UNITED STATE BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re

STEVEN ANDERSON and
MARY ANDERSON,

Debtors.

Case No. 01-33143

Chapter 7

ANDREW N. HERBACH, TRUSTEE,

Plaintiff,

v.

PHYLLIS ANDERSON,

Defendant.

Adversary No. 02-2163

MEMORANDUM DECISION ON DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

This matter came before the court upon the defendant's motion for summary judgment seeking dismissal of the action under Fed. R. Bank. P. 7056. This court has jurisdiction over the parties to and the subject matter of this proceeding pursuant to 28 U.S.C. § 1334 and 28 U.S.C. § 157. This is a core proceeding as defined in 28 U.S.C. § 157(b)(2)(A), (F), (H), and (O). For the reasons stated below, the motion will be denied, and the case will proceed to trial.

BACKGROUND

On May 22, 2000, the defendant loaned $25,000 to Insurance Associates of America (IAA), a Wisconsin limited liability company. The sole members of the LLC were her son and

daughter-in-law, Steven and Mary Anderson. According to the defendant, she issued the loan on the condition that if the loan was not repaid on demand, she would have the option to acquire a 99% equity interest in IAA. On June 8, 2000, only 17 days after the loan was made, the defendant purportedly made demand for repayment. In response, the LLC caused her to acquire a 99% interest in IAA. The defendant further alleged that she subsequently advanced another $100,000 in loans to IAA in order to keep the company in business.

The debtors, Steven and Mary Anderson, filed their chapter 7 petition on November 20, 2001. On April 18, 2002, the trustee filed the instant complaint to recover a preferential or fraudulent transfer. After the defendant moved for summary judgment, the parties had an opportunity for additional discovery and fully briefed the matter.

ARGUMENTS

The defendant, Phyllis Anderson, contends the transaction which occurred was the issuance of an interest in a limited liability company by the company itself, not the assignment of an interest owned by one of its members. Therefore, she loaned nothing to the debtors and the debtors transferred nothing to her, and the entire basis for each of the trustee's claims – all of which assume a transfer of property of the debtors either in payment of a debt of the debtors or a transfer for inadequate consideration – is without evidentiary, factual or legal foundation. Furthermore, assertions made by the trustee are inadequate to contest the motion for summary judgment.

The trustee contends the debtors transferred their interest in a limited liability company to the defendant within one year of the debtors' petition,[1] making the transfer avoidable as a preference under 11 U.S.C. § 547. The complaint further seeks judgment on the basis that the transfer is voidable and fraudulent pursuant to both 11 U.S.C. § 548(a) and state law, which applies to the trustee under 11 U.S.C. § 544(b).

DISCUSSION

The defendant's motion for summary judgment may be granted if she shows "there is no genuine issue as to any material fact and that [the defendant] is entitled to a judgment as a matter of law." Fed. R. Bankr. P. 7056.

The bankruptcy estate only succeeds to such title and rights in property that the debtor held as of the commencement of the case. *In re Carousel Int'l Corp.*, 89 F. 3d 359, 362 (7th Cir. 1996). State law determines the debtors' property interest. *Jones v. Atchison*, 925 F.2d 209 (7th Cir. 1991). To determine whether a transfer may have diminished what the creditors would have received absent the transfer, the court must first determine "what" may have been transferred and whether it constitutes an asset that might otherwise have been part of the debtors' estate.[2]

The limited liability company is a form of business entity which offers legal advantages of both a corporation and a partnership. Like shareholders of a corporation, investors of an LLC

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[1]As discussed below, the timing of the relevant transactions is disputed.

[2]Property subject to the preferential transfer provision is that property which would have been part of the estate had it not been transferred before the commencement of the case. *See generally Warsco v. Preferred Tech. Group*, 258 F.3d 557, 564 (7th Cir. 2001).

enjoy limited liability. However, the LLC can qualify for taxation as a partnership[3] under subchapter K of the Internal Revenue Code. *See* Wis. Stats. § 183.0304; I.R.C. §§ 701, 702. Therefore, depending on the context, reference to both partnership and corporate law may be helpful as these types of entities may be analogous to an LLC under certain circumstances. Each member of an LLC has an "interest" in the LLC, which represents both a financial stake in the LLC's profits and losses and the right to receive distributions. *See* Wis. Stats. §§ 183.0503, 183.0601. This interest differs from the member's broader governance rights, which include the member's right to participate in management and control of operations and to inspect the books and records of the LLC. *See* Wis. Stats. § 183.0401, et seq.

