UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF INDIANA
SOUTH BEND DIVISION

IN THE MATTER OF	)	
	)	
HOLCO CAPITAL GROUP, INC.,	)	CASE NO. 10-30006 HCD
	)	CHAPTER 7
	)	
DEBTOR.	)	
	)	
	)	
J. RICHARD RANSEL, TRUSTEE,	)	
	)	
PLAINTIFF,	)	
vs.	)	PROC. NO. 12-3023
	)	
LIBERTYVILLE BANK AND TRUST COMPANY; WELLS FARGO BANK, N.A.; HSL FINANCIAL, LLC, and SL FINANCIAL OF ILLINOIS, LLC,	)	
	)	
DEFENDANTS.	)	

Appearances:

J. Richard Ransel, Esq., Trustee, Thorne, Grodnik LLP, 228 West High Street, Elkhart, Indiana 46516;

James R. Byron, Esq., and Lisa Gilkey Schoetzow, Esq., counsel for Trustee, Thorne, Grodnik LLP, 228 West High Street, Elkhart, Indiana 46516;

Rebecca Hoyt Fischer, Esq., counsel for Libertyville Bank and Trust Company, 401 East Colfax, Suite 305, South Bend, Indiana 46617;

Carl A. Greci, Esq., and Ryan G. Milligan, Esq., counsel for Wells Fargo Bank, N.A., Faegre Baker Daniels LLP, 202 South Michigan Street, Suite 1400, South Bend, Indiana 46601; and

Stephen Scallan, Esq., counsel for HSL Financial, LLC, and SL Financial of Illinois, LLC, Staes & Scallan, P.C., 111 West Washington, Suite 1631, Chicago, Illinois 60602.

MEMORANDUM OF DECISION

At South Bend, Indiana, on September 25, 2013.

Before the court is a Motion to Dismiss filed by the four defendants in this adversary proceeding, Libertyville Bank and Trust Company ("Libertyville"), Wells Fargo Bank, N.A. ("Wells Fargo"), HSL

Financial, LLC ("HSL"), and SL Financial of Illinois, LLC ("SL"). Consolidating their positions and jointly adopting the Motion of Wells Fargo,[1] they seek dismissal of the Amended Complaint[2] filed by J. Richard Ransel, Trustee ("Trustee") of the chapter 7 debtor Holco Capital Group, Inc. ("Holco" or "debtor"), pursuant to Federal Rule of Civil Procedure 12(b)(6) and Federal Rule of Bankruptcy Procedure 7012. Following the Trustee's response in objection to the Motion and the defendants' replies, the court took the matter under advisement.[3] For the reasons that follow, the court grants the defendants' Motion to Dismiss in part and denies it in part.

BACKGROUND

For the purposes of this Motion to Dismiss, the underlying factual allegations in the Trustee's Amended Complaint are deemed to be true. It is worth adding, however, that the material facts in this case are not in dispute. Before the court are legal challenges to the Trustee's standing and authority to bring this adversary proceeding and his failure to state a claim upon which relief can be granted.

Kukui Gardens Corporation ("Kukui") is a Hawaii non-profit corporation formed to provide housing for low and moderate income families in Hawaii. In February 1969, Kukui obtained a $16 million loan from The Ford Foundation, endorsed and insured by the United States Department of Housing and Urban Development ("HUD"), to build its housing development. As a condition of receiving the loan, Kukui

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[1] Wells Fargo filed the initial Motion to Dismiss, and Libertyville, SL, and HSL concurred in the Motion and adopted Wells Fargo's brief and reply brief. The movants thus are the defendants collectively.

[2] The court granted the Trustee's Motion to Amend. R.42. The Complaint and Amended Complaint differ in only one respect: The Amended Complaint includes a count brought under 11 U.S.C. § 548(e). Because Wells Fargo's Reply Brief addressed all counts presented in the Amended Complaint, Wells Fargo requested that the Amended Complaint be dismissed, and with prejudice. The other defendants joined in that position. The court thus focuses only on the Amended Complaint in this Memorandum of Decision.

[3] The court has jurisdiction to decide the matter before it pursuant to 28 U.S.C. § 1334 and § 157 and the Northern District of Indiana Local Rule 200.1. The court has determined that this matter is a core proceeding pursuant to 28 U.S.C. § 157(b)(2)(H).

became subject to a HUD regulatory agreement requiring Kukui to establish two accounts, a Replacement Reserve Fund and a Residual Receipts Fund ("the Funds").

On January 1, 1998, Kukui and HUD contracted with Holco to service Kukui's loan (the promissory note, the mortgage, and the Funds) related to Kukui's housing development in Honolulu, Hawaii. Holco, an Indiana corporation whose president, sole officer, and sole stockholder was Kevin Horton ("Horton"), became the servicer for Kukui pursuant to the HUD regulatory agreement. Kukui's property manager was responsible for collecting the rent payments and depositing them in a Funds account. Holco provided reports to the property manager and managed the Funds for the benefit of Kukui. The Funds accounts were located at Wells Fargo and Libertyville banks and were listed in Holco's name.

In December 2007, Kukui entered into an agreement for the sale of its property. It asked Holco to release the mortgage on the property and the Funds from the two accounts. Holco refused to release the Funds, contending that it was owed $4 million for obtaining HUD's approval for prepayment of the note and for servicing the mortgage for 21 years. Kukui denied Holco's claim and argued that Holco had converted the Funds. HUD demanded the return of the balance of the Funds. After setoffs and adjustments, Kukui asserted it still was owed at least $2,703,561.77 (approximately $2.7 million).

Also in December 2007, Holco borrowed funds from Libertyville and Wells Fargo in order to make loans to Horton's other business entities unrelated to Holco. In early January 2008, Holco and Kevin Horton used Kukui's Funds to pay the following creditors of Holco:

$1,442,972.50 to Libertyville
$2,086,716.08 to Wells Fargo
$ 754,099.62 to SL Financial of Illinois
$ 400,000.00 to HSL Financial, LLC
$ 300,000.00 to Kevin Horton
$ 300,000.00 to Kevin Horton
$5,283,788.20 TOTAL[4]

[4] The two loans to Kevin Horton were listed in ¶ 29 of the Amended Complaint as paid, but were not included in the plaintiff's prayer for relief because Horton is not a defendant herein.

R. 52, Amended Complaint, at II, ¶ 29.[5] The Funds were used to pay Holco's debts in full. The payments also released the personal guarantees made on the loans by Horton, Holco's president. According to the Amended Complaint, the transfers were made while Holco was insolvent and unable to pay Holco's creditors.

On May 25, 2008, Kukui filed a lawsuit against Holco and Horton in the United States District Court for the District of Hawaii. On October 15, 2009, that court granted Kukui's motion for partial summary judgment and held that Holco had converted $2.7 million of Kukui's funds. *See* R. 52 ¶ 17; Ex. A at 34; *see also Kukui Gardens Corp. v. Holco Capital Group, Inc., HC Mortgage Co., Inc., and Kevin C. Horton*, 2009 WL 3365853 at *12 (D.Haw. Oct. 15, 2009) (unpub'd). It specifically determined that Holco owed a fiduciary duty to Kukui and that Holco held the Funds in trust for Kukui's benefit.[6] *Id.* ¶ 19.

On January 4, 2010, Kukui, as a petitioning creditor, filed an involuntary chapter 7 bankruptcy petition for relief against Holco. On March 29, 2011, this court entered its order for relief and consolidated the later-filed voluntary chapter 7 case into the earlier involuntary case.[7] On that date, as well, J. Richard Ransel was appointed Trustee. The court's docket indicates that Kukui filed a proof of claim as an unsecured creditor in the amount of $2.7 million on September 27, 2011.

As Trustee, Ransel brought this adversary proceeding against the defendants to recover the money transferred by Holco to certain creditors, namely the defendants, using the Funds. He claimed that the transfers were avoidable under 11 U.S.C. § 548 and Indiana law. The Amended Complaint alleged that

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[5] The court noticed immaterial discrepancies in the monetary amounts listed in the Amended Complaint. *See, e.g.,* R. 52, ¶ 21 ($1,442,972.56 transfer to Libertyville); ¶ 29 ($1,442,972.50 transfer to Libertyville).

[6] The Hawaii District Court subsequently entered partial summary judgment against Kevin Horton personally in the amount of $2.7 million. *See Kukui Gardens Corp. v. Holco Capital Group, Inc., et al.*, 2010 WL 145284 (D. Haw. Jan. 12, 2010). Horton filed a voluntary individual chapter 7 petition in a Florida bankruptcy court on October 17, 2011, and listed Kukui as an unsecured creditor.

