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SUPREME COURT

IN THE COURT OF APPEALS OF IOWA

No. 1-11 / 90-253

PRODUCTION CREDIT ASSOCIATION OF THE MIDLANDS,

Plaintiff-Appellee,

547

vs.

BOBBY T. SHIRLEY, and PATRICIA SHIRLEY,

Defendants-Appellants,

and

TAYLOR ENTERPRISE, INC., LYLE K. TAYLOR, and GEORGIA M. TAYLOR,

Defendants.

Appeal from the Iowa District Court for Fremont County, Glen M. McGee, Judge.

The Shirleys appeal a district court ruling finding that they had participated in fraudulent conduct, imposing a constructive trust, and requiring them to turn over all assets of Lyco, Inc. to the Production Credit Association. **AFFIRMED.**

Vicki R. Danley, Sidney, for appellants.

Jerrold L. Strasheim, Timothy V. Haight, and Carol C. Knoepfler, of Baird, Holm, McEacher, Pedersen, Hamann & Strasheim, Omaha, Nebraska, for appellee.

Considered en banc.

SCHLEGEL, J.

This case arises out of a series of lawsuits involving Lyle and Georgia Taylor; the Production Credit Association of the Midlands (PCA); the Citizens State Bank of Maryville, Missouri, (CSB); and now, Bob and Patricia Shirley. In 1985 CSB brought a foreclosure action against the Taylors and PCA. The Taylors also brought a damage action against PCA. The foreclosure action was decided in 1987; PCA obtained a large deficiency judgment against Lyle Taylor and Taylor Enterprises, Inc. (TEI). PCA also prevailed in the damages action.

In December 1987 Lyle sold to his nephew, Bob, and to Bob's wife, Patricia, 100% of the shares in Lyco, Inc. for $90,000. Lyco, an Iowa corporation formed and operated by Lyle, consisted of two vacation homes as well as some other items of personal property. On the same day as the transfer, the Shirleys leased back the property to the Taylors. Lyle used the money to pay off a portion of his debt with CSB.

PCA filed this petition against Bob Shirley, the Taylors, and TEI. Patricia Shirley was later added as a party. Following trial, the district court directed counsel for PCA to prepare the decree. The decree in final form required the Shirleys to transfer the shares and assets of Lyco to PCA. The district court later denied the Shirleys' request to depose PCA's counsel concerning the preparation of the decree. Following several posttrial orders, the Shirleys filed this appeal.

In this equity action, our review is de novo. Iowa R. App. P. 4. We examine the entire record and adjudicate anew the issues. Hatheway v. Hanson, 230 Iowa 386, 393, 297 N.W. 824, 827 (1941). We give weight to the fact findings of the trial court, especially when considering the credibility of witnesses, but are not bound by them. Iowa R. App. P. 14(f)(7); Rouse v. Rouse, 174 N.W.2d 660, 664 (Iowa 1970).

I.

We first address the Shirleys' contention there was insufficient evidence in the record for the trial court to find they participated in fraud. Because each case of this character must be decided upon its peculiar facts, we are to look for "badges of fraud." Rouse, 174 N.W.2d at 667 (citation omitted). The indices of fraud include lack of consideration, insolvency of the transferor, threat of third party creditor litigation, and unexplained retention of possession by transferor. Id. at 667-68. While a blood relationship is not per se a badge of fraud, it may strengthen the inference arising from the circumstances. Id. at 668.

"Fraud may, and usually must be, proved by circumstantial evidence. . . . The circumstances must ordinarily be considered together, and the force and weight to be given them are that of them in combination." Hatheway, 230 Iowa at 394, 297 N.W. at 827 (quoting First Nat'l Bank of Iowa City v. Hartsock, 202 Iowa 603, 604, 210

N.W. 919, 920 (1926). We conclude both that fraud existed and that the record shows by clear and satisfactory evidence the Shirleys knowingly participated in that fraud.

A. The roles of the parties are set forth below; this background paints a picture of fraud. Bob Shirley is the nephew and good friend of Lyle; for many years he has had business relationships with Lyle and TEI. Lyle Taylor formed Lyco corporation and, prior to the end of December 1987, he served as an officer, director, and sole stockholder. Lyco's assets at the end of December 1987 included two vacation homes in Arizona and Minnesota in which, over several years, Lyle and Georgia had spent and, during the pendency of this action, continued to spend most of the winter and summer months. In addition, Lyco owned personal property including furniture in both vacation homes, boats, motors, trailers, a bank account containing about $5000 cash, and a note or account receivable for a loan made to Lyle by Lyco. According to the testimony of PCA's experts and the findings of the trial court, the value of Lyco at the end of 1987 was greater than $180,000. Lyco had no liabilities.

