

In the United States Bankruptcy Court  
for the  
Southern District of Georgia  
Savannah Division

In the matter of:

SMITH AND KELLY  
COMPANY, INC.  
(Chapter 7 Case 90-40077)

*Debtor*

ILA EMPLOYERS WELFARE FUND

*Plaintiff*

v.

AMERICAN FREIGHT  
FORWARDERS AND CUSTOM  
HOUSE BROKERS, INC., and  
THOMAS HARRELSON, JOBETH  
ALLEN, JOE CAFIERO, BILL  
MAMAIS, RAF BIEZENBOS,  
LINDA G. DUKES, LYNN  
MANRIQUE, MARY McEWEN,  
BURNELL RUSSELL, JEAN-LUC  
PELTIER, JOE PLUY, EDWARD  
KOZINK, AND MADELINE PAQUIN

Individually and in their  
capacities as officers and/or  
directors of Smith and Kelly  
Company, Inc., Smith and Kelly  
International, Inc., and/or  
American Freight Forwarding  
and Custom House Brokers, Inc.  
jointly and severally

Adversary Proceeding

Number 92-4007

*Defendants*

)  
)

**MEMORANDUM AND ORDER**

Plaintiff/Creditor filed this adversary complaint to void a transfer of a license and to recover damages for the Debtor's bankruptcy estate. Defendants filed a Motion to Dismiss for Failure to State of Claim Upon Which Relief Can Be Granted. A pre-trial hearing was held on March 4, 1992.

**I. Statement of the Case**

For the purpose of this Motion it is alleged and to be taken as true fact that: Debtor, Smith and Kelly Company, Inc., filed for bankruptcy on January 16, 1990. Debtor is a corporation licensed to do business in Georgia. Smith and Kelly International, Inc., is a wholly owned subsidiary of the Debtor. Part of Debtor's income is derived from Smith and Kelly International, Inc.'s freight forwarding business.

In order to engage in freight forwarding, a business must have a freight forwarding license issued by the Federal Maritime Commission. The Debtor acquired its freight forwarding license on July 30, 1965. This license was transferred to Smith and Kelly International, Inc., on July 31, 1983. On November 3, 1989, approximately 10 weeks prior to Debtor's filing bankruptcy, the license was transferred from Smith and Kelly International,

Inc., to Smith and Kelly International, Inc., d/b/a American Freight Forwarding and Custom House Brokers. Defendant, JoBeth Allen, admitted in her answer that the name on the license changed from Smith and Kelly International, Inc., to Smith and Kelly International, Inc., d/b/a American Freight Forwarding and Custom House Brokers.

On January 16, 1990, American Freight Forwarding and Custom House Brokers ("American Freight") was incorporated as a separate entity, under the laws of the State of Georgia; also on January 16, 1990, Debtor filed its Chapter 7 petition. On January 23, 1990, Defendant American Freight, as a separate incorporated entity, requested through its vice president, JoBeth Allen, that the license be transferred from Smith and Kelly International, Inc., to American Freight. The license was transferred in late January of 1990; Plaintiff has not alleged the specific date of the actual transfer of the license to American Freight as a separate corporation.

Plaintiff is a creditor in Debtor's Chapter 7 case. Plaintiff/Creditor argues that American Freight has benefitted from the license without any consideration paid to Debtor or Smith and Kelly International, Inc. Plaintiff argues that the November 3, 1989, transfer to Smith and Kelly International, Inc., d/b/a American Freight Forwarding and Custom House Brokers, and the January 1990 transfer to American Freight Forwarding and Custom House Brokers, Inc., were fraudulent and voidable under 11 U.S.C. Section 548 and should subject Defendants to damages under 11 U.S.C. Section 550. The Court observes that the January 23, 1990, transfer might be subject to challenge under 11 U.S.C. Section 549 as well.

