UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
FORT WAYNE DIVISION

IN RE: CASE NO. 03-13400	)	
	)	
CROWN UNLIMITED MACHINE, INC.	)	
Debtor	)	
	)	
	)	
R. DAVID BOYER, TRUSTEE	)	
Plaintiff	)	
	)	
vs.	)	PROC. NO. 04-1085
	)	
CROWN STOCK DISTRIBUTION, ET. AL.	)	
Defendants	)	

DECISION

At Fort Wayne, Indiana, on October 13, 2006

This matter is before the court following trial of the issues raised in this adversary proceeding, by which trustee seeks to avoid fraudulent transfers which he contends were made by the debtor to the defendants. The transfers in question arise out of the sale of the company to the debtor in January 2000. The action is based upon Indiana law and is being asserted through the powers the trustee has been given by § 544(b) of the United States Bankruptcy Code. 11 U.S.C. § 544(b).

Prior to January 2000, Crown Unlimited Machine was a family owned corporation whose primary business was the design and manufacture of custom tube bending and cutting machinery. In 1998, Kevin Smith met the founder of the company, Steven Stroup, Sr., at a trade show. At the time Mr. Smith was the president of Wauseon Machine, Inc., but he was not the owner of the company, and he had the dream of owning and operating his own business. Following their meeting, discussions took place between the two men which, after a time, culminated in Mr. Smith expressing an interest in purchasing Crown Unlimited. At that point, Mr. Stroup referred Mr. Smith to his son, Steven Stroup II, who was the company's president and majority shareholder, as the one with whom those negotiations would have to occur.

The negotiations between Smith and Stroup II resulted in an agreement by which Smith would purchase the company's operating assets, real and personal, and assume some of its debts, for the sum of $6 million: $3.1 million cash and a $2.9 million note, bearing interest at 8%, payable to the seller. In January 1999, the parties signed what they termed an "agreement to agree" reflecting the sale price. A few months after signing this agreement, but before the sale was consummated, Mr. Smith began working for Crown Unlimited. During this period, the Stroups were able to evaluate Mr. Smith's performance and Mr. Smith was able to evaluate the company, in addition to having the opportunity to obtain the financing he needed in order to complete the purchase. As a part of Mr. Smith's earlier evaluation, he had his accountant review Crown Unlimited's books and records and formulate a valuation of the company. This valuation showed the company to be worth $2.7-$3 million as a going concern – less than the $6 million purchase price. Despite this information, Mr. Smith proceeded with the deal at the originally agreed upon price.

In December 1999, Mr. Smith formed Kevin E. Smith Enterprises, Inc., with a personal investment of $500, as the vehicle by which to complete the acquisition of Crown Unlimited. Smith Enterprises, Inc. acquired financing from Farmers and Merchants State Bank for $3.1 million, to be secured by a first lien upon the assets of Crown Unlimited. The remainder of the purchase price was provided by giving the seller a promissory note for $2.9 million, secured by a junior lien on the assets transferred, with annual payments to begin in April 2001 and the balance of the note to be paid on April 1, 2006. The amount of the annual payment was to be based on the company's performance in the previous year with a minimum payment of $100,000. The sale closed on or about January 5, 2000, with an effective date of January 1, 2000. As of the date of closing, the real estate transferred had a fair market value of $1.5 million and the equipment transferred had a fair market value of $406,185.

Following the closing, Kevin E. Smith Enterprises changed its name to Crown Unlimited Machine and it is that company – the buyer – that is the debtor in the underlying bankruptcy proceeding. The seller, the original Crown Unlimited, changed its name to Crown Stock Distribution and that company, along with its shareholders, are the defendants in this proceeding.

Soon after the acquisition, the debtor began to experience financial difficulties. The optimistic projections for its future never came to be. By the middle of 2000 it was losing money. Despite further borrowings from the bank, including a $500,000 line of credit, and loans from shareholders and other employees, it was forced to lay off employees, negotiate payment terms with its suppliers, defer principal payments on the $3.1 million bank loan and failed to pay employment taxes. Although the debtor made the first two minimum payments to its seller in April of 2001 and 2002, it was unable to make the minimum payment due in 2003. On July 28, 2003, three years after the acquisition with its seller foreclosing and seeking a receiver, the debtor filed a petition for relief under Chapter 11 bankruptcy. The case was subsequently converted to, and is now pending under, Chapter 7.

The trustee contends that the sale to the debtor constitutes a fraudulent transfer under Indiana's version of Uniform Fraudulent Transfer Act, I.C. 32-18-2. By this adversary proceeding he seeks to recover the amount that was paid at closing, $3.1 million, together with the two annual payments of $100,000 each from both the seller, the defendant Crown Stock, and its shareholders, the individual defendants, to whom the seller subsequently distributed that money. The trustee also seeks to recover an additional $590,000 that the seller distributed to its shareholders shortly before the effective date of the sale. The trustee is exercising the power conferred upon him by § 544(b) of the United States Bankruptcy Code, which allows "the trustee to avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable . . . ." 11 U.S.C. § 544(b)(1). In essence, this portion of the Bankruptcy Code allows the trustee to take advantage of state law concerning fraudulent conveyances. Matter of Xonics Petrochemical, Inc., 841 F.2d 198, 202 (7th Cir. 1988). The result is that if any unsecured creditor could reach an asset or avoid a transaction of the debtor, the trustee can use § 544(b) to do so for the benefit of the bankruptcy estate. "As part of the estate, the asset is then divided among all the unsecured creditors . . . ." Matter of Leonard, 125 F.3d 543, 544 (7th Cir. 1997).

Indiana's fraudulent transfer laws allow different creditors to challenge different types of "fraudulent conveyances" or, more precisely, to characterize a transaction as fraudulent under different theories. Any creditor can challenge a transaction as fraudulent if the debtor made the transfer

> without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor
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> * * * *
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> was engaged or was about to engage in a business . . . for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction. I.C. 32-18-2-14(2)(B).

