

**IN THE UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF ARKANSAS
HOT SPRINGS DIVISION**

**IN RE: WESLEY C. SANDIFORD and
FLORENCE J. SANDIFORD, Debtors**

**No. 6:06-bk-72762
Chapter 7**

ORDER

Before the Court is the Trustee's Application for and Notice of Compromise and Settlement filed on July 3, 2007, by Frederick S. Wetzel as chapter 7 trustee and an Objection to Application for Settlement filed on July 24, 2007, by John P. Talbot on behalf of creditor Cadleway Properties, Inc. The Court held a hearing on the application and objection on October 24, 2007, at which time the Court took the matter under advisement. This Court has jurisdiction over this matter under 28 U.S.C. § 1334 and 28 U.S.C. § 157, and it is a core proceeding under 28 U.S.C. § 157(b)(2)(A), (N), and (K). For the reasons stated below, the Court overrules Cadleway's objection to the extent that it claims a lien on the subject proceeds and holds the chapter 7 trustee's application in abeyance.

Position of the Parties

The chapter 7 trustee is holding property of the estate in the amount of \$17,953.29 resulting from the sale of real estate located at 2 Ona Lane, Hot Springs Village, Arkansas [Property]. Prior to the bankruptcy filing, the Property was being held in a purported trust settled by the debtors and pursuant to which the debtors were the sole beneficiaries. The chapter 7 trustee's application proposes to allow the debtors to claim \$8976.65 of the proceeds as exempt and for the chapter 7 trustee to keep the remaining proceeds of \$8976.65¹ as property of the estate. Cadleway consented to the sale, but objected to the terms of the proposed settlement on the ground that Cadleway has a judgment lien that attached to the Property pre-petition, and, therefore, Cadleway is entitled to the proceeds

¹ These two distributions the chapter 7 trustee proposes to make in his application actually total \$17,953.30.

from the sale of the Property. The chapter 7 trustee and Cadleway have each filed objections to the debtors' exemptions claimed in the Property and three other parcels of real estate. Because these objections were not heard at the October 24 hearing, the Court will reserve the issue of whether the debtors are entitled to any of the proceeds as exempt property. As a result, this Court must hold the trustee's application in abeyance until a hearing is held on the respective objections to exemptions.

Background

On December 20, 2001, a judgment was rendered against the debtors by a Louisiana District Court in favor of Hibernia National Bank. Hibernia assigned the judgment to Cadleway Properties, Inc. On August 8, 2006, Cadleway filed its foreign judgment against the debtors in Garland County, where the Property is located. The parties stipulated at hearing that the debtors were aware of the judgment when it was entered in 2001, and, to date, the judgment remains unpaid.²

On May 16, 2006, the debtors created a trust in order to purchase the Property and appointed Theresa Broussard, their daughter, as trustee [Trustee]. They signed a document titled Agreement and Declaration of Trust [Trust Document], which states in pertinent part:

THIS AGREEMENT AND DECLARATION OF TRUST Is made and entered into this 16th day of May, 2006, by and between Wesley C & Florence J. Sandiford, as Grantors and Beneficiaries, . . . and Theresa Broussard, as Trustee/Vance Family Trust # 20L-HSV06 . . . hereinafter referred to as the "Trustee". . . .

IT IS MUTUALLY AGREED AS FOLLOWS:

1. **Trust Property.** The Beneficiaries are about to convey or cause to be conveyed to the Trustee by deed, absolute in form, the property described in the attached Exhibit "A", which said property shall be held by

² The parties also stipulated that in August 2006, the debtors formed a corporation, Primrose Properties, Inc., in which the debtors were the sole employees and shareholders. Primrose made the payments on and received the rental payments collected from the Property.

the Trustee, in trust, for the following uses and purposes, under the terms of this Agreement and shall be hereinafter referred to as the "Trust Property".

2. **Consideration.** No consideration was paid by Trustee for such conveyance. . . .

. . . .

4. **Interests.** The interests of the Beneficiaries shall consist solely of the following rights respecting the Trust Property:

- a. The right to direct the Trustee to convey or otherwise deal with the title to the Trust Property as hereinafter set out.
- b. The right to manage and control the Trust Property.
- c. The right to receive the proceeds and avails from the rental, sale, mortgage, or other disposition of the Trust Property.