Plaintiff alleges that accounts including the Georgia Pacific account, formerly Smith and Kelly International, Inc.'s largest account, went to American Freight when the license was transferred. Defendant JoBeth Allen denies Plaintiff's assertions about the accounts. Defendant JoBeth Allen was vice president of Smith and Kelly International, Inc., later vice president of American Freight Forwarders and Custom House Brokers, Inc. Ms. Allen was also the freight forwarding agent at both businesses.

Plaintiff filed the instant adversary on January 15, 1992. Paragraph 2 of the complaint includes the following language:

Creditor-Plaintiff has sought to have the Chapter 7 Trustee proceed with or join in this matter. He has declined, and Creditor-Plaintiff therefore prays that it be allowed to proceed on behalf of the estate.

*See* Paragraph "2" of the Adversary Complaint.

Defendant moves to dismiss the adversary complaint on the grounds that the Plaintiff/Creditor has no standing to bring a fraudulent conveyance action. Defendants further allege that such an individual creditor, if allowed to proceed at all, should obtain permission from the Trustee and the Bankruptcy Court prior to commencing the action. Defendant argues that the creditor should file an appropriate motion with the Court to request such permission after obtaining the Trustee's permission and before filing the actual adversary proceeding.

Plaintiff claims that Paragraph "2" of its adversary, which requests court permission to proceed is a sufficient request for such court permission. Plaintiff argues that the Motion to Dismiss be denied and that the Court should hold a hearing on the issue of whether the Plaintiff/Creditor should be allowed to proceed with the adversary. Plaintiff argues that the Court, after considering Plaintiff's claims against Defendants, should grant permission for the adversary to proceed.

## II. Discussion

Section 548 of the Bankruptcy Code provides for the avoidance of fraudulent transfers as follows:

(a) The trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily--

(2) (A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(B) (i) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(ii) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital; or

(iii) intended to incur, or believed that the debtor

would incur, debts that would be beyond the debtor's ability to pay as such debts matured.

11 U.S.C. §548. The statute refers only to the "trustee" as being able to avoid a fraudulent transfer. *See also* Section 544(b) which allows the "trustee" to avoid fraudulent conveyances under applicable state law. Defendant argues that in order for an individual creditor to bring a fraudulent conveyance action, the creditor must obtain permission from the trustee and the Bankruptcy Court before filing the adversary proceeding. Plaintiff here did not seek permission before filing the action, but asks for such permission in the complaint.

Several courts have refused to allow parties other than the trustee to proceed at all with such fraudulent conveyance actions. These courts have concluded that individual creditors lack standing to bring such actions. In Nebraska State Bank v. Jones, 846 F.2d 477 (8th Cir. 1988), the Eighth Circuit concluded that individual creditors lacked standing to set aside alleged fraudulent conveyances in a Chapter 11 case. The creditors there filed two adversary proceedings to set aside the conveyances under 11 U.S.C. Section 544. The Court emphasized that the creditor had other options to pursue before filing the adversary proceedings and could have moved to replace the debtor-in-possession with a trustee, moved to convert or dismiss, or moved to obtain court permission to file the action. *Id.* at 478.

In In re Munoz, 111 B.R. 928 (D. Colo. 1990), the District Court concluded that an individual creditor did not have standing to bring a fraudulent conveyance action in Debtor's Chapter 7 case. The Court noted that the creditor failed to obtain permission from

the trustee or the Court before commencing the adversary proceeding and had failed to show that her claim had any potential for recovery as Debtor had previously obtained a discharge of creditor's debt and the statute of limitations barred the creditor's claim. Id. at 931.

In Munoz, the Court discussed the limitations placed on creditors allowed to proceed on such claims in place of the trustee. First, the Court noted that creditors' committees had been allowed to go forward with such claims upon obtaining court approval and demonstrating that the trustee or debtor-in-possession unjustifiably refused to use the avoidance powers. *See In re V. Savino Oil and Heating Co.*, 91 B.R. 655, 656-57 (Bankr. E.D.N.Y. 1988). According to the Munoz Court, a creditors' committee would be allowed to prosecute a fraudulent conveyance claim if the committee obtained court approval and demonstrated that the claim was meritorious. *See In re Curry & Sorenson, Inc.*, 57 B.R. 824, 827-28 (9th Cir. BAP 1986).