Additionally, creditors existing at the time of the transaction can challenge a transfer if:

> (1) the debtor made the transfer or incurred the obligation without receiving a reasonably equivalent value in exchange for the transfer or obligation; and
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> (2) the debtor:
>
> > (A) was insolvent at that time; or
> >
> > (B) became insolvent as a result of the transfer or obligation. I.C. 32-18-2-15.

The trustee's claim is based upon both of these provisions and the burden of establishing their conditions rests with him. <u>In re Morris Communications NC, Inc.</u>, 914 F.2d 458, 466 (4th Cir. 1990). <u>See also</u>, <u>Barber v. Golden Seed Co., Inc.</u>, 129 F.3d 382, 387 (7th Cir. 1997).

Although most of the disputes between the parties involve factual issues, and the evaluation of the evidence, concerning things such as "reasonably equivalent value" and "unreasonably small assets," there are two legal issues that must be resolved first, because the resolution of those issues will determine how the court analyzes the plaintiff's claim and the legal standards that are to be applied. Those legal issues involve how to characterize the original transaction between the debtor and its seller and whether the trustee has a qualifying creditor – a creditor existing at the time of the transaction – that would allow him to use I.C. 32-18-2-15. The trustee argues that the court should characterize the sale as a leveraged buyout – a transaction in which the stock of the target corporation is purchased with funds generated by encumbering the assets of the target corporation, thereby allowing the old shareholders to cash out any equity in the corporation, while the business continues burdened with the resulting debt. The trustee makes this argument because, in some ways, the sale to the debtor looks a bit like a leveraged buyout. The business was sold as a going concern, so that the buyer had the same assets, the same business, with the same location and employees, but its assets were burdened with liens securing the debt acquired to financed the transaction, the buyer assumed some of the liabilities of the seller, and the sale proceeds were eventually distributed to the shareholders. Based upon these similarities, the trustee argues that the substance of the transaction should prevail over its form and that the selling corporation was a mere conduit for its shareholders, so that the entire transaction should be collapsed and viewed as a stock sale which was financed by encumbering the assets of the corporation.

The court is not inclined to adopt the trustee's approach. It not only unnecessarily complicates this matter, but also inaccurately characterizes what transpired, overlooks significant facts and would operate to deprive the individual defendants of the defenses that § 550(b) gives to subsequent transferees. To begin with, the transaction between the two corporations was an asset sale, not a sale of stock. Although the money used to accomplish the transaction was borrowed, from both the bank and the seller, because it was structured as an asset sale, the transaction lacks the hallmarks of an LBO in which the money paid for the stock of the target corporation is generated by encumbering that corporation's assets. Mellon Bank, N.A. v. Metro Communications, Inc., 945 F.2d 635, 645 (3rd Cir. 1991). The vice of an LBO is not that the assets of the acquired corporation end up being encumbered, but that the corporation ends up shouldering the burden of a transaction from which it receives no benefit. It ends up with all the debt, but never receives anything on account of the loan proceeds, which it is obligated to repay. Id., at 645-46. Here, by contrast, the benefits and the burdens of the transaction rested in the same place. While the debtor admittedly ended up burdened with significant amount of debt as a result of the sale, it also received the benefits of that sale – the assets purchased were transferred to it, not to someone else.

The trustee's argument for collapsing the transaction also misconstrues the concept of a "mere conduit" as it is applied in avoidance actions. Just because money or property passes through the hands of a one party on its way to someone else is not enough to make that party nothing more than a conduit. The critical fact that determines whether an entity will be characterized as a conduit is whether it had the ability to put the funds in issue to its own uses. In re Pony Express Delivery Services, Inc., 440 F.3d 1296, 1300 (11th Cir. 2006); Bonded Financial Services, Inc. v. European American Bank, 838 F.2d 890, 893 (7th Cir. 1988). If not, it will qualify as a mere conduit and can be disregarded. Nonetheless, if it did have the right to put the property transferred to its own uses, it is not a conduit but is, instead, an initial transferee. Id. Here the defendant corporation was not a mere conduit passing money along to its shareholders. After the sale, it had every right to do whatever it wanted with the sale proceeds. It could have gone into another business, invested the money in the stock market, given it to charity or distributed the money to its stockholders. That it chose to do the latter does not mean that it was obligated to do so or transform it from an initial transferee into a mere conduit.

The final consideration that leads the court to reject the plaintiff's argument for collapsing the transaction is that doing so would preclude the individual defendants from raising the defenses that § 550(b) gives to subsequent transferees. The Bankruptcy Code separates the concepts of avoiding transactions and the liability for them. Whether a transaction is avoidable is determined by the various avoiding powers which are given to the trustee. See e.g., 11 U.S.C. §§ 544, 545, 547, 548, 549, 553(b), 724(a). Once it has been determined that a particular transaction can be avoided, § 550 specifies who the avoided transaction can be recovered from. 11 U.S.C. § 550. It allows the trustee to recover from not only the original transferee, but also from subsequent transferees – third parties to whom the original recipient may have later transferred the property in question. 11 U.S.C. §550(a)(1), (2). Nonetheless, the standard for imposing liability on the initial transferee and subsequent transferees is not the same, and § 550(b) gives those subsequent transferees affirmative defenses which are not available to the initial transferee. Bonded Financial, 838 F.2d at 895. Collapsing the transaction would transform the individual defendants from subsequent transferees into initial transferees and deprive them of those defenses. That is not something the court is inclined to do.

The second legal, as opposed to factual, issue the parties have is whether the trustee has a qualifying creditor – one that was in existence at the time of the sale – which would allow him to use I.C. 32-18-2-15 and challenge the transaction as one for less than reasonably equivalent value which rendered the debtor insolvent.[1] Although there is no dispute that some of the debtor's creditors, particularly trade creditors, existed at the time of the sale and were, at that time, owed money by the seller and that those debts were among the obligations the debtor assumed as part of the transaction, the defendants argue that, from the debtor's perspective, none of those obligations existed at the time of the sale. Instead, they were created by the transaction itself when the debtor assumed those liabilities; thus, the debtor had no creditors until that time and there is no qualifying creditor – no "creditor whose claim arose before the transfer" – that trustee can use as the vehicle for asserting a claim under I.C. 32-18-2-15.