A debtor's membership interest in an LLC constitutes property of the estate.[4] *In re Garrison-Ashburn, L.C.*, 253 B.R. 700, 707-08 (Bankr. E.D. Va. 2000) (holding that "[s]ection 541(a) clearly encompasses all of [the debtor-member's] interest in [the LLC], whatever that interest may be, whether economic or non-economic"); *Matter of Daugherty Construction, Inc.*,

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[3]The IRS has issued rulings stating that LLCs meeting certain criteria will be taxed as partnerships and not as corporations. *See* Revenue Ruling 88-76, 1988-2 Cumulative Bulletin 360; Revenue Procedure 95-10 (Jan. 1995); Treasury Notice 95-14 (Mar. 1995).

[4]According to Wis. Stats., §§ 183.0802(1)(d)2 and 183.0901, the bankruptcy of an LLC's member results in the dissociation of that member and dissolution of the LLC, unless the business of the LLC is continued by the consent of all the remaining members or is otherwise provided for in writing in the LLC's operating agreement. However, bankruptcy law likely prevents the termination of a member's interest in an LLC upon the bankruptcy of the member, notwithstanding the state law provisions or the LLC's operating agreement to the contrary. *See Matter of Daugherty*, 188 B.R. 607, 611 (Bankr. D. Neb. 1995) (holding that "[a]s a matter of overriding federal law, the LLCs and the debtor's interest therein continue[d] to exist notwithstanding the debtor's bankruptcy filing").

Another bankruptcy court found "for the purpose of analyzing the effect of a member's bankruptcy upon the continued exercise of membership rights, it seems most appropriate to treat the relationship among members of a limited liability company as analogous to that of that [sic] among the partners of a partnership." *In re DeLuca*, 194 B.R. 65, 74 (Bankr. E.D. Va. 1996).

188 B.R. 607, 611 (Bankr. D. Neb. 1995) (holding that the debtor's interest in the LLCs, and its rights under the LLC Articles and Agreements constituted property of the bankruptcy estate); *see also* 11 U.S.C. § 541; Wis. Stats. § 183.0703. Therefore, if the debtors' interest in the LLC is less at the time of bankruptcy than it was before the transaction in question, the transaction may be subject to avoidance as a "transfer."

Because a member has no direct interest in the specific assets owned by an LLC, a creditor of a member cannot seize any of the LLC's property in satisfaction of the member's debt.[5] *See* Wis. Stats. § 183.0701. If the LLC dissolves, the debtor-member is entitled to receive, after the claims of the LLC's creditors have been satisfied, a liquidating distribution from the LLC. *See* Wis. Stats. § 183.0905. If the LLC does not dissolve when a member terminates his or her interest, the member is generally entitled to receive a withdrawal distribution from the LLC. This distribution would be equal to the value of the member's interest at the time of the withdrawal. *See* Wis. Stats. § 183.0604. These are rights that would flow to a creditor executing on a judgment or to a bankruptcy trustee succeeding to the debtor's interest. Whether this would be of any value to the creditor or trustee would, of course, depend on the value of the entity, but that is not an issue ripe for decision on summary judgment.

The documents evidencing the transactions at issue are as follows:

• Copies of two personal checks from Phyllis C. Anderson to the order of IAA, dated May 20, 2000. Check no. 764 in the amount of $11,000 was deposited in IAA's account at

[5]A judgment creditor of a member may apply to a court and obtain a charging order against the member's interest in the LLC. *See* Wis. Stats. § 183.0705. To the extent the member's interest is charged, the judgment creditor has only the rights of an assignee of the member's interest, i.e., the creditor garnishes the financial rights that attach to the interest but does not run the business of the entity. *Id*.

M&I Northern Bank on July 1, 2000. Check no. 765 in the amount of $14,000 was deposited in IAA's account at M&I Northern Bank on May 23, 2000. (Exhibit 1001 to Affidavit of Steven D. Anderson in support of summary judgment).

• A letter dated May 22, 2000, from Steven D. Anderson, managing member of IAA, to Phyllis Anderson stating:

> This letter is to confirm our conversation in regards to the loan you are making to Insurance Associates of America, LLC.
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> In consideration of the money that you are lending Insurance Associates of America, LLC and with the financial condition of the LLC, you are hereby given the following option at your discretion; you may demand immediate repayment of the loan and if Insurance Associates of America, LLC fails to make said payment you may convert that loan into no less than 99% of the percentage equity of Insurance Associates of America, LLC. Upon receipt of written notice as to your demand to have loan paid, Insurance Associates of America, LLC will either pay the loan in full or give to you documentation of your no less than 99% equity interest in the entire LLC.
>
> (Exhibit 1002).

