UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:

DeParcq, Hunegs, Stone,
Koenig & Reid, P.A.,

Debtor.

ORDER GRANTING PARTIAL SUMMARY JUDGMENT

BKY. 4-92-7077

Brian F. Leonard, Trustee,

Plaintiff,

vs.

ADV. 4-92-353

Hunegs, Stone, Koenig & Reid, P.A.,
Richard G. Hunegs, Ralph E. Koenig
and Peter W. Riley,

Defendants.

At Minneapolis, Minnesota, .

This adversary proceeding came on for hearing on January 26, 1993, on the plaintiff's motion for partial summary judgment. Brian F. Leonard, the plaintiff, appeared in propria persona, Robert J. Tansey and Robert T. Kugler appeared on behalf of the defendants(FN1) and Jonathan S. Parritz appeared on behalf of Norman Perl. This court has jurisdiction pursuant to 28 U.S.C. Sections 1134 and 157(a) and Local Rule 201. This is a core proceeding within the meaning of 28 U.S.C. Section 157(b)(2)(H).

UNDISPUTED FACTS

1. In 1979, authorities began investigating the debtor's and in particular, Norman Perl's representation of clients who claimed personal injuries resulting from the use of the Dalkon Shield. At the time of the investigation the debtor had three shareholders each owning 2,000 shares or one third of the debtor's shares. The shareholders were Norman Perl, Donald Rudquist and Richard G. Hunegs.

(FN1). The plaintiff's complaint against defendant Peter W. Riley has been settled and dismissed. I will refer to remaining defendants simply as "the defendants."

2. On February 1, 1987, Rudquist died.

3. On June 19, 1987, the Minnesota Supreme Court suspended Perl from the practice of law for one year, retroactive to August 1, 1986.

4. On July 13, 1987, Hunegs purchased an additional 2,100 shares of the debtor's stock increasing his ownership interest in the debtor to fifty-one percent (51%).

5. On July 22, 1987, Perl's employment with the debtor was terminated.

6. On August 3, 1988, Pearl commenced a lawsuit against the debtor to redeem his stock.

7. On October 19, 1989, the Hennepin County District Court, in a lawsuit by Rudquist's widow, ordered the debtor to redeem Rudquist's stock. Rudquist's stock was redeemed by the debtor. judgment against the debtor in the amount of $2,725,325.58 representing, at least, part the value of his 2,000 shares of the debtor's stock.

9. On June 10, 1991, Richard G. Hunegs as president of the debtor, notified its shareholders of a shareholders' meeting called for June 17, 1991, to consider a voluntary dissolution pursuant to Minnesota Statutes section 302A.741. Hunegs and Perl were the only remaining shareholders.

10. On June 11, 1991, a Certificate of Incorporation was issued for the corporation of Hunegs, Stone, Koenig & Reid, P.A.

11. On June 11, 1991, the debtor transferred its pension plan to HSK&R substituting it as the "employer" under the plan.

12. On June 17, 1991, dissolution of the debtor was approved by Hunegs and a Notice of Intent to Dissolve was filed with the Minnesota Secretary of State.

13. On June 18 1991, or shortly thereafter, HSK&R began using the all the assets of the debtor occupying the debtor's office, using the same furniture, fixtures, equipment, law library, working on the same client files and employing the same employees. No consideration was given for the assets including the client files or the retainer agreements. No clients executed new retainer agreements until after January 1, 1992.

14. On July 1, 1991, the Perl judgment was entered.

15. On July 8, 1991, the Hennepin County District Court granted the debtor's petition for voluntary dissolution and appointed a receiver.

16. On November 27, 1991, Richard Hunegs, Ralph Koenig & Peter Riley and HSK&R filed an involuntary chapter 7 against the debtor.

17. On December 5, 1991, the debtor's receiver converted the case to a chapter 11 case.

18. On April 8, 1992, the court converted the case back to a chapter 7 case and the plaintiff was appointed trustee.

19. On January 20, 1993, an order was entered approving a settlement between Peter W. Riley and the plaintiff and an order was entered dismissing the plaintiff's claims against Peter W. Riley.

20. On January 28, 1993, an order was entered approving a settlement between the defendants and plaintiff with respect to the debtor's furniture, fixtures, equipment, and library and an order was entered dismissing the plaintiff's claims against the defendants with respect to the debtor's furniture, fixtures, equipment, and library.

21. Also on January 28, 1993 an order was entered granting the defendants partial summary judgment and dismissing the plaintiff's claim for turnover of the debtor's profit sharing plan.

DISCUSSION

I.