The foregoing rights shall be deemed to be personal property and may be assigned and otherwise transferred as such. No Beneficiary shall have any legal or equitable right, title or interest, as realty, in or to any real estate held in trust under this Agreement, or the right to require partition of that real estate, but shall have only the rights, as personally, set out above, and the death of a Beneficiary shall not terminate this Trust or in any manner affect the powers of the Trustee.

. . . .

9. **Removal of Trustee.** The Beneficiaries shall have the power to remove a Trustee from his office or appoint a successor to succeed him.

. . . .

11. **Objects and Purposes of Trust.** The objects and purposes of this Trust shall be to hold title to the Trust Property and to protect and conserve it until its sale or other disposition or liquidation. . . .

. . . .

14. **Recording of Agreement.** This Agreement shall not be placed on record in the county in which the Trust Property is situated, or elsewhere

. . . .

17. **Assignment.** The interest of a Beneficiary, or any part of that interest, may be transferred only by a written assignment, executed in duplicate and delivered to the Trustee. . . .

. . . .

25. **Termination.** This trust may be terminated at any time by the Beneficiaries

The Trust Document also grants powers to the Trustee, which are each conditioned on obtaining the consent of the beneficiaries. The Trust Document does not contain a spendthrift provision.

Also on May 16, 2007, Ms. Broussard, as Trustee, entered into a Contract for the Sale of Real Property, in order to purchase the Property. The contract states, in pertinent part:

THIS AGREEMENT made and entered into by and between **ROBERT EUGENE VANCE and DORIS I. VANCE . . .** hereinafter called Seller, and the **VANCE FAMILY TRUST, Theresa M. Broussard, as Trustee and not personally under the provisions of a trust agreement dated the 16th day of May, 2006, known as Trust Number 2OL-HSV06, hereinafter called Buyer, . . .**

1. **Agreement of Sale and Purchase.** The Seller hereby agrees to sell and the Buyer agrees to purchase the following described real property situated in Garland County, Arkansas, for the price, on the terms, and subject to the conditions hereinafter set forth. . . .

2. **Purchase Price.** The Buyer hereby agrees to pay and the Seller agrees to accept for the aforesaid property the sum of **EIGHTY-NINE THOUSAND FIVE HUNDRED AND NO/100 DOLLARS (\$89,500.00)**, of which the sum of NO DOLLARS (\$0.00) has been paid in cash The balance of **EIGHTY-NINE THOUSAND FIVE HUNDRED AND NO/100 DOLLARS (\$89,500.00)** shall be paid in successive, equal, monthly installments, including interest at the rate of **SIX PERCENT (6%)** per annum, in the sum of **SIX HUNDRED FIFTY AND NO/100 DOLLARS (\$650.00)** each, with the first such monthly payment thereafter becoming due on the **1st day of JUNE, 2006**, and a like sum on the same day of each succeeding month until **MAY 1, 2010**, at which time the entire unpaid principal and any accrued interest shall be due and payable. . . .

3. **Title Documents.** If the Buyer shall make all of the payments herein called for and shall fully keep and perform each and all of the covenants herein made by Buyer, the Seller shall make, execute and deliver to the Buyer the Seller's warranty deed conveying the aforesaid property free and clear of all liens and encumbrances. . . .
. . . .
10. **Escrow Agreement.** Pursuant to this contract, the Seller has executed and deposited with SECURITY TITLE, INC., Escrow Agent, a Warranty Deed conveying the subject real property to the Buyer. Upon the full satisfaction and completion of the subject contract for the sale of real property by the Buyer, and upon valid proof of said satisfaction and completion by Buyer being provided to the Escrow Agent and acknowledged by the Seller, the Escrow Agent shall immediately deliver the Warranty Deed to the Buyer for recording. . . .

Under Arkansas law, the contract for sale between the Trustee and the Vances created a

mortgage in favor of the Vances and vested equitable title in the Trustee. *Jones v. Vee Jay, Inc. (In re Vee Jay, Inc.)*, 104 B.R. 101, 104 (Bankr. W.D. Ark. 1987) (citing *Judd v. Rieff*, 295 S.W. 370 (Ark. 1927)).