• A memorandum dated June 8, 2000, from Phyllis Anderson to IAA regarding money loaned, demanding "immediate payment in full by the end of business today." (Exhibit 1003).

• A letter dated June 8, 2000, from Steven D. Anderson, managing member of IAA, to Phyllis Anderson stating: "Insurance Associates of America, LLC does not have the money to pay the loan so therefore pursuant to our agreement I am tendering to you this day the 99% of the percentage equity of Insurance Associates of America, LLC." (Exhibit 1004).

• An unsigned Consent Resolution of the Members of IAA dated June 8, 2000 (modified from June 8, 2001, by handwriting over the typed date), authorizing the issuance of a 99% membership interest in the company to Phyllis Anderson in exchange for the contribution of the outstanding loan to the company. Pursuant to the resolution, the membership of the company subsequently consisted of Phyllis Anderson with a 99% ownership, Steven Anderson with a .99% ownership, and Mary Anderson with a .01% ownership. (Exhibit 1005).

The timing and legitimacy of these transfers is disputed by the trustee, issues that are critical to any recovery that may be available to the trustee. The trustee points out in his brief that the debtor, Steven Anderson, and his counsel in a subsequent state court proceeding[6] made a number of representations to the state court regarding the disposition of his equity interest in IAA:

> THE COURT: So she [Phyllis Anderson] loaned IAA $25,000, and there was a default – You at that time were the sole shareholder, Mr. Anderson, for the purposes of our discussion here this morning?
> MR. ANDERSON: Yes, Your Honor.
> THE COURT: So in essence, you gave the stock back to your mother in exchange for what will –
> MR. ANDERSON: Yes. She had the right as collateral to – I'm sorry.
> THE COURT: Do you have anything to demonstrate that having occurred legally?
> ~~MR. ANDERSON~~ MR. FLEMING [Steven Anderson's counsel]: No, Your Honor.

The trustee argues the above exchange implies that the documents evidencing the transfer of membership interest in the LLC to Phyllis Anderson did not originate as of the dates claimed by the debtor, Steven Anderson, in his affidavit in support of the defendant's motion for summary

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[6] *Anderson, Draves, Polaski & Smith v. Insurance Associates of America*, Waukesha County, Wisconsin, Case No. 00-CV-001323; hearing held March 30, 2001.

judgment. Mr. Anderson states that the defendant was granted her interest on June 8, 2000, and that is the handwritten date on the consent resolution, but his statement in court indicates that this was not done as of March 2001. If the debtor's version is accepted, the transfer of stock was more than one year before filing; if the typed date is accepted, it is within one year. As this has implications in both the preference and fraudulent transfer contexts, it is clearly material and in dispute, making it a matter for trial.

While the defendant argues that quoting the court transcript in the trustee's brief is not adequate to put facts in dispute, this court holds that it is. No mandatory form or procedure must be followed to put facts in dispute, other than the rule that the opposing party cannot rely merely on the pleadings. *Celotex Corp. v. Catrett*, 477 U.S. 317, 324-25 (1986). There is no assertion that the exchange did not take place in court as quoted, and an attached certified transcript, or something similarly official, would convey no more information. The format used by the trustee, while somewhat truncated, is sufficiently reliable to put an important material fact in dispute.

It is also possible that no transfer or acquisition of ownership by the defendant occurred at all, which might entitle the trustee to declaratory relief that the entire membership interest of the LLC is property of the estate. It is unknown whether the LLC operating agreement had a prohibition or condition on transfers[7] of membership interest because the agreement was not included in the evidence before the court. If the LLC did not have an operating agreement, then state law would determine how the LLC's affairs are or were conducted. When a person obtains

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[7]The transaction has not been analyzed as an "assignment" of the debtor's membership interest pursuant to Wis. Stats. § 183.0704 because the debtors did not transfer their interests; the LLC issued the interest in itself. *See also* Wis. Stats. § 183.0706 (consent of other members necessary for assignment).

an interest in an LLC directly from the entity, it is necessary that the acquisition be "upon the consent of all members *and* on the effective date of the person's admission as reflected in the records of the limited liability company maintained under s. 183.0405(1)." Wis. Stats. § 183.0801(2)(a) (emphasis added). The consent resolution purportedly establishing the defendant's interest is unsigned, so even if the debtors consented, the records of the company may be inadequate to meet the statutory requirements of acquiring an interest. If the interest was not properly acquired under state law, it may also have implications under federal tax law. Under the Department of Treasury's regulations, for the purchaser of an interest in an LLC to acquire the interest in a bona fide transaction, and to be recognized as a member of the LLC for federal tax purposes, the purchaser must have dominion and control over the interest. *See* 26 C.F.R. § 1.704-1(e)(1)(iii).[8] A transfer of an interest in an LLC is not recognized if the transferor retains such incidents of ownership that the transferee has not acquired full and complete ownership of the LLC interest. *Id*.