The Standard for Summary Judgment

Under Rule 56(c) of the Federal Rules of Civil Procedure, summary judgment is proper "if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c).(FN2) "The plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden of proof at trial." Celotex, 477 U.S. at 322.

A. The Burdens

1. The Moving Party

Initially, the burden is on the party seeking summary judgment. It is the moving party's job to inform the court of the basis for the motion, and identify those portions of "the pleadings, depositions, answers to interrogatories, and admissions on file, together with affidavits, if any, which it believes demonstrate the absence of a genuine issue of material fact. Celotex, 477 U.S. at 324. Simply stated, the moving party must show the court that there is an absence of evidence to substantiate the non-moving party's case. Id. at 325. To that end, the movant discharges its burden by asserting that the record does not contain a triable issue and identifying that part of the record which supports the moving party's assertion. See Id. at 323; City of Mt. Pleasant, 838 F.2d at 273.

(FN2). Pursuant to Rule 7056 of the Federal Rules of Bankruptcy Procedure, "Rule 56 Fed. R. Civ. P. applies in adversary proceeding[s]." See Fed. R. Bankr. P. 7056.

2. The Non-moving Party

Once the movant has made its showing, the burden of production shifts to the non-moving party. The non-moving party must "go beyond the pleadings and by [its] . . . own affidavits, or by the 'depositions, answers to interrogatories, and admissions on file,'" establish that there is specific and genuine issues of material fact warranting a trial. Celotex, 477 U.S. at 324 (quoting Fed. R. Civ. P. 56(c)). The non-moving party cannot cast some metaphysical doubt on the moving party's assertion. Matsushita Elec. Indust. Co., Ltd. v. Zenith Radio Corp., 475 U.S. 574, 586 (1986). The non-moving party must present specific significant probative evidence supporting its case, Johnson v. Enron Corp., 906 F.2d 1234, 1237 (8th Cir. 1990) sufficient enough "to require a . . . judge to resolve the parties' differing versions of the truth at trial." Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986) (quoting First National Bank of Arizona v. Cities Service Co., 391 U.S. 253, 288-89 (1968)). Any affidavits must "be made on personal knowledge, must set forth such facts as would be admissible in evidence, and shall affirmatively show that the affiant is competent to testify to the matters stated therein." Fed. R. Civ. P. 56(e) (emphasis added). If, however, the evidence tendered is "merely colorable," or is "not significantly probative," the non-moving party has not carried its burden and the court must grant summary judgment to the moving party. Id. at 249-50.

II.

The Transfer of all Going Concern Assets as a Fraudulent Transfer

The plaintiff argues that the record is replete with facts demonstrating that the debtor's going concern assets were fraudulently transferred. I agree with the plaintiff; no specific and genuine issues of material fact exist warranting a trial and the plaintiff is entitled to partial summary judgment as a matter of law.

A. Is the Transfer of all the Debtor's Assets Avoidable Under Section 548(a)(1)?

Section 548, in relevant part, provides:

> (a) The trustee may avoid any transfer of an interest of the debtor in property . . . that was made . . . on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily --
>
> (1) made such transfer . . . with actual intent to hinder, delay or defraud any entity to which the Debtor was or became, on or after any date that such transfer was made, . . . indebted.

11 U.S.C. Section 548(a)(1). Thus, to avoid the transfer, the plaintiff must prove that:

> (1) there was a transfer of the debtor's interest in property;
>
> (2) made on or within a year preceding the filing of the petition;

(3) while the debtor was insolvent; with
(4) the actual intent to hinder or delay or defraud;
(5) an entity which was a creditor or became a creditor, on or after any date that such transfer took place.

Id.

1. Was There a Transfer of the Debtor's Interest in Property?

The defendants have repetitively taken the position that the debtor had no interest in client files and other assets. While that argument has some appeal on a micro level, looking at the transaction as a whole, the argument fails. What was really transferred was the debtor's entire going concern; the corporate intangible and tangible assets as a whole. On June 18, 1991, a new corporation, HSK&R, P.A., started to operate. While in form HSK&R was a new corporation, in substance it was not. HSK&R as an operating unit arose directly out of the going concern assets of the debtor. In substance, HSK&R was the same as the debtor. HSK&R occupied the debtor's office space, used the same furniture, fixtures, equipment and law library. HSK&R consisted of substantially all the same employees from the debtor and maintained all the debtor's clients.(FN3) The only significant difference between the debtor and HSK&R was their respective financial condition. Indeed, HSK&R was financially a much stronger entity than the debtor. HSK&R had the advantage of all of the debtor's assets while jettisoning all its liabilities. Simply, the debtor was left holding the bag allowing HSK&R and its shareholders to evade any liability and to reap all benefits from the debtor's going concern assets.