PCA is a creditor of Lyle and TEI; it received a judgment and decree in foreclosure on September 18, 1987, in the amount of approximately $1.75 million. A deficiency judgment against Lyle and TEI still remains due and payable to PCA in excess of $1.5 million.

At the end of December 1987 Lyle sold to Bob and Patricia 100% of the outstanding shares in Lyco for the total sum of $90,000. The $90,000 was paid by check made out to Lyle and dated January 2, 1988. Lyle then paid CSB which held liens and security interests in substantially all of the assets of Lyle and TEI including a security interest in the stock.

On the same day as the sale of the Lyco shares an oral lease arrangement was made under which Lyle and Georgia rented from Lyco the vacation homes in Arizona and Minnesota and all furnishings therein, along with the boats, motors, and trailers, for rent of $800 per month. The amount of the monthly rent was suggested by Lyle. Bob made no inquiries as to what he could get by renting the Lyco assets to someone else, and indeed Bob testified that he did not want to rent the property to anyone else. The leaseback arrangement apparently had no expiration date. By check dated January 2, 1988, Lyle prepaid Lyco six months' rent of $4800. The $4800 check for the prepaid rent was drawn on TEI's bank account and not on the personal bank account of Lyle and Georgia.

Thereafter, Lyle continued to make rental payments to Lyco in the amount of $800 per month (all payments being drawn on TEI's bank accounts). According to Lyle's testimony, rental payments were made through approximately mid-July 1989. Through the date of trial, Lyle and Georgia had continued to live in the Lyco homes as they had lived

before the sale of the Lyco shares. Since mid-July 1989 Lyle and Georgia apparently had paid no rent for the Lyco properties and yet continued to occupy the homes and use the assets without making any payment to Lyco.

Both Lyle and TEI were insolvent at the time of the sale of the Lyco shares. Lyle arranged for the sale of the Lyco shares and, at the same time, attempted to negotiate a settlement with PCA. At the time the Lyco shares were sold by Lyle to Bob and Patricia, mediation had been requested, and PCA was prevented by the provisions of the Iowa Mediation Statute from executing on its foreclosure judgment against Lyle and TEI. While the mediation stay was in effect, Lyle then negotiated and sold the Lyco shares to Bob and Patricia, without notice to PCA. Also, at the time of the sale of the Lyco shares, Lyle and his attorney, Robert Leonard, were negotiating with PCA for a settlement and suggested that PCA could look to Lyco shares as a source of payment. Only after the sale of the Lyco shares and approximately five days before the mandatory mediation conference did Lyle tell PCA of the sale of the Lyco shares which had been accomplished secretly and even then did not tell PCA about the oral leaseback arrangement.

For over two years before the sale of the Lyco shares, Lyle seems to have engaged in a pattern of behavior calculated to defraud or defeat PCA. This pattern of behavior is established by the decree in the foreclosure

action. In addition, during the pendency of this case, Lyle and TEI have been held in contempt, based on conclusions and findings as part of previous court orders, due to their violation of the court's injunction orders by, among other things, disposing of rent after PCA had attempted to garnish the rent. We determine the transfer of the Lyco stock by Lyle to the Shirleys was fraudulent.

B. We also agree with the trial court that the evidence shows the Shirleys, through Bob, knew of Lyle's fraudulent intent and indeed participated in it. Bob is Lyle's nephew and admitted at trial that not only was there a blood relationship, there was also an extensive business relationship, and they used the same attorney, Robert Leonard. There is sufficient evidence in the record to determine the Shirleys participated in fraud.

Bob is an experienced businessman; a partner in a large farming partnership known as BTR Partnership; owner of Shirley Ag Service, Inc., of Percival, Iowa; and is manager, director, and a stockholder of Percival Grain, a grain elevator in Percival, Iowa. Bob testified at trial that prior to purchasing the Lyco shares, he did not ask to see existing financial statements of Lyco such as balance sheets or income statements, was aware of no appraisal of Lyco's assets, and did not inquire of any real estate broker as to the value of Lyco's vacation homes. He further testified that at the time of the sale he did not know an account receivable was owing to Lyco from Lyle. He

also did not know that Lyco had around $5000 in a bank account at the time of the sale. There is no contract or other document memorializing the sale, and Bob did not obtain a release of the Lyco shares from CSB once payment was made.