[7] This court's Memorandum of Decision of March 29, 2011, contains a detailed factual background of the undisputed underlying facts in this bankruptcy case. *See* R. 61, Case No. 10-30006.

the payments made by Holco to the defendants constituted fraudulent transfers under § 548(a)(1)(A) and (B) that could be recovered under Indiana Code § 32-18-2-1 *et seq*. (the Uniform Fraudulent Transfer Act) and as converted Funds in which the defendants could have no ownership interest. *See* R. 52, Cts. I, II, III. Count IV alleged that Holco, by breaching its fiduciary duty to Kukui, caused the defendants to be unjustly enriched by those transfers. It demanded turnover of the transferred payments by the defendants to the Trustee under a constructive trust theory. In addition, because the defendants had refused the Trustee's earlier requests for turnover, it sought treble damages and other costs pursuant to Indiana Code § 34-24-3-1. *See id.*, Ct. V. Finally, the Amended Complaint charged that the debtor's transfers to the defendants also constituted transfers under § 548(e). *See id.*, Ct. VI.

Wells Fargo filed a reply brief in support of its Motion to Dismiss, *see* R. 46, and renewed its Motion to Dismiss with regard to the Amended Complaint.[8] *See* R. 53. The other defendants renewed their joinders in Wells Fargo's Motion. *See* R. 54-56. The court then granted the parties' stipulated motion and ordered that no further responsive pleading to the Amended Complaint would be required before the court's ruling on the pending Motion to Dismiss. *See* R. 59. The court then took the Motion to Dismiss under advisement.

DISCUSSION

Wells Fargo Bank and the joining defendants have moved to dismiss the Trustee's Amended Complaint for "failure to state a claim upon which relief can be granted" pursuant to Federal Rule 12(b)(6) of the Federal Rules of Civil Procedure, which is made applicable in adversary proceedings by Federal Rule

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[8] The court notes that Wells Fargo miscalculated the deadline for responding to the Trustee's Motion. *See* R. 46, p. 10, n.2. It believed it had until August 27, 2012, to respond. However, the Trustee's Motion for Leave to Amend the Trustee's Complaint was filed on July 25, 2012, and the 30-day deadline required responses to be filed on or before Friday, August 24, 2012. *See* N.D. Ind. L.B.R. B-7007-1(a). The court further observes that Wells Fargo's Reply Brief chose to address the merits of the Amended Complaint, which simply added one count to the original Complaint, rather than to challenge the Trustee's request to amend. *See* R. 46, p. 10-11. In the court's view, the defendants' position, broadening their dismissal motion to encompass the Amended Complaint, was a cogent and practical one.

of Bankruptcy Procedure 7012(b). Motions to dismiss pursuant to Federal Rule of Civil Procedure 12(b)(6) are reviewed under the Supreme Court's directives established in *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S. Ct. 1955, 167 L.Ed.2d 929 (2007), and *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S. Ct. 1937, 173 L.Ed.2d 868 (2009). Those decisions dictate that a complaint must be dismissed if its allegations do not "contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Iqbal*, 556 U.S. at 678, 129 S. Ct. at 1949 (quoting *Twombly*, 550 U.S. at 570). The phrase "plausible on its face" means that "the plaintiff must have pled 'factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" *G & S Holdings LLC v. Continental Cas. Co.*, 697 F.3d 534, 537 (7th Cir. 2012) (quoting *Iqbal*, 556 U.S. at 678). In addition, when a party alleges fraud in the complaint, he "must state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b); Fed. R. Bankr. P. 7009; *see also Cincinnati Life Ins. Co. v. Beyrer*, 722 F.3d 939, 948 (7th Cir. 2013).

The court is mindful that, when weighing whether to grant a motion to dismiss, it "must accept as true all of the factual allegations contained in the complaint." *Erickson v. Pardus*, 551 U.S. 89, 94, 127 S. Ct. 2197, 167 L.Ed.2d 1081 (2007); *see also Seidel v. Byron*, 405 B.R. 277, 284 (N.D. Ill. 2009). A court may also consider documents referenced in the plaintiff's complaint and central to the plaintiff's claims. *See Seidel*, 405 B.R. at 284. In addition, a court may take judicial notice of the records in its own cases. *See In re Fink*, 351 B.R. 511, 517 n. 1 (Bankr. N.D. Ill. 2006) (noting documents in previous bankruptcy).

A. *Trustee's Lack of Standing*

The defendants' central argument for dismissal is that the Trustee lacks standing under the Bankruptcy Code to bring this action. They assert that he has no standing to recover the property at issue, the Funds, because the debtor has no interest in that property. The property is not property of the estate under two theories: It is held in trust for the benefit of Kukui, and Kukui alone has a personal claim to it.

The court begins with the charge that the Trustee lacks standing under the statute, the Bankruptcy Code. Courts have distinguished standing inquiries that are constitutional, prudential and statutory. The Seventh Circuit has described "statutory standing" in this way:

> The term "statutory standing" is found in many cases, . . . but it is a confusing usage. It usually refers to a situation in which, although the plaintiff has been injured and would benefit from a favorable judgment and so has standing in the Article III sense, he is suing under a statute that was not intended to give him a right to sue; he is not within the class intended to be protected by it.

Kohen v. Pacific Inv. Mgmt. Co. LLC, 571 F.3d 672, 677 (7th Cir. 2009) (listed cases omitted).

A motion to dismiss for want of statutory standing is brought under Rule 12(b)(6) for failure to state a claim, whereas a constitutional or Article III standing challenge is brought under Rule 12(b)(1) for absence of subject matter jurisdiction. *See, e.g., CGM, LLC v. BellSouth Telecomm., Inc.*, 664 F.3d 46, 52 (4th Cir. 2011); *Harold H. Huggins Realty, Inc. v. FNC, Inc.*, 634 F.3d 787, 795 n. 2 (5th Cir. 2011); *D.G. ex rel. Tang v. William W. Siegel & Assocs.*, 791 F. Supp.2d 622, 624 n.2 (N.D. Ill. 2011). Although both are categorized as standing issues, "'statutory' standing – that is, whether a cause of action exists under a particular law – is a question that can arise only after the court's Article III power to act has been established." *Schuster v. U.S. Postal Service*, 182 F.3d 922 at *1 (7th Cir. 1999) (citing *Steel Co. v. Citizens for a Better Env't*, 523 U.S. 83, 118 S. Ct. 1003, 140 L.Ed.2d 210 (1998)); *see also Katz v. Pershing, LLC*, 672 F.3d 64, 75 (1st Cir. 2012) (stating that "federal courts normally must decide whether a particular plaintiff has constitutional standing before considering that plaintiff's statutory standing"). Therefore, although the defendants did not raise the issue, this court has an independent obligation to assure itself of its jurisdiction by assessing whether the Article III standing requirements have been satisfied.

Standing is a threshold issue; it is fundamental to the determination of this court's jurisdiction to hear the matter before it. "In essence the question of standing is whether the litigant is entitled to have the court decide the merits of the dispute or particular issues." *Bond v. Utreras*, 585 F.3d 1061, 1069 (7th Cir. 2009) (quoting *Warth v. Seldin*, 422 U.S. 490, 498, 95 S. Ct. 2197, 45 L.Ed.2d 343 (1975)). Article III standing is considered under Rule 12(b)(1) by determining whether subject matter jurisdiction exists. The court begins, as it must, by accepting as true the material facts alleged in the complaint and by drawing all reasonable inferences in favor of the nonmoving party. *See Scanlan v. Eisenberg*, 669 F.3d 838, 841 (7th Cir. 2012). It is the plaintiff who asserts federal jurisdiction and who has the burden of proving the standing elements. *See Lee v. City of Chicago*, 330 F.3d 456, 468 (7th Cir. 2003) (citing cases). The Supreme Court set out those requirements:

> First, the plaintiff must have suffered an "injury in fact" – an invasion of a legally protected interest which is (a) concrete and particularized, . . . and (b) "actual or imminent, not 'conjectural' or 'hypothetical.'" . . . Second, there must be a causal connection between the injury and the conduct complained of – the injury has to be "fairly . . . trace[able] to the challenged action of the defendant, and not . . . th[e] result [of] the independent action of some third party not before the court." . . . Third, it must be "likely," as opposed to merely "speculative," that the injury will be "redressed by a favorable decision."

Lujan v. Defenders of Wildlife, 504 U.S. 555, 560-61, 112 S. Ct. 2130, 119 L.Ed.2d 351 (1992) (citations omitted). In other words, standing requires "injury, causation, and redressability." *Grede v. Bank of New York Mellon*, 598 F.3d 899, 900 (7th Cir.), *cert. denied*, 131 S. Ct. 418 (2010).

The question whether the Trustee is entitled to have the court decide the merits of this adversary proceeding is evaluated as of the commencement of the proceeding. *See Lujan*, 504 U.S. at 570 n.5. In the complaint the Trustee first declared that this court had jurisdiction over the fraudulent transfer allegations he raised pursuant to 28 U.S.C. §§ 157 and 1334. The defendants did not dispute the Trustee's assertion of the court's jurisdiction, and the court stated that its jurisdiction was founded on 28 U.S.C. § 157(b)(2)(H), which grants bankruptcy judges authority to hear and determine "proceedings to determine, avoid, or recover fraudulent conveyances." *See In re Doctors Hosp. of Hyde Park, Inc.*, 463 B.R. 93, 100 (Bankr. N.D. Ill. 2011) ("Under 28 U.S.C. § 157(b)(2)(H), fraudulent conveyance actions are core proceedings which by statute permit a bankruptcy judge to enter final judgment on the action.").