The defendants have repetitively and strenuously argued throughout this proceeding that the client files cannot be considered an asset of the debtor. Section 481.14 of Minnesota Statutes provides:

> When an attorney shall refuse to deliver money or papers to a person from or from whom the attorney had received then in the course of professional employment, the attorney may be required to do so upon petition, by an order of court . . .

Minn. Stat. Section 481.14 (1992). The plain language of section 481.14 tells me that the attorney must give back every the attorney received from the client. The statute does not mention documents generated by the attorney. The implication of the specific exclusion is that the attorney has an ownership interest in its work papers, the client does not. Thus, the plain language is clear: the attorney does have a real ownership interest in client

(FN3). While one client file has "no intrinsic value," collectively 1,200 open personal injury files form a valuable asset; a prosperous law firm.

files.

More importantly, the debtor's clients were transferred. The retainer agreements with these client were valuable assets and the essence of the debtor's business. The clients' rights to terminate the employment arrangement may affect the value of the debtor's business, but it certainly did not render the business valueless. All of the debtor's assets including clients, files, physical assets and intangible assets such as good will and "blue sky" were transferred to the defendants.

Therefore, I conclude that there was a transfer of all of the debtor's property.

2. Was the Transfer Within a Year Before the Original Petition was Filed?

Clearly, the transfer was within one year of the petition. On June 18, 1991 HSK&R was up and running with all of the debtor's assets. Five months later, on November 27, 1991, an involuntary chapter 7 petition was filed against the debtor.

3. Was the Debtor Insolvent at the Time of the Transfer? A professional corporation is insolvent when:

> (a) . . . [the] financial condition[] [is] such that the entity's debts is greater than all of such entity's property, . . . , exclusive of --
> (i) property transferred, concealed or removed with intent to hinder, delay, or defraud creditors . . .

11 U.S.C. Section 101(32)(A). This test has been met. Deposition testimony and record facts establish that the debtor was saddled with debt and had few if any assets. To be exact, as of June 11, 1992 the debtor had $6,235,853.99 in liabilities which included Perl's $2.7 million judgment. Admittedly, the debtor could not satisfy this judgment. Further aggravating the debtor's solvency, section 101 excludes those assets which were transferred. Thus, the value of the client files was not considered. Therefore, without argument, debtor was insolvent at the time of the transfer or at least rendered insolvent as a result of the transfer.

4. Was There Actual Intent to Hinder or Delay or Defraud a Creditor?

The trustee has again met his burden. The fraudulent intent at issue for purposes of section 548(a)(1) is the debtor's intent. In re Anchorage Marina, Inc., 93 B.R. 686, 691 (Bankr. D. N.D. 1988). Where the debtor is a law firm, the intent of those individuals making decisions for the law firm is presumed to be the debtor's intent. In re Otis & Edward, P.C., 115 B.R. 900, 920 (Bankr. E.D. Mich. 1990). Here, the individual defendants controlled a majority of the voting rights of the debtor. Therefore, the defendants' intent for purposes of section 548(a)(1) was the debtor's intent. See, In re Anchorage Marina, 93 B.R. at 691.

However, direct evidence of an actual intent to hinder, delay or defraud is virtually impossible to obtain. Courts recognize this insurmountable task gleaning intent from inferences drawn from the debtor's course of conduct. Specifically, courts have traditionally relied on "badges" or "indicia of fraud" to presume fraudulent intent. Max Sugarman Funeral Home v. ADB Investors, 926 F.2d 1248, 1254 (1st Cir. 1991); In re Warner, 87 B.R. 199, 202 (Bankr. M.D. Fla. 1988); In re Breuer, 68 B.R. 48, 51 (Bankr. N.D. Iowa 1985). Common indicia of fraudulent intent include:

> (1) a relationship between the debtor and the transferee;
> (2) lack of consideration for the conveyance;
> (3) insolvency and indebtedness of the debtor;
> (4) the transfer of the debtor's entire estate; and
> (5) pendency or threat of litigation at the time of the transfer.

Max Sugarman Funeral Home, Inc, 926 F.2d at 1254; In re Warner, 87 B.R. at 202; In re Fitzpatrick, 73 B.R. 655, 657 (Bankr. W.D. Mo.), aff'd in part and rev'd in part on other grounds, 60 B.R. 808 (W.D. Mo. 1985).

While the presence of a single indicia of fraud may spur mere suspicion, the presence of several can constitute "conclusive evidence" of an actual intent to defraud, absent "significant clear" evidence of a legitimate supervening purpose. Max Sugarman Funeral Home, Inc., 926 F.2d 1255. In this case, there is "conclusive evidence" of an actual intent to defraud. Indeed, the debtors conduct is laden with badges of fraud.