The debtors filed a joint, voluntary chapter 7 petition on November 27, 2006. The debtors listed the Property in Schedule A and stated that they held a “Fee simple (titled as Vance Family Trust)” interest. On March 26, 2007, the chapter 7 trustee filed a motion to sell the Property. Cadleway objected to the motion on April 5, 2007, and requested a hearing. An order was entered on April 16, 2007, withdrawing Cadleway’s objection to the sale and granting the chapter 7 trustee’s motion to sell upon the condition that the net proceeds are held until the Court could determine the bankruptcy estate’s interest in the proceeds. The Property was sold and on July 3, 2007, the chapter 7 trustee filed the application at issue; Cadleway filed an objection, claiming the proceeds from the sale of the Property.

Findings of Fact and Conclusions of Law

The issue before the Court is whether the debtors held an interest in the Property to which Cadleway’s judgment lien attached, and, if so, whether the chapter 7 trustee may avoid Cadleway’s lien under 11 U.S.C. § 544. It is undisputed that the Property has never been titled in the names of the debtors; however, Cadleway contends that the trust should be considered void, resulting in the debtors holding an equitable interest to which Cadleway’s judgment lien attached.

Within bankruptcy proceedings, state law primarily determines the extent of a debtor’s interest in property. *Chiu v. Wong*, 16 F.3d 306, 309 (8th Cir. 1994); *Vee Jay, Inc.*, 104 B.R. at 104. It is undisputed that Cadleway properly filed its foreign judgment against the debtors with the Garland County Circuit Court; therefore, the judgment will have the same effect as a judgment rendered by a court of Arkansas. Ark. Code Ann. § 16-66-602 (2005). Under Arkansas statute, “[a] judgment in the . . . circuit courts of this state . . . shall be a lien on the real estate owned by the defendant . . .” Ark. Code Ann. § 16-65-117(a)(1)(A) (2005). In Arkansas, liens attach to “equitable estates as well as

those clearly titled in the name of the defendant.” *Rice v. La Sher Oil Co. (In re Akel)*, 269 B.R. 800, 801 (Bankr. E.D. Ark. 2001) (citing *Cohn v. Hoffman*, 6 S.W. 511, 513 (Ark. 1887)). If the trust is void, the debtors held an equitable interest in the Property pursuant to the contract for sale, and Cadleway’s judgment would have attached to the Property upon filing the foreign judgment.

In determining the validity of the trust, the Court must look to Arkansas law, under which the Arkansas Trust Code and consistent common law controls. Ark. Code Ann. § 28-73-106 (Supp. 2007). A trust in Arkansas is created to the extent its purposes are “lawful, not contrary to public policy, and possible to achieve.” Ark. Code Ann. § 28-73-404 (Supp. 2007); *see also* Restatement (2d) *Trusts* § 63 (stating that “[a] trust is invalid if the purpose of the settlor in creating the trust is to defraud his creditors or other persons”). Under Arkansas law, “a transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation: (1) With actual intent to hinder, delay, or defraud any creditor of the debtor” Ark. Code Ann. § 4-59-204(a) (2001). The statute lists several “badges of fraud” that may be considered when determining whether actual intent exists. Ark. Code Ann. § 4-59-204(b) (2001).

Cadleway’s argument against the validity of the Trust Document is that it was created for the fraudulent purpose of shielding the Property from Cadleway’s judgment lien. As evidence that the trust arrangement was fraudulent, Cadleway points to the debtors’ knowledge of the judgment but lack of payment, the debtors appointment of their daughter as Trustee, and the timing of the formation of the trust relative to the filing of the bankruptcy petition.

Cadleway also raises several provisions of the Trust Document as evidence that the trust is invalid. Typically, the trustee holds legal title to trust property while the beneficiaries hold an equitable interest. *Kohn v. Pearson*, 670 S.W.2d 795, 798 (Ark. 1984) (citing 76

Am. Jur. 2d *Trusts* § 5 (1975), stating that a “distinguishing feature of any type of trust is that it involves a separation of equitable interest and legal title”); *Halliburton Co. v. E.H. Owen Family Trust*, 773 S.W.2d 453, 456 (Ark. Ct. App. 1989) (asserting that “[a] trust is a fiduciary relationship in which one person is the holder of the title to property subject to an equitable obligation to keep or use the property for the benefit of another”). However, according to the Trust Document, the Trustee held both legal and equitable title to the trust property while the beneficiaries’ rights were “deemed to be personal property.” The document states that “No Beneficiary shall have any legal or equitable right, title or interest, as realty, in or to any real estate held in trust under this Agreement”