The defendant's argument is based upon In re Morse Tool, Inc., 148 B.R. 97, 131 (Bankr. D. Mass. 1992), where the bankruptcy court came to precisely that conclusion. Despite this support, the court feels that a more appropriate way to analyze the issue is that followed by the Sixth Circuit's Bankruptcy Appellate Panel in In re Bushey, 210 B.R. 95, 101-03 (6th Cir. BAP 1997). There the

[1]There is no dispute concerning the existence of creditors that give the trustee standing to use I.C. 32-18-2-14(2) because that statute allows the transfer to be challenged by any creditor "whether the creditor's claim arose before or after the transfer was made . . . ."

defendant argued, and the trial court concluded, that the trustee had no qualifying creditor because the debt that existed at the time of the challenged transfer had been paid and the debtor's account with that creditor had been reduced to zero before being subsequently used again, so that it was owed money as of the date of the petition. The BAP rejected the defendant's argument and the trial court's conclusion and, instead, held that

> an 'open account' functioning continuously between the time of the transfer and the filing of a fraudulent conveyance action is an 'existing' creditor for the purpose of §1336.04[2] notwithstanding that the account had a zero balance at some moment during the credit relationship. Id. at 102 (footnote added).

The court reasoned:

> In an open account context, the 'existing' creditor relationship is not defined by the balance on the account; it is the availability and continuous use of the credit facility that determines whether an appropriate creditor interest is present against which to measure the propriety of the conveyance. Every change in the balance of an open account – including a change to or from 'zero' – is a 'new balance,' not a 'new debt' for fraudulent conveyance purposes. Reduction to a zero balance of an open account, no other facts appearing, tells the creditor nothing about the underlying financial condition of the borrower. . . .The continuous nature of the risk faced by the creditor in an open account relationship is the defining characteristic of the 'existing' creditor, not the account balance at any moment during the relationship. Id. 210 B.R. at 102.

Consequently, it is not so much the nature of the debt but the nature of the relationship that determines whether a particular creditor is an existing creditor for the purposes of challenging a transaction. So long as the relationship is the same, even though the debt is not, the creditor qualifies.

In this instance, the debtor assumed more than just its seller's obligations to trade creditors, it assumed the entire credit relationship. The debtor did not open new accounts with the company's various suppliers after the sale; instead, it continued to use the very same accounts that had been

[2]§1336.04 is the Ohio equivalent of I.C. 32-18-2-15.

opened and used by Crown before the sale. The transaction had been structured as the sale of a going concern and, after it closed, all involved just kept going without much concern for what had changed. From the suppliers' perspective it would appear that nothing had changed at all: the name on the account was still the same, it was billed to the same address, and the same people still answered the phone and placed orders. More significantly, the seller never did anything to close those accounts or to try stop the debtor from continuing to use them. Indeed, in many respects, by having the debtor assume those liabilities, it actually facilitated the continued use of those trade accounts because nothing ever occurred that would have prompted the debtor to face the need to open new ones. After the sale had closed, it would have been a very easy thing for the seller to notify its trade creditors that the Crown Unlimited they were used to dealing with was no longer running the business and that the trade accounts that had been opened under that name should be closed. By not doing so, it allowed those credit relationships to continue. Since those credit relationships continued to be available and were continuously used by the debtor, those trade creditors qualify as existing creditors and give the trustee standing under I.C. 32-18-2-15.

Indiana law[3] will allow the transfers from the debtor to Crown Stock Distribution to be avoided if the trustee can demonstrate that the transfers were made or an obligation incurred "without receiving a reasonably equivalent value in exchange" and if the debtor "was either engaged or about to engage in a business . . . for which the remaining assets of the debtor were unreasonably small . . . ." I.C. 32-18-2-14(2). Both of these inquiries present factual issues. Yet before

[3]Indiana has adopted the Uniform Fraudulent Transfer Act, the UFTA, which has been codified at I.C. 32-18-2 et seq. Much of the UFTA has been derived from the Bankruptcy Code's provisions concerning fraudulent transfers. As a result, in the absence of decisions from Indiana's courts, the court can look to bankruptcy decisions for guidance concerning what is otherwise a matter of state law.

determining whether a something occurred for less than reasonably equivalent value or if the remaining assets were unreasonably small, there must first have been a transfer or an obligation incurred.

A transfer is defined as "any mode of disposing of or parting with an asset or an interest in an asset, whether the mode is direct or indirect, absolute or conditional, or voluntary or involuntary." I.C. 32-18-2-10. This definition is principally derived from the Bankruptcy Code's definition for the same term. Unif. Fraudulent Transfer Act § 1, comment 12. It is as broad as possible and extends to include any situation involving any transfer of any type of an interest in property. In re Smiley, 864 F.2d 562, 565 (7th Cir. 1989)(discussing 11 U.S.C. § 101(50)). When the debtor paid cash to its seller, both at closing and on account of the minimum annual payments called for by the $2.9 million note, those payments constituted transfers for the purposes of the Indiana Uniform Fraudulent Transfer Act. In a like manner, when it agreed to pay its seller $2.9 million and gave a note to that effect it incurred an obligation.