The relationship between the parties was clearly incestuous. The officers and directors of the debtor and the transferee are virtually identical. This single identity provided a convenient transfer vehicle to both the debtor and HSK&R. Indeed, the debtor's insiders had the absolute corporate authority to convey all the going concern assets to the insiders of HSK&R without interference. Enjoying the incestuous relationship, HSK&R gave no consideration for the transfer at a time in which the debtor was insolvent. The defendants having failed to provide significantly clear evidence of a legitimate supervening purpose, I am left with only one conclusion; the debtor transferred its going concern assets with the actual intent to defraud creditors. See also U.S. v. Gleneagles Inv. Co., Inc., 565 F.Supp. 556, 580 (M.D. Penn. 1983)(citation omitted), aff'd U.S. v. Tabor Court Realty Corp., 803 F.2d 1288 (3rd Cir. 1986) (a court may infer an intent to hinder, delay, or defraud creditor where a transferor and the transferee have knowledge of the claims of creditors, know that these creditors cannot be paid and transfer corporate assets for no consideration).

Going beyond the badges of fraud, there can be no doubt that the transfers have had the actual effect of hindering and delaying the collection efforts of Perl. As a result of the Perl judgment obtained May 22, 1991 the defendants took several tactical offensive moves. The first was the incorporation of HSK&R on June 11, 1991. Once a new corporate form was established, the defendants, with the approval of a majority of the debtor's shareholders,(FN4) brought a state court action to dissolve the debtor.(FN5) With dissolution underway, the debtor transferred, all of its going concern assets to the new corporate form, HSK&R. With the assets successfully out of the reach of Perl, HSK&R began

(FN4). Getting approval of a majority of the debtor's shareholders was a mere technical formality; Hunegs was the majority shareholder.

(FN5). Dissolution was not the only alternative.

operations. Frankly, the defendants have never really denied that the purpose of their actions was to thwart collection by Perl.

5. Was a Creditor Defrauded, Delayed or Hindered by the Actions Taken by the Defendants?

Perl was a creditor of the debtor both before and after the transfers. See 11 U.S.C. Section 101(5) & (10).

6. Conclusion.

The transfer of all of the debtor's going concern assets to HSK&R is avoidable under 11 U.S.C. Section 548(a)(1).

B. Is the Transfer of the Debtor's Assets Avoidable Under Section 548(a)(2)?

Section 548(a)(2), in relevant part, provides:

> (a) The trustee may avoid any transfer of an interest of the debtor in property . . . that was made . . . on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily --
>
> (2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (B)(i) was insolvent on the date that such transfer was made . . . or became insolvent as a result of such transfer
>
> . . .

11 U.S.C. Section 548. Thus, to avoid the transfer, the trustee must prove that:

> (1) there was a transfer of the debtor's interest in property;
> (2) made on or within a year preceding the filing of the petition;
> (3) while the debtor was insolvent; and
> (4) the debtors received less than reasonably equivalent value in exchange for the transfer.

First Nat'l Bank in Anoka v. Minnesota Utility Contracting, Inc. (In re Minnesota Utility Contracting, Inc.), 110 B.R. 414, 417 (D. Minn. 1990) aff'g 101 B.R. 72 (Bankr. D. Minn. 1989). Since the first three have been previously discussed, the question becomes, did the debtor receive reasonably equivalent value in exchange for all the assets of the debtor corporation. Here the plaintiff has met its burden. The defendants have not raised any triable issues of material fact.

Throughout the case and in these papers the defendants have never asserted that the debtor received reasonably equivalent value. It is undisputed that the debtor has not received any value for its going concern assets. While at times there has been oblique references to paying off bank lines and trust accounts nothing indicates that the debtor received reasonably equivalent value. The evidence is all to the contrary. Since the debtor did not receive any value for the assets transferred, the transfers are avoidable pursuant to section 548(a)(2).

III.

Remedy

While section 548 provides for the avoidance of fraudulent transfers, section 550 deals with remedies available to the trustee after avoidance. The issue of the appropriate remedy will be one of the issues to be taken up at the trial scheduled to begin on February 8, 1993.

THEREFORE, IT IS ORDERED:

1. The plaintiff's motion for partial summary judgment is granted; and

2. The transfer of all the debtor's assets to Hunegs, Stone, Koenig and Reid, P.A. is void.

ROBERT J. KRESSEL
CHIEF UNITED STATES BANKRUPTCY JUDGE