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[8]The regulation provides as follows:

> A donee or purchaser of a capital interest in a partnership is not recognized as a partner under the principles of section 704(e)(1) unless such interest is acquired in a bona fide transaction, not a mere sham for tax avoidance or evasion purposes, and the donee or purchaser is the real owner of such interest. To be recognized, a transfer must vest dominion and control of the partnership interest in the transferee. The existence of such dominion and control in the donee is to be determined from all the facts and circumstances. A transfer is not recognized if the transferor retains such incidents of ownership that the transferee has not acquired full and complete ownership of the partnership interest. Transactions between members of a family will be closely scrutinized, and the circumstances, not only at the time of the purported transfer but also during the periods preceding and following it, will be taken into consideration in determining the bona fides or lack of bona fides of the purported gift or sale. ...

26 C.F.R. § 1.704-1(e)(1)(iii).

Assuming the defendant acquired an interest in IAA as alleged, the defendant asks that the court find as a matter of law that there was no preference and fraudulent conveyance that occurred incident to the acquisition. To avoid a transaction under either theory, there has to have been a "transfer" of the debtor's interest in an asset.

Section 547(b) permits the trustee to avoid the transfer of an interest of the debtor in property –

> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made –
> (A) on or within 90 days before the debtor of the filing of the petition; or
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
> (5) that enables such creditor to receive more than such creditor would receive if –
> (A) the case were a case under chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b); *see generally In re O'Connell*, 119 B.R. 311 (Bankr. M.D. Fla. 1990) (finding transfer of interest of debtor in partnership and partnership property was preference).

The defendant claims that her acquiring an interest in the LLC from the LLC does not constitute a transfer of an interest of the individual debtors. They transferred or assigned nothing to the debtor-husband's mother in their individual capacity. However, no rocket science need be applied to discern that before the consent resolution the debtors had 100% ownership and the defendant had no interest in the LLC, but after the consent resolution, the defendant owned almost all of it and they retained almost none of it. They and they alone caused this result. No property or act of any outside party was involved. The fact that they were acting in their

representative capacity does not change the fact that they controlled the change in ownership of an asset that would have been property of the debtors' estates. Despite the defendant's protestations to the contrary, "[m]ere circuity of arrangement will not save a transfer which effects a preference from being invalid as such." *Dean v. Davis*, 242 U.S. 438, 443 (1917). As the concept of "transfer" under 11 U.S.C § 101(54)[9] is to be viewed expansively, including an indirect act resulting in parting the debtor from his or her property, the record at this point in the proceedings is sufficient to preclude summary judgment for the defendant on the issue of whether a transfer took place. The debtors indirectly transferred their interest in the LLC.

It is also uncontested that the defendant forgave, or satisfied, a $25,000 debt of the LLC in conjunction with this transfer. It does not appear that the debtors were personally liable for the debt. However, their property clearly was, as their interest in IAA took a sharp reduction when the debt was satisfied, and a "[']claim against the debtor[']includes a claim against property of the debtor." 11 U.S.C. § 102(2). Therefore, it appears from the record as it exists at this point that the transfer satisfied a claim against the debtor. Genuine issues of fact also exist as to whether the debtors were insolvent at the time of the transfer. Additionally, we do not know whether the transfer enabled the defendant to receive more than she would have received in the debtors' chapter 7 case. Thus, whether or not this transfer may be avoided as a preference is a matter for trial.

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[9]The Code defines a "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." 11 U.S.C. § 101(54).

Just as there are sufficient material facts in dispute for trial of the preference issue, material facts are also in dispute with respect to the fraudulent transfer issues. Section 548(a) permits the trustee to avoid a transfer of the debtor if the debtor "made such transfer ... with actual intent to hinder, delay, or defraud" or "received less than a reasonably equivalent value" or "was insolvent ... or became insolvent as a result of such transfer." 11 U.S.C. § 548(a). This section only applies to transfers that occurred within one year of filing. 11 U.S.C § 548(a)(1). The timing of the transaction is a material act that is in dispute and must be determined at trial. Genuine issues of fact also exist regarding the debtors' intent and the fair market value of the interest transferred. Although the defendant asserts in her brief she invested funds in an insolvent LLC, there has been no evidence presented regarding the value of the LLC. Also, since she alleges she received almost full ownership in the company in exchange for her $25,000 loan 17 days earlier, an inference of some value may be warranted.