The Amended Complaint alleges fraudulent transfers of Funds money by the debtor, made within two years of the bankruptcy petition, while the debtor was insolvent, and with the intent to hinder, delay, or defraud the debtor's creditors. The court finds that, at this motion to dismiss stage, the plaintiff presented sufficient allegations of economic injury to the debtor's estate and creditors that was caused by the debtor's alleged wrongdoing, the transfer of the Funds. *See Branch v. F.D.I.C.*, 825 F.Supp. 384, 418 (D. Mass. 1993) (finding trustee was proper plaintiff to bring claims founded on §§ 548, 550, and unjust enrichment to ensure pro rata distribution); *In re Pearlman*, 472 B.R. 115, 119-23 (Bankr. M.D. Fla. 2012) (finding trustee was charged under Bankruptcy Code with task of recovering fraudulent transfers by the debtor for the benefit of the estate). He further alleged that the injury could be rectified by the payment of damages to the Trustee for the benefit of all the debtor's creditors. In other words, the Trustee sufficiently established the standing requirements of injury, causation, and redressability.

There was no challenge to the Trustee's prudential standing, and the court need not raise the issue on its own. *See G & S Holdings LLC*, 697 F.3d at 540 (stating that matters of prudential standing are waived if not preserved). Nevertheless, the court notes that the Trustee has alleged a specific harm, not a generalized grievance, and finds that he, on behalf of the bankruptcy estate and its creditors, is the proper party or "real party in interest" to bring a § 548 claim. *See id.* at 540-41; *see also In re Automotive Professionals, Inc.*, 389 B.R. 630, 633 (Bankr. N.D. Ill. 2008).

Moreover, the Trustee's statutory standing is clear. Subsections (a) and (e) of § 548, upon which the Trustee relies, expressly designate the trustee as the party with the power to avoid fraudulent transfers in order to benefit the debtor's estate. It is the trustee who has the statutory authority to maintain an action under § 548.[9] *See* 4 *Collier on Bankruptcy* ¶ 548.02 at 548-34 (A.N. Resnick & H.J. Sommer, eds., 16th ed. 2010) ("Section 548 vests the power to avoid fraudulent transfers in the bankruptcy trustee."); *In re Motorwerks, Inc.*, 371 B.R. 281, 288 n.3 (Bankr. S.D. Ohio 2007) (stating that a trustee's standing "springs

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[9] Courts have extended standing to allow § 548 actions by other parties, such as creditors and creditors' committees, when a trustee has unjustifiably failed to bring the action, when the claim is colorable and in the best interest of the estate, and when the party has obtained leave from the bankruptcy court to proceed. *See In re Consolidated Industries*, 360 F.3d 712, 716 (7th Cir. 2004) (citing *Fogel v. Zell*, 221 F.3d 955, 965-66 (7th Cir. 2000)); *see also In re Archdiocese of Milwaukee*, 483 B.R. 693, 700 (Bankr. E.D. Wis. 2012) (denying derivative standing). That circumstance is not before the court in this case.

directly from the Bankruptcy Code[, which] grants the trustee direct powers such as the ability to avoid certain types of transfers pursuant to 11 U.S.C. §§ 547, 548, and 549"). A trustee appointed under § 701 or § 702 of the Code is given that authority. A summary of the types of claims a trustee has the power to raise was presented in *In re Central Illinois Energy, L.L.C.*, 406 B.R. 371, 373 (Bankr. C.D. Ill. 2008):

> "In general, a chapter 7 trustee is authorized to assert the following four categories of claims:
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> 1. Claims based on nonbankruptcy law that the debtor could have brought outside of bankruptcy that become property of the estate by operation of Section 541;
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> 2. Turnover claims under Sections 542 and 543;
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> 3. Claims based on avoidance powers created by the Bankruptcy Code under Sections 545, 547, 548 and 549; and
>
> 4. Claims based on avoidance powers created by state law that a trustee is empowered to assert under Section 544.

In this case, the Trustee is bringing suit against the defendants under § 548, a statute that was intended to give him a right to sue. *See Kohen*, 571 F.3d at 677; *cf. Bank of America v. Knight*, _ F.3d _, 2013 WL 4016522 at *2 (commenting that fraudulent conveyance suits should be pursued by a trustee, who would make recoveries for all creditors, rather than by a bank which wanted everything for itself). The court determines, therefore, that Trustee Ransel, the appointed Trustee in this bankruptcy case, assuredly has the requisite standing, power, and authority to bring an adversary proceeding under § 548 to recover property that was fraudulently transferred. *See In re Housecraft Indus. USA, Inc.*, 310 F.3d 64, 71 (2d Cir. 2002) (stating that it "would be meritless" to challenge a trustee's standing "because §§ 548 and 549 both expressly provide that the 'trustee may avoid' the fraudulent transactions"); *In re Cannon*, 277 F.3d 838, 848 (6th Cir. 2002) ("Because 11 U.S.C. § 548(a)(1) grants the trustee the power to 'avoid any transfer of an interest of the debtor in property' . . ., we have difficulty comprehending Defendants' argument that the trustee lacks Article III standing to seek to avoid preferential transfers.").

B. *Defendants' Lack of Standing*

Turning the tables on the defendants, the Trustee asked the court to dismiss the Motions to Dismiss on the ground that the defendants themselves lacked standing to bring the motions. He asserted that they are third parties, neither the victims of the debtor's alleged acts nor the beneficiaries of the alleged trust. He insisted that they have no "standing" to assert Kukui's right as the beneficiary of that alleged trust.

The defendants responded that the Amended Complaint itself alleged the fiduciary relationship between Holco and Kukui and the "trust funds" held by the debtor for Kukui's benefit. They contended that a trust existed and was clearly established, both in the Trustee's pleading and under Indiana trust law. They then argued that the Trustee had not established the debtor's interest in the Funds and that they, as defendants herein, have a right to assert defenses based on the debtor's lack of interest in the property.

When a complaint is filed demanding the turnover or return of funds from defendants, of course those defendants have standing to defend. The defendants herein are affected by the outcome of the Trustee's claims, and their arguments are related to the facts alleged and the claims brought against them by the Amended Complaint. *See In re Celebrity Resorts, LLC*, 2010 WL 5289298 at *1 (Bankr. M.D. Fla. Dec. 17, 2010) ("Defendants have standing to defend against Plaintiff's claims and to assert the existence of the Trusts.").

More to the point, however, both parties have misused the legal concept of standing. Standing is a requirement imposed on a plaintiff, the party seeking relief, who invokes federal jurisdiction when filing a pleading in this court and must demonstrate standing. *See Scanlan*, 669 F.3d at 841. This plaintiff has done so. The defendants now have the right to defend against the allegations of the Amended Complaint. *See In re Brooks*, 479 B.R. 917, 920 (Bankr. N.D. Ga. 2012) ("It should go without saying that a defendant need not establish its standing to defend against claims.") (*quoting Benoist v. U.S. Bank Nat'l Ass'n*, 2012 WL 3202180 at *6 (D. Hawaii 2012)). Although the parties have cast their arguments in terms of standing, standing is not the real issue before the court.

C. *Trustee's Authority to Transfer "an Interest of the Debtor in Property"*

Having found that the Trustee has standing to bring a § 548 cause of action, the court turns to the defendants' challenge to the kind of claim a Trustee has "standing" to bring.[10] As a premise, the defendants posited that a trustee may bring only claims on behalf of the estate, pursuant to § 323, and on behalf of the creditors as a class, pursuant to § 544. They then argued that the Trustee's claims failed under either category because the debtor had no interest in the property the Trustee sought to recover. According to the defendants, the debtor lacked interest in the Funds money for two reasons: (1) The Funds were held in trust by the debtor in segregated accounts for the benefit of Kukui; and (2) the transfers from those Funds personally injured only Kukui and therefore Kukui alone could assert a claim on the Funds.

The Trustee answered that he is authorized to bring claims on behalf of the estate and its creditors, and insisted that the defendants were challenging the merits of his complaint, not its sufficiency. He focused on the debtor's conduct in transferring money from the Funds. The Amended Complaint charged that the transfers made by the debtor to the defendants were fraudulent transactions, and it sought judgment against each defendant based upon § 548(a) and (e) and corresponding state court statutes.

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[10] The Seventh Circuit pointed out that an objection to a trustee's "standing" to pursue particular claims was not a standing issue but rather an issue on the merits of the case. It clarified that standing referred to injury, causation, and redressability rather than to Congress' grant of authority to a trustee to pursue a particular action.

> Whether a given action is within the scope of the Code is a question on the merits rather than one of justiciability. To avoid confusion, therefore, the rest of this opinion refers to the Trustee's "authority" to act on behalf of the investors, rather than his "standing" to do so.