In order to avoid a transfer or an obligation, it must have been made without receiving reasonably equivalent value in exchange. According to the statute, "[v]alue is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied." I.C. 32-18-2-13(a). This is really just a fancy way of saying look at what the debtor gave for what it got. See, In re Consolidated Capital Equities Corp., 143 B.R. 80, 87 (Bankr. N.D. Tex. 1992)("Fraudulent conveyance analysis focuses upon what the debtor surrendered and what the debtor received."); Barber, 129 F.3d at 387. Such a determination is highly fact-specific. Barber, 129 F.3d at 389; In re Ozark Restaurant Equipment Co., Inc, 850 F.2d 342, 345 (8th Cir. 1988). Furthermore, since fraudulent conveyance laws are intended to protect a debtor's creditors, the transaction is to be evaluated from their perspective, not that of the defendant/transferee. Mellon Bank, 945 F.2d at 646; In re Hannover Corp, 310 F.3d 796, 802 (5th Cir. 2002); In re R.M.L., Inc. 92 F.3d 139, 150 (3rd Cir. 1996); In re Fidelity Bond and Mortgage Co., 340 B.R. 266, 286 (Bankr. E.D. Pa. 2006). In this instance, at closing the debtor gave its seller \$3.1 million in cash and promised to pay it an additional \$2.9 million. Thus, this initial transfer totaled \$6 million and the question becomes whether that was a reasonable value to place upon the business. See, Peltz v Hatten, 279 B.R. 710, 736-737 (D. Del. 2002).

Defendants argue that the \$2.9 million note was essentially worthless because it was never paid, and much of the evidence before the court indicates it never could be paid, so that its existence should be disregarded, not only for the purposes of determining what the debtor transferred and the nature of the obligation it incurred but also for the issues of whether Crown Stock gave reasonably equivalent value in exchange and whether the debtor was rendered insolvent. Once the note is excluded, they argue, the only thing transferred was \$3.1 million and not only was that reasonably equivalent value for a company worth at least \$3 million, but also the transfer did not render the debtor insolvent. The court disagrees.

To begin with, the statute permits the avoidance not only of transfers that have been made but also of obligations that have been incurred. While the court is well aware of the need to discount contingent liabilities and assets on a balance sheet in order to account for the possibility that the contingency may never occur or that an asset may never be realized, see, Xonics, 841 F.2d at 199-200; Covey v. Commercial National Bank of Peoria, 960 F.2d 657, 659-60 (7th Cir. 1992); R.M.L. 92 F.3d at 156, it is not aware of any authority for discounting, on the obligor's balance sheet, a debt which is not contingent to account for the fact that it may become insolvent and, thus, never have to pay. The parties to the transaction certainly behaved as if the promissory note created an absolute and not a contingent liability. It was entered as such on the debtor's balance sheet, the debtor honored its obligation to pay, at least for a while, and when it failed to do so Crown Stock was happy to initiate proceedings to enforce that obligation. Furthermore, to discount the note because of the possibility of non-payment views things from the perspective of the transferee, Crown Stock, and not from the perspective of the debtor and its creditors, as is required. Covey, 960 F.2d at 660. The promissory note cannot be ignored, whether for the purpose of determining what the debtor gave to its seller, reasonably equivalent value, or the debtor's solvency. Both it and the amount the debtor paid at closing were part and parcel of the entire deal.

The trustee must still prove, however, that the debtor did not receive reasonably equivalent value in exchange for this $6 million transfer of cash and promises, Barber, 129 F.3d at 387, and this requires the court to place a value upon Crown Unlimited at the time the debtor acquired that business back in January 2000. Morris Communications, 914 F.2d at 466; Peltz, 279 B.R. at 737. The only valuation prepared around the time of the transaction was the one prepared by Mr. Smith's accountant, Les Thornton, which valued the business at between 2.7 and 3 million dollars. At trial, both sides presented extensive testimony on the valuation issue and, depending on which expert was testifying, the value of the business was anywhere from $3 million to $7 million. Having considered the evidence presented to it, with due regard for the credibility of the witnesses who testified, their qualifications, background, experience, and expertise, as well as their valuation methods, the information they considered and had available to them, and the assumptions each expert made in formulating their respective opinion, the court finds that the fair market value of Crown Unlimited in January of 2000, at the time it was sold to the debtor, did not and could not have exceeded $4 million. At the time of the transfer, the seller's hard assets, real and personal, had a fair market value of less than $2 million. Although the sale included intangible assets that are not part of that stipulated value, and the court does recognize that there is additional value attributable to the transfer of the entire package of assets as a going concern, there is no permutation of those intangibles, whether patents, trademarks, contract rights, accounts receivable, goodwill, going concern value, or future business plans, that the court can see that would push the value of the business purchased above $4 million and definitely nothing that would command the $2 million premium the debtor paid above that value.

If determining "reasonably equivalent value" were nothing more than a mathematical comparison, the court's analysis could end with the conclusion that the debtor transferred cash and promises totaling $6 million in return for a business worth no more than $4 million. But the determination of reasonable equivalency requires more than just a mathematical comparison of what was given in return for what was received. Barber, 129 F.3d at 387. Market value is only one component, albeit a very important component, of an analysis that considers the "totality of the circumstances" and depends on all the facts of each case, so that a dollar for dollar exchange is not required. In re Morris Communications NC, Inc., 914 F.2d 458, 466-67 (4th Cir. 1990); Barber, 129 F.3d at 387. This broader perspective includes such things as the good faith of the transferee and whether the sale was the result of an arms length transaction, in addition to market value. Barber, 129 F.3d at 387; Morris Communications, 914 F.2d at 466-467; In re MDIP, Inc., 332 B.R. 129, 133 (Bankr. Del. 2005); Peltz, 279 B.R. at 736-737; In re Lindell, 334 B.R. 249, 255-56 (Bankr. D. Minn. 2005). Nonetheless, those other considerations do not by themselves result in a conclusion that reasonably equivalent value was given. See, R.M.L., 92 F.3d at 148-54 (debtor did not receive reasonably equivalent value in exchange despite transferee's good faith, arms length nature of the transaction and that rates charged were market rates).