Section 544(b) permits the trustee to avoid a transfer that is voidable for fraud under applicable state law. The trustee contends the transfer should be set aside as a fraudulent conveyance under Wis. Stats. §§ 242.04 and 242.05. Pursuant to Wis. Stats. § 242.04(1):

> A transfer made or obligations incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> (a) With actual intent to hinder, delay or defraud any creditor of the debtor; or
>
> (b) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> 1. Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or

2. Intended to incur, or believed or reasonably should have believed that the debtor would incur, debts beyond the debtor's ability to pay as they became due.

Wis. Stats. § 242.04(1).[10]

Section 242.04(2), Wis. Stats., in turn, sets forth a list of non-exclusive factors to consider in determining actual intent under sub. (1)(a): (a) the transfer or obligation was to an insider; (b) the debtor retained possession or control of the property transferred after the transfer; (c) the transfer or the obligation was disclosed or concealed; (d) before the transfer was made or the obligation was incurred, the debtor had been sued or threatened with suit; (e) the transfer was of substantially all of the debtor's assets; (f) the debtor absconded; (g) the debtor removed or concealed assets; (h) 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; (i) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred; (j) the transfer occurred shortly before or shortly after a substantial debt was incurred; and (k) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor. Taking into consideration the facts presented in a light most favorable to the trustee, several of these factors are put in doubt by the evidence presented. For example, the LLC was apparently involved in litigation, placing the debtor-husband before the state court in 2001, where he asserted that he solely owned IAA. This is contrary to his assertions now. A trial is necessary to make that determination.

The trustee further requests judgment against the defendant under Wis. Stats. § 242.05, which provides:

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[10]See Wis. Stats. § 242.03 for general definition of "value."

> (1) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made or the obligation was incurred if the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation and the debtor was insolvent at that time or the debtor became insolvent as a result of the transfer or obligation.
> (2) A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time and the insider had reasonable cause to believe that the debtor was insolvent.

Wis. Stats. § 242.05.[11] There are sufficient factual allegations in the complaint to support a finding under Wis. Stats. §§ 242.04 or 242.05 to defeat summary judgment.

Section 893.425(3), Wis. Stats., provides that any action brought with respect to an alleged fraudulent transfer obligation incurred under Ch. 242 should be barred as to any claim brought pursuant to § 242.05(2) if the claim is not brought within one year after the transfer is made or the obligation is incurred.[12] Wisconsin law provides for a four-year statute of limitations

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[11]Wis. Stats. § 242.02 provides, in relevant part, the following definition of insolvency:

> (1) In this section:
> (a) "Assets" do not include property that has been transferred, concealed or removed with intent to hinder, delay or defraud creditors or that has been transferred in a manner making the transfer voidable under this chapter.
> (b) "Debts do not include an obligation to the extent it is secured by a valid lien on property of the debtor not included as an asset.
> (2) A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation.
> (3) A debtor who is generally not paying debts as they become due is presumed to be insolvent.

[12]An action with respect to a fraudulent transfer or obligation under ch. 242 shall be barred unless the action is commenced:

> (1) Under s. 242.04(1)(a), within 4 years after the transfer is made or the obligation is incurred or, if later, within one year after the transfer or obligation is or could reasonably have been discovered by the claimant.
> (2) Under s. 242.04(1)(b) or 242.05(1), within 4 years after the transfer is made or the obligation is incurred.
> (3) Under s. 242.05(2), within one year after the transfer is made or the obligation is incurred.

for those claims brought under §§ 242.04(1)(a), (1)(b) or 242.05(1). As noted above, the timing of the transactions has been cast into doubt by the trustee. Thus, the applicability of the statute of limitations under Wis. Stats. § 893.425, and the potential defenses thereunder, will be determined after a trial on the merits of the complaint.

CONCLUSION

There are allegations in the complaint that the transfer, as made to the defendant, was fraudulent or was preferential or, in the alternative, was ineffective, and therefore void and of no legal effect. These allegations are sufficient to defeat the defendant's motion for summary judgment.

Dated at Milwaukee, Wisconsin, December 17, 2002.

BY THE COURT:

____/s/_____
Honorable Margaret Dee McGarity
United States Bankruptcy Judge

Wis. Stats. § 893.425.