Grede v. Bank of New York Mellon, 598 F.3d 899, 900 (7th Cir.), *cert. denied*, 131 S. Ct. 418 (2010) (distinguishing the Supreme Court's use of "standing" in *Caplin v. Marine Midland Grace Trust Co.*, 406 U.S. 416, 92 S. Ct. 1678, 32 L.Ed.2d 195 (1972)). The term "standing" was used, however, in *In re Teknek, LLC*, which stated that "the trustee has no standing to bring 'personal' claims of creditors, which are defined as those in which the claimant has been harmed and no other claimant or creditor has an interest in the cause." *Teknek*, 563 F.3d 639, 646 (7th Cir.), *cert. denied*, 558 U.S. 948 (2009)(quoted citations omitted). The defendants, relying on *Teknek*, argued that the Trustee lacked standing to bring the personal claim of Kukui. In this court's view, that is a substantive rather than threshold issue, but the court addresses it as the defendants presented it.

It is clear that a trustee has the authority under the Bankruptcy Code to avoid transfers under § 548. His duties, itemized in § 704, underscore that responsibility. Nevertheless, a trustee generally must "prove by a preponderance of the evidence that there was a fraudulent transfer and [that] recovery is appropriate." *Knippen v. Grochocinski*, 2007 WL 1498906 at *3 (N.D. Ill. May 18, 2007) (citing *Frierdich v. Mottaz*, 294 F.3d 864, 867 (7th Cir. 2002)).

Under § 548(a)(1)(A) and (B), a trustee has the burden of proving three necessary elements initially in order to establish a fraudulent conveyance: that there was "a transfer," that it was "of an interest of the debtor in property," and that it was "made on or within two years before the date of the filing of the bankruptcy petition." There is no debate that Holco moved Funds money to the defendants, in fulfillment of the requirement that there be a "transfer." *See* § 101(54). The transfers undisputedly were made within the 2-year period set by the statute, as well.[11]

The issue actually being debated herein is whether the debtor's payments to the defendants were transfers of property in which the debtor has an interest. Courts often acknowledge that the "interest of a debtor in property" in § 548(a) corresponds with the debtor's "property of the estate" in § 541(a). *See In re Enron Corp.*, 318 B.R. 655, 660 (Bankr. S.D. Tex. 2004) (finding the phrases synonymous); *see also* § 704(a) ("The trustee shall – (1) collect and reduce to money the *property of the estate* for which such trustee serves.") (italics added). The court begins by reviewing the defendants' theory that the debtor (and, hence, the Trustee) had no interest in the Funds because they were trust funds.

(1) <u>The Funds as "Estate Property": Defendants' Trust Theory</u>

Relying on the Hawaii District Court's ruling that Holco held the Funds in trust for Kukui's benefit, the defendants asserted that the Funds accounts were not property of the estate because "[t]he transfer of a property interest that the debtor holds in trust for another person will not qualify" as a transfer

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[11] The involuntary petition was filed January 4, 2010. The transfers alleged in the Amended Complaint were made between January 15 and February 1, 2008, within two years of the bankruptcy filing.

of an interest of the debtor in property. R. 46 at 4-5 (quoting *Dunham v. Kisak*, 192 F.3d 1104, 1109 (7th Cir. 1999)).[12] They cited § 541(d) of the Bankruptcy Code[13] and contended that, in a trust arrangement like this one, Holco's interest in the Funds was purely a legal interest, not an equitable one. Without an equitable interest, they insisted, as a matter of law the Funds could not constitute property of the debtor.

To support their position, the defendants also referred the court to *Matter of Maple Mortgage, Inc.*, 81 F.3d 592 (5th Cir. 1996). In that case, Maple transferred funds to Chase in order to purchase Chase's servicing rights to mortgages. Less than 45 days later, Maple filed bankruptcy, before it had earned any servicing fees. The Trustee claimed that the transfer of the funds to Chase was preferential or fraudulent. However, the bankruptcy court agreed with Chase that the transfer was not of an interest of the debtor in property. The court determined that, under § 541(d) and the terms of the contract between Chase and Maple, the interest held by the debtor was property of its estate only to the extent of the debtor's legal title. The district and appellate courts affirmed. The Fifth Circuit held that, although "Maple had legal title to the funds, it was holding those funds for the benefit of those to whom the money was owed, and therefore Maple had no equitable interest in the funds transferred." *Id.* at 597. Without an equitable interest, the court concluded, the trustee could not avoid the transfer from the debtor to Chase under § 547 or § 548.

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[12] The Seventh Circuit, in *Dunham*, did state that general principle, but only in dictum. It declined to "confront the question of whether the 1995 deed amounted to a 'transfer of an interest of the debtor in property'" under § 548(a)(1), because the trustee forfeited the issue by failing to challenge the bankruptcy court's specific findings that there was no evidence that the debtor intended to hinder, delay, or defraud his creditors; that the debtor was insolvent when the transfer was made; or that the transfer rendered him insolvent. *Dunham*, 192 F.3d at 1110. The circuit court affirmed on those adequate and independent bases.

[13] Section 541(d) of the Bankruptcy Code states:

> Property in which the debtor holds, as of the commencement of the case, only legal title and not an equitable interest, such as a mortgage secured by real property, or an interest in such a mortgage, sold by the debtor but as to which the debtor retains legal title to service or supervise the servicing of such mortgage or interest, becomes property of the estate . . . only to the extent of the debtor's legal title to such property, but not to the extent of any equitable interest in such property that the debtor does not hold.

11 U.S.C. § 541(d).

In response, the Trustee did not address or distinguish *Maple*. Instead, he defended his role as Trustee, the representative of the bankruptcy estate, bringing this action to recover fraudulent transfers on behalf of creditors under § 548 and Indiana's Uniform Fraudulent Transfer Act. Because a bankruptcy estate is comprised of "all legal *or* equitable interests of the debtor" and the debtor held at least a legal right to the Funds, he urged the court that he, as Trustee, could claim legal title to the Funds accounts under § 541(a)(1). He then argued that, once deposits were made into the Funds accounts, the debtor possessed them, had a legal right to them, and had control of them. For that reason, he insisted, the debtor held an equitable interest in them as well, and the Funds accounts were property of the estate. Looking to state law, the Trustee relied upon Indiana Code § 30-4-2-6 of Indiana's Trust Code, which provided that "the trustee takes the title to the trust property."[14] He emphasized that the debtor not only managed and serviced the Funds for Kukui but also commingled its own money with the Funds accounts and paid its own debts out of the Funds. The Trustee concluded that the debtor's transfer of Funds money to selected creditors (the defendants), intending to defraud another creditor (Kukui), was a fraudulent transfer that he as Trustee could avoid under § 548.

The Trustee compared this allegedly fraudulent transfer to a Ponzi scheme and pointed to similarities in *In re Canyon Systems Corp.*, 343 B.R. 615 (Bankr. S.D. Ohio 2006), a Ponzi case. The Trustee noted that, just as in *Canyon*, Kukui gave its money to the debtor so that Holco would service the mortgage, note, and Funds. Similarly, Holco deposited the money into the Funds, commingled other money in that account, and then paid its own debts from those Funds, instead of (or in addition to) servicing Kukui's note, mortgage, and Funds. The Trustee specifically noted that the debtor paid $5,283,788.20 (almost $5.3 million) to the defendants, and that $2.7 million of that amount had been converted. *See* R. 38 at 10, n.1.

No matter which way the parties describe the challenge, the dispositive issue before the court is whether the Funds property that the debtor transferred to the defendants was property in which the debtor held an interest under § 548 and the related state law claims. To establish the property interests of the debtor,

[14] The defendants replied that, under the following Trust Code provision, the beneficiary holds the "equitable interest in the trust property." Ind. Code § 30-4-2-7.

the court first turns to federal law to determine what "property" is and then to state law to decide the extent of the debtor's interest in the property. *See In re Kuehn*, 563 F.3d 289, 293 (7th Cir. 2009); *In re Krueger*, 192 F.3d 733, 737 (7th Cir. 1999).

The Code provides a sweeping definition of "property of the estate" in § 541(a), and it normally includes "property fraudulently or improperly transferred by the debtor before bankruptcy." *Koch Refining v. Farmers Union Central Exchange*, 831 F.2d 1339, 1343 (7th Cir. 1987). The Supreme Court and Seventh Circuit have made clear that "'property of the debtor' subject to the preferential transfer provision is best understood as that property that *would have been* part of the estate had it not been transferred before the commencement of bankruptcy proceedings." *Begier v. I.R.S.*, 496 U.S. 53, 58, 110 S. Ct. 2258, 110 L.Ed.2d 46 (1990) (italics added); *accord, Warsco v. Preferred Technical Group*, 258 F.3d 557, 564 (7th Cir. 2001); *Homann v. R.I.H. Acquisitions IN, LLC (In re Lewinski)*, 410 B.R. 828, 833 (Bankr. N.D. Ind. 2008). The Fourth Circuit applied that analysis to § 548. *See French v. Liebmann (In re French)*, 440 F.3d 145, 151-52 (4th Cir.), *cert. denied*, 549 U.S. 815 (2006) ("§ 548 plainly allows a trustee to avoid any transfer of property that *would have been* 'property of the estate' prior to the transfer in question – as defined by § 541 – even if that property is not 'property of the estate' *now*.") (citing *Begier*)).[15] However, the Code also limits the breadth of "property" in other subsections of § 541. *See, e.g.*, § 541(b)(1); § 541(d). With this guidance in mind, the court turns to the "property" in which the debtor might hold an interest herein.