For the purposes of analyzing reasonably equivalent value, the court is willing to accept that the transferee, the debtor's seller, acted in good faith, at least in the sense that it did not set out to defraud the debtor and was not guilty of any conscious deception. As the court will discuss later, however, it did know that the business was not worth the $6 million the debtor was paying and this significantly weakens the benefits that may come from the good faith determination. The court is also satisfied that sale was the result of an arms length transaction, in the sense that it did not occur between insiders and neither party occupied a fiduciary or "special" relationship to the other.[4] Nonetheless, the great disparity between the price the debtor paid and the value of what it received in return far outweighs these other considerations. The court concludes that the transfer from the debtor to its seller was for less than reasonably equivalent value.

The next step in the court's analysis is the question raised by I.C. 32-18-2-14(2), which is whether the debtor was "engaged or was about to engage in a business or a transaction for which the remaining assets . . . were unreasonably small in relation to the business or transaction." I.C. 32-18-2-14(2). There is no dispute that the debtor was or was about to engage in business, the question is

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[4]Although the transaction between the buyer and the seller was an arms length transaction, the sale price was not the product of any serious negotiations. The discussions concerning the terms of sale were carried out between Mr. Smith and Mr. Stroup II. The information before the court indicates that Mr. Stroup II was a tough-minded business man, well used to the give and take of business negotiations. Mr. Smith's initial offer for the company was $2.4 million. In response, Mr. Stroup II said he believed the company was worth $6 million, undoubtedly thinking that this was nothing more than his first shot in a negotiating process that would end somewhere between the two figures that had been put forward. Mr. Smith said he would think about it and, about a week later, whether out of naivete or enthusiasm for the dream of owning his own business, agreed to the $6 million figure Mr. Stroup II had thrown out. The negotiations between the parties focused on how that price would be paid – not on how much should be paid.

whether its assets were unreasonably small for that purpose. Once again, this is a question of fact, to be resolved based upon the evidence presented to the court.

Unlike either § 548(a) or the Uniform Fraudulent Conveyance Act, which both use the term "unreasonably small capital," the UFTA speaks in terms of the debtor's remaining assets being "unreasonably small." This change in phraseology does not appear to have been intended to be a change in meaning. Instead, it was designed to eliminate a potential ambiguity and dispel the idea that the test depended upon the special meanings corporation law gave to the term capital. Unif. Fraudulent Transfer Act. § 4, comment 4. The inquiry is supposed to be broader than narrow technical definitions of capital, and the focus of the reported decisions, whether under § 548, the UFCA, or the UFTA, appears to be the same and reflects that broader perspective. The question is whether the debtor has the "ability . . . to generate enough cash from operations or asset sales to pay its debts and still sustain itself." In re Vadnais Lumber Supply, Inc., 100 B.R. 127, 137 (Bankr. D. Mass. 1989). See also, Moody, 971 F.2d at 1070; Morse Tool, 148 B.R. at 132. This can even consider the debtor's ability to borrow. Moody, 971 F.2d at 1072-73.

Unreasonably small assets is not the same thing as insolvency. If it were, there would be little difference between I.C. 32-18-2-14 and 15. It is a financial condition which is just short of insolvency, whether balance sheet or equitable, but which is likely to eventually lead to insolvency. Vadnais Lumber, 100 B.R. at 137. See also, Moody, 971 F.2d at 1070; In re O'Day Corp., 126 B.R. 370, 407 (Bankr. D. Mass. 1991). Another way to conceptualize the issue is to ask whether the transaction in question put the debtor "on the road to ruin." In re Joy Recovery Technology Corp., 286 B.R. 54, 76 (Bankr. N.D. Ill. 2002). The test is one of "reasonable forseeability," Moody, 971 F.2d at 1073, based, not on hindsight, but on the information and considerations available at the time. _Morse Tool_, 148 B.R. at 133. This is often accomplished by reviewing the projections made at the time of the transaction and making a determination of their reasonableness. _Moody_, 971 B.R. at 1073; _O'Day_, 126 B.R. at 404-05. _See also_, _Vadnais Limber_, 100 B.R. at 139.

In this instance, the debtor was doomed to failure following the transfer. The defendants argue that because the business "survived" for three years following the acquisition, it was not left with unreasonably small assets and that its demise was due to the changes Mr. Smith made after he took over. While those changes may have had some impact upon Crown's demise, the court is satisfied that the true cause of the debtor's financial problems was not what happened after the sale, but the excessive purchase price paid to acquire the business and the debt associated with it. The only reason the debtor survived for as long as it did was through the financial equivalent of advanced life support. That does not demonstrate that it had adequate assets. _See_, _Morse Tool, Inc._, 148 B.R. at 133; _O'Day_, 126 B.R. at 408.

After the sale, the debtor could only have survived under the best of circumstances. Although the financial projections prepared prior to the sale indicated it was possible to successfully service the debt, those projections were not reasonable ones. They were largely premised upon the debtor maintaining or exceeding record sales levels and did not adequately account for the fact that sales sometimes decline. Reasonable projections must consider the difficulties that are likely to arise and incorporate some margin for error. _Moody_, 971 F.2d at 1073. This is particularly critical in an industry like the debtor's which is known to be cyclical. While the debtor's production floor was certainly capable of operating at the projected levels, no one seems to have seriously asked whether the marketing department could sell the debtor's product quickly enough to maintain that record level of production. In addition to the unreasonableness of the projections prepared around the time of the sale, Les Thornton's original appraisal, which had valued the company between $2.7 and $3 million, expressed doubt about the company's survivability at a price above $6 million, and expert witnesses for both plaintiff and defendants testified that the debtor had a working capital deficit after the sale. Following the transfer, the assets of the debtor were unreasonably small in relation to its business.

The debtor transferred cash and promises totaling $6 million in exchange for the assets of Crown Unlimited which were worth no more than $4 million. This transfer was for less than reasonably equivalent value. Following the transfer, the debtor's remaining assets were unreasonably small in relation to its business. The transfer was fraudulent within the meaning of I.C. 32-18-2-14 and may be avoided.

