes the Court's findings of fact and conclusions of law required by Rule 752, Fed.R. Bankr.P.

2. The plaintiff-trustee shall prepare judgment in accordance with this memorandum decision.

3. The bankrupts may amend their bankruptcy schedules to assert their homestead exemptions in the subject property.

DATED this 26 day of September, 1980.



Ralph R. Mabey
United States Bankruptcy Judge