In this instance, the transferred property was money from the Funds. According to the Amended Complaint, the Funds were two accounts Kukui set up pursuant to a HUD regulatory agreement. Holco, under contract with Kukui and HUD, serviced Kukui's note, mortgage, and the Funds for Kukui's housing units. The Amended Complaint described three parties to the business arrangement: Kukui (which held the mortgage and note on the Kukui Gardens property), Hawaiian Properties (which managed the property and

[15] Both § 547(b) and § 548(a) require that a transfer of property must involve "an interest of the debtor in property" to be avoidable. Therefore, to the extent the issue is the debtor's property interest, case law under either of those Code sections is helpful in the analysis.

collected rents), and Holco (which managed the Funds). From 1998 through 2007, Holco received the rent payments, deposited them into the Funds accounts, and produced a report on Funds transactions. The accounts were in Holco's name and were located at Wells Fargo and Libertyville banks. In December 2007, however, when Kukui sold its property and asked Holco to release the mortgage and the Funds, Holco refused, claiming that Kukui owed Holco certain payments.

The Amended Complaint then alleged two separate acts of misconduct by the debtor. It first alleged that Holco converted Kukui's Funds by refusing to release the Funds in late 2007 or early 2008 when Kukui and HUD demanded them. The Hawaii District Court, in its summary judgment ruling against Holco in 2009, concluded that this action by Holco constituted a conversion of the Funds. It is important to note at this point, however, that the Hawaii District Court's Order has no *res judicata* or collateral estoppel effect on this proceeding. The defendants did not assert, as an affirmative defense, that the Order qualified to preclude any of the plaintiff's claims. *See Carr v. Tillery*, 591 F.3d 909, 913 (7th Cir. 2010) ("Since res judicata is an affirmative defense, the defendant should raise it and then move for judgment on the pleadings.") (citing Fed. R. Civ. P. 12(c), cases). It is also noteworthy that this court is not "bound to accept as true a legal conclusion couched as a factual allegation." *Cincinnati Life Ins. Co. v. Beyrer*, 722 F.3d 939, 946 (7th Cir. 2013) (quoting *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S.Ct. 1937, 173 L.Ed.2d 868 (2009)). For that reason, the allegations in the Amended Complaint labeling the Funds accounts as "Kukui's trust funds" and the transfers into the Funds accounts as "fiduciary for the benefit of Kukui" are not deemed to be true by this court. Finally, the court comments that the parties have assumed a trust relationship without submitting evidence of the underlying documents that would establish the relationships among the parties of interest – documents such as the HUD regulations and any contractual agreements between Holco and Kukui and/or Holco and HUD. *See* R. 52, II ¶ 4 (alleging that Kukui was subject to a HUD regulatory agreement); ¶ 5 (alleging that Kukui and HUD contracted with Holco).[16]

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[16] The Hawaii District Court Order quoted portions of the Regulatory Agreement between Kukui (continued...)

In addition to alleging Holco's refusal to release the Funds to Kukui and HUD, the Amended Complaint also alleged that Holco further converted and fraudulently transferred the Funds by taking money from the Funds to pay its own creditors. It claimed that there were two purposes for the payments: to pay off Holco's own loan obligations and to release Horton's personal liability to those creditors. This adversary proceeding is focused on the second alleged conversions and/or fraudulent transfers, which occurred between January 15 and February 1, 2008. Those acts by the debtor were separate from the first conversion and allegedly caused separate injuries, but both involved Holco's alleged misuse of the Funds.

The parties bolstered their arguments by focusing on different allegations concerning the Funds, and the Alleged Complaint supported both positions. The defendants described the Funds as accounts completely segregated and held in trust for Kukui's benefit. *See* R. 52, ¶¶ 7, 18, 19. The Trustee emphasized Holco's ownership of and control over the Funds accounts: The accounts were titled in Holco's name, and Holco received the rents, deposited the money into the accounts, kept possession of the money, made money transfers, and controlled the accounts. *See id.*, ¶¶ 6, 7, 11, 18, 20, 21, 23, 25, 27.

There is no direct allegation of commingled funds in the Amended Complaint. Nevertheless, it did allege that the debtor owed Kukui $2.7 million and that the debtor transferred a total of almost $5.3 million to the defendants (and to Kevin Horton). *See id.* ¶¶ 17, 29. The court finds that it is plausible and reasonable to infer, from the Amended Complaint's allegations, that Holco commingled money in the Funds accounts and paid off those debts with combined funds.

The cases cited by the parties helped to clarify the issue of the extent of this debtor's interest in the Funds property. The Fifth Circuit, in *In re Maple Mortgage Company*, held that the trustee could not recover the transferred funds, as a preference or a fraudulent transfer, because the debtor had only a legal interest to the funds. Its ruling was based on the terms of the contractual agreement between Maple and

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[16](...continued)
and HUD, including ¶ 2, which required owners to establish (a) a "reserve fund" which "shall at all times be under the control of the mortgagee" and (c), a "residual receipts fund" which "shall be under the control of the Commissioner." R. 52, Ex. A, Hawaii District Court Order, at 4.

Chase, terms which clearly stated that neither party owned the underlying mortgages, that they merely owned the servicing rights to the mortgages, and that they did not hold unfettered discretion over the funds. *See id.*, 81F.3d at 595-96. In *Maple*, there was no allegation of commingled funds or fraudulent activity.

Maple, in turn, relied on an earlier Fifth Circuit case, *In re Southmark Corp. v. Grosz*, 49 F.3d 1111 (5th Cir. 1995). The issue in *Southmark* was whether the bank account from which a payroll check was drawn was property of the estate. It was an account owned, maintained, and controlled by the debtor, the parent company, but it contained commingled funds from its affiliated companies. The circuit court, reversing the bankruptcy and district courts' decisions, held that the funds were property of the estate. The court focused on the debtor's legal title over the bank account, its ownership of the account, and its absolute discretion to spend the funds and to pay the creditors of its own choosing. It concluded that those indicia demonstrated a sufficient "interest of the debtor in property" for purposes of preference law. *Southmark*, 49 F.3d at 1116.

The Tenth Circuit generally followed that analysis and reached a similar conclusion. *See In re Amdura*, 75 F.3d 1447 (10th Cir. 1996). In that case, the parent company combined the receipts of all subsidiary companies into one account and paid their expenses from that account. The parent company held control of all the commingled assets in the account. It paid the expenses of all the subsidiaries, kept records, and used the same account for its own deposits and withdrawals. When the parent company and its subsidiaries filed bankruptcy, the issue was whether the subsidiary or the parent owned the funds deposited by the subsidiary into the bank account. The appellate court, affirming the lower courts' summary judgment decisions, held that the funds were the property of the parent, not the subsidiary, based upon indicia of ownership: The parent's name was on the account; the parent paid the subsidiary's debts; and the parent had the right to spend money from the account as it chose. *See id.* at 1451. Both *Amdura* and *Southmark* concluded that the control over the main or master account and the discretionary power to distribute and use the account funds were critical criteria in assessing property rights. In both cases, those factors established that the parent corporation held the property rights to the bank account funds. When the parent corporation filed bankruptcy, then, the property right to the bank account became property of its bankruptcy estate.

In this case, the defendant banks insisted that the debtor held the Funds in trust for Kukui's benefit and was not entitled to the proceeds in the accounts because it did not possess both legal title and an equitable interest. The Trustee asserted that the debtor owned the accounts, had the power to distribute the proceeds to the defendants and to withhold them from Kukui, and held control over the accounts. Therefore, he claimed, the Funds were included in the bankruptcy estate and he as Trustee could avoid the fraudulent transfers of those amounts from the Funds.

These arguments result in radically different conclusions, even though the alleged facts in the Amended Complaint are not necessarily conflicting. Holco could well have established the Funds accounts in 1998 in order to service Kukui's mortgage and note, but over the next decade used the accounts for other purposes. Nothing in the parties' briefs or in this record proves that the Funds were used (or were required to be used) exclusively for the singular purpose of servicing the mortgage and note. The parties agree, however, that Holco had complete control over the Funds and had the authority and ability to pay the creditors it chose to pay and to refuse to turn over the Funds to Kukui. The Amended Complaint's allegations plausibly allowed the court to draw the reasonable inference that the debtor could have transferred either Kukui's, its own, or commingled money from the Funds to the defendants. For that reason, the court determines that the defendants have failed to demonstrate that the Funds were solely trust accounts for Kukui's benefit.

(2) <u>The Funds as "Estate Property": Defendants' Personal Claims Theory</u>

The defendants also argued that the Trustee's Amended Complaint raised claims that were personal only to Kukui because they were direct injuries to Kukui alone. The Trustee insisted that the Funds were property that the debtor fraudulently transferred to the defendants, property that he as Trustee could recover to distribute to the debtor's creditors – including, of course, Kukui.