The trustee's second claim is based upon I.C. 32-18-2-15. This part of Indiana's Uniform Fraudulent Conveyance Act allows creditors existing at the time of the transaction to avoid a transfer or an obligation that was made for less than reasonably equivalent value, I.C. 32-18-2-15(1), if the debtor became insolvent as a result thereof. I.C. 32-18-2-15(2)(B). The reasonably equivalent value analysis required by I.C. 32-18-2-15(1) is precisely the same as that required by I.C. 32-18-2-14(2). So the court's previous finding on that point is equally applicable here. As a result, the only question is whether the debtor became insolvent as a result of the sale.

"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" I.C. 32-18-2-12(c). This requires the use of a balance sheet test as of the time of the transaction. See, R.M.L., 92 F.3d at 154-55; Mellon Bank, 945 F.2d at 648. Here that test is relatively simple. Before the sale, the debtor was apparently solvent, if only barely so. It had no debt, $500 in initial capital, the right to buy Crown Unlimited for $6 million and the right to borrow

$3.1 million from Farmers and Merchants State Bank to help facilitate that transaction. After the sale, the fair value of all of the debtor's assets was, at best, $4 million. Its debts, however, exceeded $6 million. It owed the Bank $3.1 million, the seller $2.9 million, and there were the additional liabilities as a result of having assumed the seller's trade debt. The debtor was clearly insolvent as a result of the sale.

Thus far, the court has focused almost exclusively on the trustee's claim to avoid the transfer of $3.1 million to the debtor's seller in January of 2000. But there are three other transfers the trustee also seeks to avoid. They are the two $100,000 minimum payments made, in April 2001 and April 2002, on account of the $2.9 million promissory note the debtor gave to its seller as part of the sale and $590,000 the seller distributed to its shareholders as a dividend in December 1999 shortly prior to the sale.

As for the $590,000 dividend, the defendants argue that this claim was not included in the parties' joint pre-trial order and, thus, cannot be properly advanced. That is true. More significantly, the trustee's argument largely depends upon the court's willingness to collapse the transaction and view it as an LBO, rather than an asset sale, thereby allowing the trustee to characterize the dividend as a transfer involving property of the debtor. That is not something the court is inclined to do. At the time that dividend was paid, the money belonged to the debtor's seller, now the defendant Crown Stock Distribution, and not to the debtor. Thus, it was not "a transfer made . . . by [the] debtor" and, as such, cannot be avoided as fraudulent under either I.C. 32-18-2-14 or I.C. 32-18-2-15.

The trustee's claim to the two $100,000 payments stands on a different footing. Those payments most definitely involved transfers of the debtor's property. They represented the minimum payments made on account of the $2.9 million note the debtor gave to its seller as part of the sale.

While the court recognizes that payments, whether of interest or of principal, made on account of an existing obligation constitute value, I.C. 32-18-2-13, and probably reasonably equivalent value, this assumes that the underlying obligation was legitimately incurred, and the $2.9 million note was not legitimately incurred. It was part and parcel of the fraudulent conveyance that occurred in January 2000. As a result, the obligation was fraudulently incurred, it may be avoided as such, and payments made on account of such an obligation are themselves avoidable.

The Bankruptcy Code separates the concepts of avoidability and liability for an avoided transfer. State law only determines the right to recover, by supplying the rules that decide whether a particular transaction is avoidable; if it is, the Bankruptcy Code determines what may be recovered and from whom. See, In re Acequia, 34 F.3d 800, 809 (9th Cir. 1994); In re Myers, 320 B.R. 667, 670 (Bankr. N.D. Ind. 2004). In doing so, § 550 frees the trustee from restrictions that might be imposed when the trustee proceeds under § 544(b). For example, state law often limits the trustee's recovery to the amount owed the creditor whose rights were invoked. In re Integrated Agri, Inc., 313 B.R. 419, 428 (Bankr. C.D. Ill. 2004). See also, I.C. 32-18-2-18(b)(creditor may recover the lesser of the value of the property transferred or the amount needed to satisfy the creditor's claim). Section 550 cuts the trustee loose from this limitation and allows it to recover the entire value of the property transferred, even it exceeds the debt to the creditor that provided the basis for the action. Matter of Leonard, 125 F.3d 543, 544-45 (7th Cir. 1997); Acequia, 34 F.2d at 809; Integrated Agri, 313 B.R. at 428. At the same time, however, § 550 also provides defendants with affirmative defenses they can raise in order to reduce or eliminate any liability or otherwise mitigate the consequences of avoidance. The defendants bear the burden of proving that they qualify for any of those protections.

Before the court proceeds to an analysis of the issues presented by § 550, it must first deal with an affirmative defense the defendants have raised that is not based upon that portion of the Bankruptcy Code. That is the state law defense created by I.C. 32-18-2-18(d) which allows "a good faith transferee" "a reduction in the amount of the liability" or "to retain any interest in the asset transferred" "to the extent of the value given the debtor." Defendants argue that, regardless of the court's conclusions concerning avoidability, value was transferred to the debtor – in the form of the assets of Crown Unlimited – and that this value should serve to reduce or eliminate the trustee's recovery. If it succeeds, this defense would either reduce the trustee's recovery to zero, or allow the defendants to retain the money that was transferred, because the total amount the trustee can recover is limited by the $3.3 million transferred to Crown Stock and the value of the assets the debtor received as a result of the sale at least approached $4 million. (See pg. 13 "the value . . . could not have exceeded $4 million.).