Bob and Lyle had multifaceted business relationships. Bob owned and operated Shirley Ag Service, a fertilizer and trucking business, and over the years, Shirley Ag Service did $50,000 or more in business per year with Lyle and TEI. Bob was the manager, treasurer, and a stockholder in Percival Grain. Over the years, Percival Grain customarily bought all of Lyle's grain crop or at least the landlord's share. In addition, Bob and his sons were engaged in the farming business through BTR Partnership. Bob and BTR over the years had been a major tenant of Lyle, renting 1500 acres or more from TEI for a period of several years or more. In addition, it seems it was the regular practice of Bob, Lyle, and TEI to trade work back and forth.

Bob's knowledge and participation in Lyle's fraudulent intent also is disclosed by the transaction itself. The sale of the Lyco shares was not an arms-length transaction. Robert Leonard acted as both Lyle's attorney and Bob's attorney for the transaction. Robert Leonard had represented Lyle and TEI in the foreclosure action and damage action. Bob never received any documents disclosing what he was buying. In addition, Bob never asked Lyle what the property was worth before he bought the stock, and Bob

already owned one vacation home in Tucson, Arizona. There was no title search with respect to the real property, and Bob did not ascertain whether Lyco had good title to either of the homes which were the principal assets of the corporation he was buying. Bob did not personally inspect either of the two homes, nor did he review any present insurance policies that Lyle had maintained on the properties. Bob did not know what condition the Minnesota or Arizona home was in, he never made a list of furniture or what the furniture was worth, which was being sold as part of the transaction, nor did he know how much money was in Lyco's bank account.

Bob knew of Lyle's financial troubles with PCA. He testified that he had received the mediation notice and the decree prior to the sale of the Lyco shares. The decree not only set out the judgment against Lyle, but as indicated also contained extensive findings with respect to Lyle's pattern of conduct calculated to prejudice PCA. Furthermore, Bob continued to farm approximately 1500 acres of land owned by TEI and dealt with the court-appointed receiver for PCA as part of the foreclosure action. Moreover, at the inception of the foreclosure action, Bob, through Shirley Ag Service, had sent a notice to PCA in an effort to get a first lien on crops or fertilizer which Shirley Ag Service contemplated selling to Lyle and TEI.

Following purchase of the Lyco shares, Bob gave Lyle's son, William Taylor, a job. Moreover, Bob loaned William

Taylor money to purchase certain livestock of TEI on which PCA had foreclosed.

We conclude there is compelling evidence of actual fraud: The transfer of the Lyco shares was for inadequate consideration of less than half the value of the underlying assets; the transfers were made not only while litigation was pending but after judgment had been rendered against Lyle and TEI, and at a time when Lyle and TEI were both insolvent and without any other assets with which to pay PCA the deficiency judgment; Lyle was not concerned whether he was realizing anywhere near the value of the Lyco shares; he made no effort to ascertain what that value was, such as obtaining appraisals of the underlying assets or even making inquiries; he did not resort to commercially reasonable methods of selling Lyco's assets such as advertising them, listing them with brokers, or selling assets separately; the Lyco assets were contemporaneously leased back, and Lyle remained in exclusive possession of those assets; the rent on the leaseback was paid with TEI funds rather than Lyle's funds; and Bob planned to transfer the Lyco shares back to Lyle at a future date, with Lyle in the meantime paying enough rent for the Lyco assets to repay the Shirleys' interest for the $90,000 they had borrowed to pay for the Lyco shares. These circumstances establish the "badges of fraud" described above. See Rouse, 174 N.W.2d at 667.

II.

The Shirleys argue Lyle's fraudulent intent cannot be imputed to them from their attorney, Bob Leonard. Where a transferee takes property knowing of the transferor's fraudulent purpose and accepts the transferred property wholly or in part to aid accomplishing it, the transfer is actually fraudulent even though for adequate consideration. Rouse, 174 N.W.2d at 668; Hatheway, 230 Iowa at 394, 297 N.W. at 827. The trial court found "[t]he knowledge of Bob and Patricia was actual and also was imputed from Robert Leonard . . ." As previously discussed, we believe the Shirleys had knowledge of Lyle's fraudulent purpose regardless of any information from their attorney.