In In re Prime Motor Inns, Inc., 135 B.R. 917 (Bankr. S.D.Fla. 1992), the Bankruptcy Court set forth the following four requirements, which must be satisfied before a creditors' committee can bring a cause of action on behalf of a bankruptcy estate:

- (a) a demand must have been made upon the trustee or debtor-in-possession to bring such action;
- (b) such demand must have been unjustifiably refused;
- (c) there must have been a prima facie demonstration of a colorable claim; and
- (d) the party seeking to bring the action must have

obtained leave of court to do so.

[Citations omitted] In re Prime Motor Inns, Inc., 135 B.R. at 919.

In Matter of Milam, 37 B.R. 865 (Bankr. N.D. Ga. 1984), a creditor brought an action against a debtor to avoid a fraudulent transfer to the debtor's wife. The Bankruptcy Court concluded that the avoiding powers were vested solely in the trustee. According to the Court, the trustee has the discretion to decide if an avoidance action is needed, and any creditor opposing the trustee's decision could petition the Court to remove the trustee for cause. Id. at 867-69. The Court discussed the various factors to be considered by the trustee in deciding to use the avoidance powers, including the costs and benefits to the estate. The Court concluded that:

Such factors may not be very important for a disappointed creditor. The orderly administration of bankruptcy law would not be served by permitting creditors holding unsecured claims to decide independently of the trustee to institute suits against the debtor. Without the safeguard of an independent, impartial trustee to review the merits of creditor claims which are frequently biased, the debtor might be forced to defend numerous proceedings that waste, instead of conserve assets, that unreasonably delay administration of the estate, and that deny the debtor the possibility of rehabilitation and a fresh start . . . .

Milam, 37 B.R. at 868.

In light of the considerations set forth in Milam, I conclude that an

individual creditor must obtain Court permission in order to pursue a fraudulent conveyance action in a debtor's bankruptcy case. However, the issue remains as to whether the Plaintiff's request for permission as set out in Paragraph "2" of the adversary complaint is a sufficient request for such permission.

Paragraph "2" of the complaint is for all practical purposes a request for permission to proceed with the adversary proceeding. Defendant argues that the request should have been made by motion prior to instituting the instant adversary proceeding.

In In re Curry & Sorenson, Inc., supra., the Court suggested that a creditor who believed that the debtor-in-possession had failed to properly prosecute an action could bring such a failure to the Court's attention by motion. According to the Court, it could order a hearing to determine if proceeding with the action was warranted. Curry & Sorenson, 57 B.R. at 828.

Here, the creditor admits, by inference, that Court approval is necessary by making a request in the complaint. It is the existence of a request for permission and not the form of the request which is at issue. I find that a request for Court permission may be made within the complaint. Likewise, a separate motion in the Debtor's bankruptcy case requesting permission would have been sufficient. However, by making the request in the adversary proceeding, the Defendants in the case have been given notice and opportunity to be heard on the issue of granting Court permission that they might not have been entitled to had the request been made by motion.

In Paragraph "2" of the complaint, Plaintiff states that the creditor attempted to have the Chapter 7 trustee proceed with or join the action, but that the Trustee declined. At the March 4, 1992, pre-trial hearing, Plaintiff suggested that the Trustee declined to pursue the transfer action because one of the employees involved in the transfers had assisted in the administration of the case a great deal; however plaintiff has not provided any additional reasons for the Trustee's decision to decline. Nevertheless, the allegations of the complaint raise very serious questions as to whether this claim should have been pursued. Taking the allegations to be true Debtor allowed the transfer of a very valuable asset from its subsidiary corporation to a separate corporation owned and managed by insiders of the Debtor, for no consideration.