Initially, the court is somewhat skeptical that it should allow the defendants to raise a defense that is not found in § 550. Had Congress wanted to make such a defense available, it could certainly have included one. It did not, and the court should be reluctant to allow defendants to assert equitable defenses that are not found in the Bankruptcy Code. See, In re Coleman, 426 F.3d 719, 726-27 (4th Cir. 2005)(Bankruptcy court may not use its equitable powers to limit the ability to avoid transfers under 544). See also, Acequia, 34 F.3d at 810-11; Bonded Financial, 838 F.2d at 894-96. Congress did provide a defense not unlike the one defendants advance in § 550(e). It gives a "good faith transferee" "a lien upon the property recovered to secure the lesser of" "the cost . . . of any improvements made after the transfer" or the increase in the property's value "as a result of such improvements." 11 U.S.C. 550(e). This clearly suggests that Congress knew how to insulate a transferee from the consequences resulting from a transferee's actual outlays, and if Congress had wanted to give any further protection to a transferee as a result of what had been advanced it could have easily done so. Congress did provide just that type of defense to a defendant in a fraudulent conveyance action prosecuted under § 548. Under § 548(c), "a transferee . . . that takes for value and in good faith has a lien on or may retain any interest transferred . . . to the extent that such transferee . . . gave value in exchange for such transfer," 11 U.S.C. 548(c), and I.C. 32-18-2-18(d) is based upon § 548(c). See, Unif. Fraudulent Transfer Act. § 8, comment 4. See also, Bruce A. Markell, The Indiana Uniform Fraudulent Transfer Act Introduction, 28 Ind. L. Rev. 1195, 1225-26 (1995). Unfortunately, the defense is not available where, as here, the transfer "is voidable under section § 544." Id. Perhaps Congress did not choose to make it so or perhaps it felt that state law should control. But if state law is to control the issue of a transferee's liability under these circumstances, what is to become of the other state law limitations placed upon avoidance, such as those that limit recovery to the amount of a creditor's claim? The court seriously doubts it is entitled to pick and choose which state law defenses it is supposed to recognize and which ones it is supposed to ignore.

Despite the court's misgivings, it is willing to consider the defense under I.C. 32-18-2-18(d). As an affirmative defense, it is the defendants' burden to prove that they qualify for its protections. In re Hannover Corp. 310 F.3d 796, 799 (5th Cir. 2002); In re Hill, 342 B.R. 183, 202 (Bankr. D. N.J. 2006). In this instance, that requires Crown Stock to prove that it is "a good faith transferee," since we know that it gave value to the debtor. Whether the recipient of a fraudulent conveyance qualifies as a good faith transferee is a question of fact, Hannover Corp. 310 F.3d at 799, Covey, 960 F.2d at 662, which largely turns on its knowledge at the time of the transaction sought to be avoided. In re Sherman, 67 F.3d 1348, 1355 (8th Cir. 1995); Hill, 342 B.R. at 203. See also, Bonded Financial, 838 F.2d at 898 (discussing 550(b)(1)). Unfortunately, "there is little agreement among courts regarding the appropriate legal standard for this defense." Hannover, 310 F.3d at 800. Nonetheless,

> [i]n evaluating the innocence, or good faith, of the transferee, the court takes an objective approach to determine what the transferee knew or should have known such that the transferee does not act in good faith when it has sufficient knowledge to place it on inquiry notice of the voidability of the transfer. Hill, 342 B.R. at 203 (citations and internal quotation marks omitted). See also, Sherman, 67 F.3d at 1355; In re M & L Business Machine Co., Inc., 84 F.3d 1330, 1334-38 (10th Cir. 1996).

Accordingly, the court must examine what the debtor's seller knew about the potentially fraudulent nature of the sale, in this instance, the knowledge of Mr. Stroup II because he was the one who negotiated the terms of the sale with Mr. Smith.

Mr. Stroup II had more than sufficient knowledge of the potentially fraudulent nature of the sale to place him on inquiry notice and, thus, disqualify the seller from claiming to be a good faith transferee. To begin with, he knew or should have known that a sale for $6 million would not be for reasonably equivalent value. Only a year before the sale negotiations, in 1998, he had valued the company at $2.5 million. This number was based upon an independent appraisal that had been obtained in 1994 valuing the company at $1.2 million, which he then adjusted upward to account for a 20 percent annual increase in sales. While this may have been only a rough estimate, there is nothing before the court that would justify such an explosive increase in value during the following year. Even if one were to continue the extrapolated 20 percent annual increase, this still produces a value of no more than $3.5 million at the time of closing. Consequently, he had no reason to believe that the company was worth $6 million. Furthermore, the court has already described how that figure came to be agreed upon, see footnote 4, and so it does not consider that number to have been the product of arms length negotiations. In addition to his knowledge of the excessive sale price, Mr. Stroup II also knew that the debtor would be financing a significant amount of the purchase price. While he may not have know precisely how much money the buyer would be borrowing, he knew enough to place him on inquiry notice concerning the debtor's possible insolvency as a result of the transaction. Thus, the defendant has failed to prove that Crown Stock qualifies as a good faith transferee under I.C. 32-18-2-18(d).

Once it has been determined that a transfer is avoidable, § 550 specifies what may be recovered and from whom. "[T]he trustee may recover, for the benefit of the estate, the property transferred, or . . . the value of [that] property, from – the initial transferee of such transfer . . . or any immediate or mediate transferee of [the] initial transferee." 11 U.S.C. 550(a)(1), (2). Here, Crown Stock is the initial transferee of $3.3 million and the individual defendants are its immediate or mediate transferees. The court needs to consider their liability because Crown Stock did not keep the money it received from the debtor. Instead, it distributed those funds to its shareholders, the individual defendants as follows:[5]

Steven Stroup II – $1,643,730.00

Laura Stroup – $837,980.00

Steven Stroup, Sr. – $161,150.00

Loretta Stroup – $161,150.00

Clayburn Stroup – $32,230

Donald Houseworth – $322,300

[5]The parties stipulated as to the amount of the distribution made to each individual defendant from the $3.1 million paid at closing. They did not stipulate as to the precise amount distributed to each shareholder as a result of the two $100,000 payments, although they did stipulate that those distributions were made according to each individual's proportionate interest. The court knows those percentages and, therefore has been able to calculate the amount distributed to each.

The distributions to the individual defendants do not total the entire $3.3 million because Crown Stock used part of the money to pay some of its own liabilities and a distribution was also made to another shareholder, Mark Wenger, with whom the trustee settled. Because "the trustee is entitled only to a single satisfaction," 11 U.S.C. 550(d), Crown Stock is entitled to a credit for the $5,000 the trustee received in settlement of the claim against Mr. Wenger. Lindell, 334 B.R. at 256-57.