A trustee of a chapter 7 debtor has the duty of marshaling the debtor's available property for distribution to the debtor's creditors. He is authorized to bring suit to recover all the "property of the estate" as long as the debtor has an interest in that property. The Seventh Circuit has clarified, however, that a trustee is authorized to bring general, not personal, claims of creditors. *See In re Teknek, LLC*, 563 F.3d 639, 646 (7th Cir.), *cert. denied*, 558 U.S. 948 (2009); *see also Fisher v. Apostolou*, 155 F.3d 876 (7th Cir. 1998); *Koch Ref. v. Farmers Union Cent. Exch., Inc.*, 831 F.2d 1339 (7th Cir. 1987), *cert. denied*, 485 U.S. 906 (1988). Personal claims are "those in which the claimant has been harmed and 'no other claimant or creditor has an interest in the cause.'" *Id.* (quoting *Fisher*, 155 F.3d at 879) (quoting in turn *Koch*, 831 F.2d at 1348)). General claims are "'allegations that could be asserted by any creditor' or 'could be brought by the trustee as a representative of all creditors.'" *Id.* (quoting *Fisher*, 155 F.3d at 879) (quoting in turn *Koch*, 831 F.2d at 1348-49)).

> To determine whether an action accrues individually to a claimant or generally to a corporation, then, we must look to the injury for which relief is sought. We must consider whether that injury is "peculiar and personal to the claimant or general and common to the corporation and creditors."

In re Teknek, 563 F.3d at 647 (citing *Koch*, 831 F.2d at 1349).

To make that determination, the court turned to the Amended Complaint, which described the two claimed misdeeds by Holco: The first, Holco's refusal to release the Funds to Kukui when the Kukui Gardens property was sold, was background information outside the two-year reach-back period. The second, Holco's transfer of money from the Funds to pay its own creditors, is the focus and subject of the Amended Complaint. The court finds that Kukui certainly was injured personally by the first act, but that any and all of Holco's creditors (including Kukui) were injured by the second act. The Funds accounts were established under the name of Holco, were controlled by Holco, and were distributed to Holco's creditors by Holco. The parties agreed that the debtor had legal title to the Funds accounts, and the Trustee has shown that the debtor had complete discretion to pay his own creditors from the account funds. *See In re Smith*, 966 F.2d 1527, 1531 (7th Cir. 1992) (finding that debtor who "exercised significant control (over a significant amount of money) in choosing to pay off a single creditor" had a property interest in the funds under the debtor's agreement with the bank; holding that transfer of those funds in his control was a preferential transfer of "an interest of the debtor in property"); *In re Amdura Corp.*, 75 F.3d at 1451 (concluding that parent company, not subsidiary, had "the right to spend the money entirely as it saw fit"); *In re Southmark*, 49 F.3d at 1116 (concluding that parent company held title to general bank account with commingled funds and had unfettered discretion to pay its own creditors). The court finds that the defendants have not shown that Holco was limited in its access to the Funds accounts or in its right to withdraw and use money in the accounts. Rather, the allegations clearly demonstrate Holco's complete control to use the funds for any purpose it chose – including paying off its own debts instead of releasing the accounts to Kukui.

The allegations also demonstrate that the obligations Holco owed to the defendants were paid off fully, to the detriment of any other creditors. The transfers of almost $5.3 million to the defendants (and Horton, who is not a defendant) certainly were accepted by the defendants as funds from Holco, belonging to Holco, and being used in payment of Holco's debt to them. *See Warsco*, 258 F.3d at 564 (debtor's transfer of "something of value to a particular creditor" is considered avoidable by a trustee). The transfers just as certainly diminished Holco's bankruptcy estate. *See Southmark*, 49 F.3d at 1116-17 ("[T]he primary consideration in determining if funds are property of the debtor's estate is whether the payment of those funds diminished the resources from which the debtor's creditors could have sought payment."); *In re Lewinski*, 410 B.R. at 834 (concluding that gambling chips had clear value and that their transfer diminished the debtor's estate and therefore was avoidable). The court therefore finds that Kukui was not the only party injured by the allegedly fraudulent transfer of the Funds money to the defendants. The defendants have failed to demonstrate that the Amended Complaint's claims belong solely to Kukui and are personal only to Kukui.

In summary, the court concludes that the defendants were unsuccessful in showing that the Funds money was not "property of the estate" of the debtor, or property in which the debtor held an interest, under either of their theories, the "trust" or the "personal claim" theory.

D. *Defendants' Rule 12(b)(6) claims*

The defendants also challenged each count of the Amended Complaint for its sufficiency under Federal Rule 12(b)(6). The court will dismiss a complaint whenever its allegations do not "contain sufficient factual matter, accepted as true, to 'state a claim to relief that is plausible on its face.'" *Ashcroft v. Iqbal*, 556 U.S. 662, 678, 129 S. Ct. 1937, 173 L.Ed.2d 868 (2009) (quoting *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 570, 127 S. Ct. 1955, 167 L.Ed.2d 929 (2007)). It examines this Amended Complaint to determine whether the Trustee "pled 'factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.'" *G & S Holdings LLC v. Continental Cas. Co.*, 697 F.3d 534, 537 (7th Cir. 2012) (quoting *Iqbal*, 556 U.S. at 678). It also requires the allegations of fraud to "state with particularity the circumstances constituting fraud." Fed. R. Civ. P. 9(b); Fed. R. Bankr. P. 7009; *see also Cincinnati Life Ins. Co. v. Beyrer*, 722 F.3d 939, 948 (7th Cir. 2013).

(1) Counts I and II: The Federal and State Fraudulent Transfer Claims

The Amended Complaint alleged that the debtor's payments to the defendants were transfers of property of the debtor, made within two years of the petition date, and made with actual intent to defraud the debtor's creditors. It further alleged that the debtor received less than reasonably equivalent value in exchange for the transfers, under both federal and state law, and that the debtor either was insolvent or became insolvent as a result of the transfers. Count I charged that the debtor's actions constituted fraudulent transfers pursuant to 11 U.S.C. § 548(a)(1)(A) and/or (B). Count II alleged that the debtor's actions were fraudulent transfers under Indiana's Uniform Fraudulent Transfer Act ("UFTA"), Indiana Code § 32-18-2-1 *et seq*.

The defendants asserted that the Trustee's lack of an equitable interest in the Funds was fatal to his fraudulent transfer claims. In their view, Counts I and II were precluded and must be dismissed because the debtor held "only a limited legal right" to the Funds and thus no "property of the debtor" was transferred to the defendants. R. 15 at 9; R. 46 at 3-4.

The Trustee responded that he sought to recover Funds money that the debtor managed, controlled, and transferred to pay off loans held by the defendants, Holco's creditors, within the two-year preferential period. He claimed that the transferred amounts were owed to the estate as fraudulent conveyances and could be recovered for the benefit of the estate and its creditors, including Kukui, an unsecured creditor. Describing the fraudulent transaction as one similar to a Ponzi scheme, the Trustee sought judgment on those transfers in the total amount of almost $4.7 million (which amount does not include the transfers to Horton), far in excess of the $2.7 million judgment the debtor owed to Kukui.[17]

Section 548(a)(1)(A), the "actual fraud" statute, "allows the avoidance of any transfer of an interest in the debtor's property if the debtor made the transfer 'with actual intent to hinder, delay, or defraud' another creditor." *In re Sentinel Management Group, Inc.*, _ F.3d _, 2013 WL 4505152 at *5 (7th Cir. Aug. 26, 2013) (reversing on ground that transfers of segregated funds demonstrated actual intent to defraud and could be avoided). Section 548(a)(1)(B), the "constructive fraud" provision, "empowers the bankruptcy trustee to avoid certain transfers out of the bankruptcy estate, including one for which the debtor 'received less than a reasonably equivalent value' for property and thus 'became insolvent as a result of such

[17] A "Ponzi scheme" is a "fraudulent investment scheme in which money contributed by later investors generates artificially high dividends or returns for the original investors, whose example attracts even larger investments." *Black's Law Dictionary* 1278 (9th ed. 2009); *see, e.g., In re Lancelot Investors Fund, L.P.*, 467 B.R. 643, 649-50 (Bankr. N.D. Ill. 2012), *aff'd*, 2013 WL 4767495 (7th Cir., Sept. 6, 2013) (a Ponzi scheme case).

transfer.'" *In re Smith*, 614 F.3d 654, 657 (7th Cir. 2010) (reversing on ground that deed was recorded within § 548's two-year look-back period). Indiana's UFTA allows a trustee to avoid a fraudulent transfer if the debtor transferred the property without receiving a reasonably equivalent value in exchange for it and if the debtor was insolvent or became insolvent as a result of the transfer. Ind. Code § 32-18-2-15; *see In re Merrillville Surgery Ctr., LLC*, 2013 WL 3338418 at *4 (N.D. Ind. July 2, 2013). Under both the Indiana UFTA and § 548(a)(1), a transfer of property in which the debtor has an interest is fraudulent and avoidable whether the fraud is actual or constructive. The Trustee has alleged both types of fraud.