According to the court in In re Curry & Sorenson, *supra.*, judicial intervention may be necessary in such situations to determine if the trustee's failure to use the avoidance powers was unjustifiable or an abuse of discretion. Certainly in light of very serious contentions I conclude that such intervention is called for in this case. *See also Matter of Natchez Corp. of West Virginia*, 953 F.2d 184 (5th Cir. 1992) (A creditor may act on behalf of a trustee or debtor-in-possession to avoid a transfer if the creditor has moved the Bankruptcy Court for authorization and has shown appropriate circumstances which would permit the action); Matter of Pointer, 952 F.2d 82 (5th Cir. 1992). A creditor may be granted leave to commence an avoidance action only under extreme circumstances. Such circumstances exist where the trustee unjustifiably failed to act and no other objective third party such as a creditors' committee was available to file suit. In re Prime Motor Inns, Inc., 135 B.R. at 920 N.4. *See also In re Shelby Motel Group, Inc.*, 123 B.R. 98 (N.D. Ala. 1990);

In re McKeesport Steel Castings Co., 799 F.2d 91 (3rd Cir. 1986).

The following factors should be considered before allowing an individual creditor to proceed with an avoidance action:

- 1) Whether the trustee justifiably declined to sue. In re V. Savino Oil & Heating Co., 91 B.R. at 656-57; In re Prime Motor Inns, Inc., 135 B.R. at 920 n.4.
- 2) Whether the claim is potentially meritorious. *See* In re Munoz, 111 B.R. at 931; In re Prime Motor Inns, Inc., 135 B.R. at 919.
- 3) Whether such an action would benefit debtor's bankruptcy estate or be a detriment and waste of resources. *See generally* In re Curry and Sorenson, Inc., 57 B.R. at 828.

*See generally* In re Chernicky Coal Co., Inc., 67 B.R. 828, 832 (Bankr. W.D.Pa. 1986) (holding that a creditor who did not seek authorization from the Bankruptcy Court could assert a claim under 11 U.S.C. Section 549 in Debtor's Chapter 11 case because appropriate circumstances were shown: (1) No trustee responsible for filing claims had been appointed; (2) debtor had no reason to file the claim; and (3) debtor's liabilities would have increased if the transfer had been avoided.)

As the Court does not have enough information to make a decision to grant or deny the request to proceed with this action, a hearing will be held for the limited purpose of reviewing the trustee's decision not to join or bring such an adversary complaint and the

benefit or detriment to the estate due to bringing such an action. As in In re V. Savino Oil & Heating Co., Inc., supra., such authority to pursue a fraudulent conveyance action should be given to an individual creditor only upon a showing of extraordinary circumstances. *See also In re Prime Motor Inns, Inc., supra.* Therefore, the burden will be upon Plaintiff to show that it has a colorable claim and that there is reasonable likelihood of a benefit to the estate from proceeding with the action.

In particular it will be necessary to consider, on at least a preliminary basis, the potential value of a license such as the one transferred based on

- 1) The cost to Debtor of securing the licenses;
- 2) The book value assigned to it;
- 3) The income stream which it produced while in Debtor's hands; and
- 4) The cost savings realized by American Freight when it obtained an existing license rather than applying for and obtaining a new license in its own right.

#### ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS  
THE ORDER OF THIS COURT that a hearing will be held on

Wednesday, July 15, 1992  
at 10:00 o'clock a.m.  
Bankruptcy Courtroom  
United States Courthouse

Savannah, Georgia

at which time Plaintiff shall set forth the legal and factual basis on which this Court's permission to proceed is sought. Defendant and/or Trustee will be afforded an opportunity to introduce evidence relevant to this issue as well. TRUSTEE IS ORDERED to appear at the date and hour set forth above.

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Lamar W. Davis, Jr.  
United States Bankruptcy Judge

Dated at Savannah, Georgia

This \_\_\_\_ day of June, 1992.