Just because a transfer is recoverable, as here, from the initial transferee does not automatically mean that it is also recoverable from the subsequent transferees. Section 550(b) gives immediate and mediate transferees affirmative defenses that are not available to the initial transferee. Bonded Financial, 838 F.2d at 895. In particular the trustee may not recover from a subsequent "transferee that takes for value, . . . in good faith, and without knowledge of the voidability of the transfer . . . ." 11 U.S.C. 550(b). This is an affirmative defense which the defendants bear the burden of proving. In re Joy Recovery Technology Corp., 257 B.R. 253, 271 (Bankr. N.D. Ill. 2001); In re Toy King Distributors, Inc., 256 B.R. 1, 149 (Bankr. M.D. Fla. 2000); In re Smoot, 265 B.R. 128, 140 (Bankr. E.D. Va. 1999).

The court has already evaluated Mr. Stroup II's good faith in connection with Crown Stock's defense under I.C. 32-18-2-18(d) and found it lacking. That analysis is equally applicable to his defense under 550(b), see, Bonded Financial, 838 F.2d at 898; Sherman, 67 F.3d at 1357, so he does not qualify as a good faith transferee. See, Unif. Fraudulent Transfer Act § 8, comment 2 ("Knowledge of the facts rendering the transfer voidable would be inconsistent with the good faith that is required of a protected transferee.") The same cannot be said, however, for the other individual defendants. They did not have his high degree of involvement in the transaction or his knowledge of its details. Indeed, with the exception of Mr. Stroup, Sr. it does not appear that those individuals were much involved in the operation of the business. Quite to the contrary, it appears that they were more or less content to let Mr. Stroup II make the necessary decisions and run things. Accordingly, the court finds that they had no reason to know of the possibly fraudulent nature of the transaction that resulted in the distributions they received, and, thus, no duty to investigate further. Bonded Financial, 838 F.3d at 897-98.

It remains, however, for the individual defendants to also prove that they took "for value" in order for their § 550(b) defense to be successful. Value is not defined for the purposes of § 550, although it is defined for the purposes of § 548. There it is defined as "property, or satisfaction or securing of an antecedent debt . . . ." 11 U.S.C. 548(d)(1). So, to take for value appears to contemplate some type exchange, the giving of one thing for another. Lindell, 334 B.R. at 254. That is precisely the way it is defined in the UFTA. "Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or satisfied." I.C. 32-18-1-13(a). Thus, value for the purpose of § 550(b)(1) "looks to what the transferee gave up . . . ." Bonded Financial, 838 F. 2d at 897. See also, Hanover, 310 F.2d at 802. It is on this point that the defense falters. The individual defendants gave nothing in exchange for their distributions from Crown Stock. Those distributions were made, not in return for some exchange of property or services, or the payment of an antecedent debt, but solely on account of their status as shareholders in the company. Such distributions are not an exchange of anything and do not constitute value for the purposes of § 550(b). See, In re Agricultural Research & Technology Group, 916 F.2d 528, 540 (9th Cir. 1990)(distributions on account of partnership interest were not for value). See also, In re Brentwood Lexford Partners, LLC, 292 B.R. 255, 267 (Bankr. N.D. Tex. 2003); In re Teknek, LLC, 343 B.R. 850, 861 (Bankr. N.D. Ill. 2006)(discussing distributions of profits or dividends on account of equity interests and reasonable equivalent value).

The trustee also seeks prejudgement interest. Prejudgment interest is not designed to punish a defendant for requiring a successful plaintiff to litigate its claim. City of Milwaukee v. Cement Div. of Nat. Gypsum Co., 515 U.S. 189, 195-96, 115 S.Ct. 2091, 2096 (1995). Instead, the essential rationale for awarding it is to compensate the prevailing party for the loss of the use of its money or property while it was in its opponent's possession. Partington v. Broyhill Furniture Industries, Inc., 999 F.2d 269, 274 (7th Cir. 1993). In the Seventh Circuit, unless the court engages in refined rate-setting, tailored specifically to the facts of the case, it "... should use the 'prime rate' -- that is, the rate banks charge for short term unsecured loans to creditworthy customers" during the litigation. Matter of Oil Spill By The Amoco Cadiz Off the Coast of France on March 16, 1978, 954 F.2d 1279, 1332 (7th Cir. 1992), see also, Gorenstein, 874 F.2d at 436; Partington, 999 F.2d at 274. Based upon the Federal Reserve's Statistical Release, the bank prime rate on the date this action was commenced, January 27, 2004, was 4%. The Federal Reserve Board, http://www.federalreserve.gov/releases/h15/data/Daily/H15_PRIME_NA.txt (last visited Oct. 13, 2006). The trustee is entitled to prejudgment interest at that rate from that date through the date of judgment.

The trustee is entitled to judgment against the Defendant Crown Stock Distribution, Inc., in the sum of $3,295,000.00 Additionally, the trustee is also entitled to judgment against the individual defendants, Steven Stroup II, Laura B. Stroup, Steven Stroup, Sr., Loretta J. Stroup, Clayburn E. Stroup, and Donald Houseworth in the following amounts:

Steven Stroup II – $1,643,730.00

Laura Stroup – $837,980.00

Steven Stroup, Sr. – $161,150.00

Loretta Stroup – \$161,150.00

Clayburn Stroup – \$32,230

Donald Houseworth – \$322,300

The trustee is also entitled to recover interest on the amount due from each defendant, at the rate of 4%, from January 27, 2004 to the date of the judgment herein.

As the trustee is only entitled to a single satisfaction, 11 U.S.C. § 550(d), any payment the trustee receives on account of an individual defendant's liability shall be credited to the corporation's liability.

Judgment will be entered accordingly.

SO ORDERED.

/s/ Robert E. Grant
Judge, United States Bankruptcy Court