The court already has found that the defendants have not shown that the Trustee lacked standing or lacked an interest in the property of the debtor. The court now finds that the defendants have not shown that the Trustee has failed to state a claim for relief in Counts I and II. The Trustee has alleged who made each transfer (Holco); what was transferred (Funds account money); to whom each transfer was made (defendants); how much was transferred; and on what dates each transfer occurred. *See In re Merrillville Surgery Ctr., LLC*, 2013 WL 3338418 at *3. He does not need to establish, on a motion to dismiss, the requisite intent under subsection (A) or reasonably equivalent value under subsection (B). *See id.* The Trustee has described the debtor's complete ability to control the Funds accounts, to refuse to turn them over to Kukui, and to transfer Funds money to its own creditors. The Trustee's allegations also have presented sufficient elements of fraud and intent by setting forth the specific times, dates, and details of the transfers from the Funds accounts to each defendant. The misconduct was alleged fully, not in conclusory statements. Under either federal or state law, his story holds together and the events could have happened as he described. *See Swanson v. Citibank, N.A.*, 614 F.3d 400, 404 (7th Cir. 2010).

The court therefore concludes that the Trustee's claims of fraudulent transfer in Counts I and II contain sufficient facts to state a claim to relief under § 548(a)(1) and Indiana's UFTA statute that are plausible on the face of the Amended Complaint. For those reasons, the court denies the defendants' Motion to Dismiss Counts I and II of the Amended Complaint.

(2) Count III: Conversion

Count III alleged the Trustee's entitlement to recovery of the transfers made by the debtor to the defendants. It stated that the Hawaii District Court Order determined that the Funds in question were converted funds that the Trustee could recover as "converted funds in which the defendants can have no ownership interest." Count III, ¶ 3. The defendants contended, as they have throughout this adversary proceeding, that the Trustee has no right to possession of the Funds because neither the estate nor the creditors have a valid interest in the Funds. The court found, *supra*, that the defendants failed to prove (a) that the Funds were trust accounts solely for Kukui's benefit, or (b) that Kukui, and not the bankruptcy estate or the creditors of the debtor, held the sole claim to the Funds because it was the only injured party. The court again finds those arguments unavailing and determines that the Trustee has an interest in the Funds on behalf of the bankruptcy estate and the creditors of the debtor.

In Indiana, a person commits conversion when he "knowingly or intentionally exerts unauthorized control over the property of another person." Ind. Code. § 35-43-4-3. Once a plaintiff proves that the defendants committed conversion and that he is the victim of conversion, he needs only to establish a right to recover by a preponderance of the evidence. *See In re Baker*, 2011 WL 4549156 at *4 (Bankr. S.D. Ind. Sept. 28, 2011).

A typical conversion action brought by a trustee usually arises when a defendant wrongly diverted money from the debtor's bank account into his own account, or wrongly sold the debtor's vintage automobile and pocketed the proceeds. *See, e.g., In re FYM Clinical Laboratory, Inc.*, 1997 WL 666238 at *3 (S.D.N.Y. Oct. 27, 1997); *In re Ticketplanet.com*, 313 B.R. 46, 69 (Bankr. S.D.N.Y. 2004). In this case, however, the Trustee based his conversion claim on the defendants' failure or refusal to turn over the funds transferred to them by the debtor. The Trustee followed a method similar to one set forth in 11 U.S.C. § 550(a), which allows a trustee to recover transferred property from a transferee for the benefit of the estate. In his brief, he explained that he sent letters to the defendants demanding the return or repayment of the money received from Holco, on the ground that they had received Funds money held in trust for Kukui. *See* R. 38 at 16; *see also* R. 52, Exs. F-I (letters). He then argued that the defendants, by refusing to return the money to the Trustee, "knowingly or intentionally exerted unauthorized control" over the debtor's property that is now property of the bankruptcy estate. *See* R. 38 at 16. The Trustee's position, in other words, is not that the defendants took the Funds money from the debtor in an unauthorized manner; rather, his allegation is that they kept the money, maintaining "unauthorized control" over it and refusing to return it to the Trustee, after being told that it was improperly paid to them.

The problem the court finds, however, is that the Trustee's brief explained his contentions but that the Amended Complaint failed to state these allegations in Count III. The pleading did not set forth the elements of conversion and then state a claim to relief under it that was plausible. The Amended Complaint relied on the Hawaii District Court's Order, which had determined that the debtor Holco (not the defendants) had converted the Funds of Kukui (not of Holco) by refusing to turn them over to Kukui (not to Holco's bankruptcy Trustee). That Order neither applied to the defendants nor gave the Trustee authority to recover those Funds amounts paid by the debtor to the defendants. Based on the allegations before it under Count III, the court cannot reasonably infer that the defendants are liable for any misconduct.

The court therefore determines that the allegations in Count III do not contain sufficient factual matter to state a claim to relief that is plausible on its face. For that reason, the court grants the defendants' Motion to Dismiss as to Count III of the Amended Complaint. Count III of the Amended Complaint is dismissed.

(3) <u>Count IV: Breach of Fiduciary Duty, Imposition of Constructive Trust</u>

Count IV asserted that the funds paid to the defendants were trust funds Holco held as a fiduciary, funds that were acquired by fraud and paid to the defendants in breach of Holco's fiduciary duty. It further alleged that the defendants were unjustly enriched by the debtor's fraudulent conduct and must repay those funds to the Trustee because the funds are subject to constructive trusts. The defendants contended that

Count IV must be dismissed because the Trustee's request for a constructive trust was inappropriate. According to the defendants, the Trustee's allegations of a breach of fiduciary duty are misplaced.

> [T]he fiduciary duty alleged in the Trustee's complaint belonged to Holco, not Wells Fargo. There is no allegation of a fiduciary relationship between Wells Fargo and Kukui as would be required for the imposition of a fiduciary trust.

R. 15 at 11-12.

The Trustee responded that he had an unqualified right to the converted Funds money, as property of the estate, and that the defendants would be unjustly enriched if they were permitted to retain the payments. He explained: "[T]he Money was Money given to the Debtor by Kukui for the Debtor to service Kukui's note, mortgage, and funds, not for the debtor to pay its own debts." R. 38 at 15.

When a plaintiff asks the court to impose a constructive trust based on a claim of constructive fraud, in Indiana he "must establish that a duty of care exists." *Purcell v. Old Nat'l Bank*, 972 N.E.2d 835, 842 (Ind. 2012). A claim of constructive fraud requires proof of "a fiduciary or fiduciary-like relationship." *In re Rueth Development Co.*, 976 N.E.2d 42, 52 (Ind. App. 2012).

> A fiduciary relationship exists when a confidence is reposed by one party in another with resulting superiority and influence exercised by the other. In a fiduciary relationship, one party places a special trust and confidence in a dominant party and it is presumed that a transaction entered into during such a relationship is not at arm's length.

Doe v. Roman Catholic Archdiocese of Indianapolis, 958 N.E.2d 472, 477 (Ind. App. 2011) (citations omitted). "[I]t must be shown that the dominant party improperly influenced the weaker party to gain an 'unconscionable advantage.'" *Paul v. Home Bank S.B.*, 953 N.E.2d 497, 505 (Ind. App. 2011). The plaintiff alleging the existence of a constructive fraud has the burden of proving that a duty of care and a fiduciary relationship exist.

In this case, a fiduciary relationship is alleged to exist between Kukui and Holco.[18] No fiduciary relationship is alleged between Kukui and Wells Fargo or, for that matter, between Holco and Wells Fargo. It is important, again, to separate the two alleged misappropriations or conversions of Holco. There are no allegations of a fiduciary duty owed by the defendants to any interested party.

Therefore the allegations in the Amended Complaint do not support a determination that the defendants owed a fiduciary duty to Holco or to Kukui. The Trustee is unable to prove the three required elements for breach of fiduciary duty: (1) the existence of a fiduciary relationship; (2) a breach of the duty owed by the fiduciary to the beneficiary; and (3) harm to the beneficiary." *York v. Fredrick*, 947 N.E.2d 969, 978 (Ind. App. 2011).

Nor do the allegations of the Amended Complaint support a claim for unjust enrichment. Count IV alleged that the defendants were unjustly enriched by the debtor's payments to them and charged that "equity require[d] that the funds paid to the defendants are subject to constructive trusts." R. 52, Count IV at ¶ 3. A "constructive trust" is a remedy in equity for unjust enrichment. It is an implied rather than a real trust, and it is imposed on parties in limited circumstances to prevent unjust results.

> Also referred to as quantum meruit or quasi-contract, unjust enrichment requires a party who has been unjustly enriched at another's expense to make restitution to the aggrieved party. To recover under an unjust enrichment claim, a plaintiff must generally show that he rendered a benefit to the defendant at the defendant's express or implied request, that the plaintiff expected payment from the defendant, and that allowing the defendant to retain the benefit without restitution would be unjust.

Reed v. Reid, 980 N.E.2d 277, 296 (Ind. 2012) (citing *Bayh v. Sonnenburg*, 573 N.E.2d 398, 408 (Ind. 1991), *cert. denied*, 502 U.S. 1094 (1992)).