A trust like the one presented in this case resembles a type of trust originally created under Illinois law called a "land trust." *BA Mortgage and Int'l Realty Corp. v. Am. Nat'l Bank and Trust Co.*, 706 F. Supp. 1364, 1369-70 (N.D. Ill. 1989). Illinois statute defines a land trust as “any trust arrangement under which the legal and equitable title to real estate is held by a trustee, the interest of the beneficiary of the trust is personal property and the beneficiary or any person designated in writing by the beneficiary has (i) the exclusive power to direct or control the trustee in dealing with the title to the trust property, (ii) the exclusive control of the management, operation, renting and selling of the trust property and (iii) the exclusive right to the earnings, avails and proceeds of the trust property.” 735 Ill. Comp. Stat. 5/15-1205 (West, WESTLAW through 2007 Reg. Sess.).

The transfer that the debtors caused to occur from the Vances to the Vance Family Trust does possess some factors evident of actual intent to defraud creditors. Further, the Trust Document in this case has all of the characteristics of a land trust, and whether a land trust is valid in Arkansas appears to be a case of first impression. However, it is unnecessary for the Court to rule on whether the trust fails for either reason. If the trust was not created to defraud creditors and is valid under Arkansas law, then the debtors only held a personal property interest in the Property and Cadleway’s lien would not attach under section 16-65-117(a)(1)(A) of the Arkansas Code. On the other hand, if the trust is invalid and the debtors were the owners of an equitable interest in the Property at the time

Cadleway filed its judgment, Cadleway's lien may still be avoided by the chapter 7 trustee.

Section 544(a)(3) of the bankruptcy code confers on the chapter 7 trustee the power to “avoid any transfer of property of the debtor or any obligation incurred by the debtor that is avoidable by . . . a bona fide purchaser of real property . . . from the debtor” 11 U.S.C. § 544(a)(3). In other words, a bankruptcy trustee is a hypothetical bona fide purchaser and “is deemed to have conducted a title search, paid value for the property and perfected its interest as a legal title holder as of the date of commencement of the case.” 5 Collier on Bankruptcy ¶ 544.08, at 544-18 (15th ed. rev. 2004). However, bankruptcy law does not permit an interest to be avoided if the chapter 7 trustee would have had constructive notice under applicable state law. *Id.*; *Midlantic Nat'l Bank v. Bridge (In re Bridge)*, 18 F.3d 195, 200 (3d Cir. 1994). In Arkansas, a bona fide purchaser of land takes property “in good faith, for valuable consideration, and without notice of a prior interest.” *Bill's Printing, Inc. v. Carder*, 161 S.W.3d 803, 807 (Ark. 2004). A purchaser is on constructive notice if the purchaser is aware “of such facts and circumstances as would put a person of ordinary intelligence and prudence on such inquiry that, if diligently pursued, would lead to knowledge of those prior interests.” *Id.* Although Cadleway asserted at hearing that the debtors had an interest in the Property, Cadleway presented no evidence why a lien on such purported interest could not be avoided by the trustee under § 544. The chapter 7 trustee, as a bona fide purchaser of the debtors' interest in the Property, would not have had any record or constructive notice of Cadleway's lien. Cadleway's lien was against the debtors personally, not against the Property or the Vance Family Trust. The Property was never titled in the debtors' names, and the Trust Document that linked the debtors to the Property was not recorded. Therefore, even if the trust were void under Arkansas law, because a bona fide purchaser would not have had constructive notice of Cadleway's potential interest in the Property, the chapter 7 trustee, with the powers of a bona fide purchaser, may avoid the lien Cadleway would have if the trust failed.

For the reasons stated above, the Court overrules Cadleway's objection to the chapter 7 trustee's application for compromise and settlement to the extent it seeks on a lien on the proceeds from the sale of the Property. The Court holds the trustee's application in abeyance pending resolution of the chapter 7 trustee's and Cadleway's objections to the debtors' claim of exemptions.

IT IS SO ORDERED.

January 10, 2008

DATE



BEN T. BARRY

UNITED STATES BANKRUPTCY JUDGE

cc: John P. Talbot, attorney for Cadleway Properties, Inc.
Frederick S. Wetzel, III, chapter 7 trustee
Kathy A. Cruz, attorney for debtors