When the parties operated under a contract, however, then the contract's provisions control the rights of the parties and a remedy at law, rather than in equity, is available. *See Eagle Aircraft, Inc. v.*

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[18] The Amended Complaint, relying on the Hawaii District Court's determinations and conclusions, alleged that the "funds in question were trust funds held by Holco as a fiduciary." R. 52, Count IV, ¶ 1; *see also* R. 52, II at ¶¶ 7, 19. As this court stated earlier, it recognizes the Hawaii court's thorough, complex opinion and found its analysis quite helpful, but its legal conclusions have no *res judicata* effect herein. Nor is this court "bound to accept as true a legal conclusion couched as a factual allegation." *See supra* at 17.

Trojnar, 983 N.E.2d 648, 660 (Ind. App. 2013) (stating that a contract precludes application of unjust enrichment). The Amended Complaint alleged that Kukui and HUD operated under a contract with Holco. *See* Amended Complaint, R. 52, II at ¶ 5 (stating that "Kukui and HUD *contracted* with Holco"). It also alleged that Holco held commercial loans with the defendants, and the defendants stated in their briefs that the loan agreements were contractual. *See id.* at ¶¶ 21, 23, 25, 27; *see also* R. 15 at 12 ("all of the relevant relationships were governed by contract"). For those reasons, an implied contract cannot be imposed upon the defendants.

In light of the existing contracts referenced in the Amended Complaint, the court finds that the Amended Complaint's allegations in Count IV do not contain sufficient factual matter, accepted as true, to state a plausible claim for the imposition of a constructive trust. For that reason, the defendants' Motion to Dismiss as to Count IV is granted. Count IV of the Amended Complaint is dismissed.

4. <u>Count V: Damages under Indiana Code § 34-24-3-1</u>

Count V demanded treble damages, attorney's fees, costs, and expenses under Indiana Code § 34-24-3-1. It alleged that the defendants refused to return the converted funds after having received demand letters from the Trustee. The defendants argued in response that the Trustee did not assert or establish a conversion claim against the defendants.

Treble damages are authorized under the damages statute for civil actions, found at Indiana Code § 34-24-3-1. The statute provides that, "[i]f a person . . . suffers a pecuniary loss as a result of a violation of IC 35-43 [enumerated crimes, which include theft and conversion] . . ., the person may bring a civil action against the person who caused the loss," seeking up to three times the amount of actual damages, plus costs, expenses, and reasonable attorney's fees. Ind. Code. § 34-24-3-1. The plaintiff must demonstrate his right to recover damages under this statute by proving all the elements of the alleged criminal act by a preponderance of the evidence. *See In re Baker*, 2011 WL 4549156 at *4 n.5 (Bankr. S.D. Ind. Sept. 28, 2011); *Ruse v. Bleeke*, 914 N.E.2d 1, 8 (Ind. App. 2009).

The Trustee failed to prove the elements of conversion by a preponderance of the evidence, and for that reason Count III was dismissed for failure to state a claim. Consequently, the Trustee's request for treble damages cannot succeed and Count V must be dismissed.

There is a second reason, as well, that the Trustee cannot claim damages under this state statute. The provision grants damages to a person who "has suffered a pecuniary loss as a result of alleged criminal conduct." *See* Ind. Code § 34-24-3-1. However, a trustee in bankruptcy has not suffered any pecuniary loss and thus cannot seek that relief. *See In re Myers*, 320 B.R. 667, 669 (Bankr. N.D. Ind. 2005); *see also In re First Fin'l Assocs., Inc.*, 371 B.R. 877, 920 (Bankr. N.D. Ind. 2007); *Bridgeforth v. Thornton*, 847 N.E.2d 1015, 1029 (Ind. App. 2006). Accordingly, Count V of the Amended Complaint fails to state a claim for relief under the state damages provision, Indiana Code § 34-24-3-1.

The defendants' Motion to Dismiss Count V is granted, and Count V of the Amended Complaint is dismissed.

5. <u>Count VI: 11 U.S.C. § 548(e)</u>

Section 548(e) of the Bankruptcy Code allows a trustee to avoid a transfer of an interest of the debtor in property if, within ten years of filing, the debtor made the transfer to a self-settled trust or similar device. In Count VI, the Amended Complaint alleged that the transfers by the debtor to the defendants constituted transfers under § 548(e) because they were made within ten years of the date of the bankruptcy petition, were made when the debtor owed a fiduciary duty to Kukui, and were "in anticipation of a money judgment which would have occurred because of the debtor's fraud, deceit, and/or manipulation in its fiduciary capacity it owed to Kukui." R. 52, Count VI, ¶ 4.

The defendants asserted that § 548(e) has no application to this case because (a) no "transfer of an interest of the debtor in property" was made, and (b) no transfer *to* a *self-settled trust* or similar device was made. They pointed out that the transfers were made *from* a trust account to the defendants, and that the trust account was not self-settled. According to Black's Law Dictionary, a "self-settled trust" is "[a] trust in which the settlor is also the person who is to receive the benefits from the trust, usu[ally] set up in an attempt to protect the trust assets from creditors." *Black's Law Dictionary*, at 1654 (9th Ed. 2009). In this case, they insisted, no transfer was made to a self-settled trust and the debtor was not the beneficiary of the trust. For that reason, they concluded, § 548(e) was inapplicable and Count VI of the Amended Complaint must be dismissed.

Section 548(e)(1) of the Bankruptcy Code allows a trustee to "avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition, if –

> (A) such transfer was made to a self-settled trust or similar device;
> (B) such transfer was by the debtor;
> (C) the debtor is a beneficiary of such trust or similar device; and
> (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.

11 U.S.C. § 548(e)(1). The burden of proving the elements of this provision is placed on the Trustee. *See In re Huber*, 493 B.R. 798, 811 (Bankr. W.D. Wash. 2013). If transfers of assets into a self-settled or similar trust were made, the transfers are avoidable as fraudulent transfer. *See In re Mastro*, 465 B.R. 576, 611 (Bankr. W.D. Wash. 2011).

This subsection was added in 2005 to close the "self-settled trusts loophole." *See In re Mortensen*, 2011 WL 5025249 at *6 (Bankr. D. Alaska May 26, 2011).[19] *Mortensen* arose in Alaska, one of the states that permits self-settled trusts, and that case exemplifies the intent of the statutory addition to the Code. In that case, Mortensen's trust transferred real property to a self-settled trust; Mortensen made the transfer, and he was the beneficiary of the trust. *See id.*, 2011 WL 5025249 at *6. The court then found, from the evidence before it, that he transferred the property "with actual intent to hinder, delay, or defraud"

[19] The court, in its research, has not found that Indiana has enacted a statute protecting self-settled trusts, and the Trustee has not cited to such a statute. *See in re Porco*, 447 B.R. 590, 595 (Bankr. S.D. Ill. 2011) (describing history of § 548(e), stating that Illinois has not enacted such a statute).

his creditors. *See id.* at *7. Finally, the court granted the trustee the authority to avoid the real property under § 548(e). *See id.* at *8.

None of these circumstances is found in the allegations of Count VI of the Amended Complaint. There is no allegation of a self-settled trust, a trust of any kind, or a similar device. The court concludes that clearly no self-settled trust or other device was created. *See Porco*, 447 F.3d 590, 596 (Bankr. S.D. Ill. 2011). In addition, Count VI does not allege that the debtor was the beneficiary of a trust. Two of the required factors of § 548(e) therefore are not found in Count VI, and the court need go no further.

The court finds that Count VI of the Amended Complaint fails to allege the necessary elements to set aside a fraudulent transfer under § 548(e). For that reason, the court grants the defendants' Motion to Dismiss and dismisses Count VI.

In summary, the court has determined that the Trustee has standing to bring fraudulent transfer claims under 11 U.S.C. § 548(a)(1)(A) and (B). In addition, the Trustee's Amended Complaint presented allegations with sufficient factual matter to state a plausible claim to relief under § 548(a)(1) and under Indiana's Uniform Fraudulent Transfer Act. For that reason, Counts I and II are not dismissed. However, the Amended Complaint's remaining counts failed to plead sufficient factual content that allowed the court to draw the reasonable inference that the defendants were liable for the misconduct alleged. For that reason, the court determines that the Amended Complaint failed to state a claim to relief in Counts III, IV, V, and VI, and those counts of the Amended Complaint are dismissed.

CONCLUSION

For the reasons presented in this Memorandum of Decision, the court grants in part and denies in part the Motion to Dismiss the Amended Complaint of J. Richard Ransel, Trustee of the chapter 7 debtor Holco Capital Group, Inc., which was filed jointly by the defendants Libertyville Bank and Trust Company, Wells Fargo Bank, N.A., HSL Financial, LLC, and SL Financial of Illinois, LLC. The Motion to Dismiss is DENIED as to Counts I and II of the Amended Complaint. The Motion to Dismiss is GRANTED as to Counts III, IV, V, and VI of the Amended Complaint.

SO ORDERED.

/s/ HARRY C. DEES, JR.
HARRY C. DEES, JR., JUDGE
UNITED STATES BANKRUPTCY COURT