The Shirleys knew of Lyle's fraud because Bob was aware of: the financial difficulties of TEI and Lyle; the foreclosure action and the judgment against Lyle and TEI and rented TEI's land from the receivers; the loss by Lyle of the damage action against PCA and its importance to Bob as tenant of TEI's farmland; Lyle's inequitable, deceptive and dishonest conduct before and during the foreclosure action and damage action as fully detailed in the foreclosure decree, a copy of which Bob admittedly received; the common knowledge of Lyle's financial predicaments and litigation in which Lyle and TEI were involved; the reports in the local newspaper to which Bob subscribed; and conversations between Bob and Lyle in which Lyle testified he assumes he told Bob "everything." In any

event, the Shirleys had inquiry notice of all these things and were charged with whatever knowledge of all the facts they could have ascertained by proper inquiry. Commercial Credit Corp. v. Interstate Fin. Corp., 236 Iowa 459, 466, 18 N.W.2d 178, 181 (1945); see 58 Am. Jur. 2d Notice § 13 (1989) (no right to shut eyes or ears to avoid information and then claim had no notice).

The proof is clear and convincing that the Shirleys were knowing participants in the fraud. See Rouse, 174 N.W.2d at 668; see also Hatheway, 230 Iowa at 393, 297 N.W. at 827 (knowledge of grantor's fraudulent intent may be implied from the relationship of the parties). The record shows the Shirleys had knowledge the transaction was fraudulent without any information from their attorney. We affirm the trial court's finding that the Shirleys knew of Lyle's fraudulent purpose.

III.

The Shirleys next contend they are bona fide purchasers for value of the Lyco stock under Iowa Code sections 554.8301 and 554.8302. They argue, therefore, PCA may not recover the stock from them. "A 'bona fide purchaser' is a purchaser for value in good faith and without notice of any adverse claim: . . . who takes delivery of a certificated security in bearer form or in registered form, issued or endorsed to that purchaser or in blank." Iowa Code § 554.8302(1)(a) (1991). We believe the facts detailed above clearly show the Shirleys were not bona fide purchasers.

Because of their knowledge of Lyle's fraudulent purpose, they do not possess the requisite good faith.

IV.

The Shirleys next argue the remedy imposed by the trial court was inequitable. They state PCA has not shown what it would have received had all of the Taylors' property been sold at auction and applied to creditors. The Shirleys believe the "most equitable solution would be for the court to refuse to interfere with the situation at all. . . ." We disagree. When a debtor transfers property with actual intent to hinder, delay, or defraud the debtor's creditors, and the transferee knowingly participates in the transferor's fraud, the transferee is not entitled to the return of any consideration. Rouse, 174 N.W.2d at 668.

Contrary to appellants' belief, the case of C. Mac Chambers Co. v. Iowa Tae Kwon Do Academy, 412 N.W.2d 593 (Iowa 1987), does not support their claim for return of the $90,000. The court there held that for a conveyance to be set aside as a fraud on creditors, it is necessary to show the creditors were prejudiced, even where there was actual fraudulent intent. Id. at 596 (citation omitted). We determine PCA has proven the requisite prejudice so the Shirleys are not entitled to a return of the consideration paid.

PCA must be able to show it would have received something which has become lost by reason of the conveyance. Id. (citations omitted). The record

establishes prejudice to PCA because the consideration paid by the Shirleys is less than half the value of the Lyco shares. The inadequate consideration paid by the Shirleys to Lyle (and passed on to CSB) effectively prevented PCA from bidding on the 1850 acres of TEI farm land encumbered by a first lien to CSB and cost PCA at least the full value of the Lyco shares. If CSB had been paid the full value of the Lyco shares, CSB would have then credit bid $100,000 less on the 1850 acres, PCA would have outbid CSB, and PCA could have realized the equivalent of the full value of the Lyco shares by reselling the 1850 acres. The Shirleys have no claim for the return of the $90,000 paid for the Lyco shares or to any lien securing payment of the $90,000. We affirm the trial court ruling that Bob and Patricia are not entitled to any credit for consideration paid at the time of the transfer.

Under Iowa law constructive trusts are imposed "where the person holding title to the property would profit by a wrong or would be unjustly enriched if he or she were permitted to keep the property." Cox v. Waudby, 433 N.W.2d 716, 720 (Iowa 1988); see Regal Ins. Co. v. Summit Guar. Corp., 324 N.W.2d 697, 705 (Iowa 1982) (constructive trusts arise from actual fraud, constructive fraud, and equitable principles other than fraud). Because actual fraud was proved, the remedy of a constructive trust imposed by the trial court was proper. The remedy the trial court ordered here was for the Shirleys to convey the property to PCA as

the property existed at the time of the fraudulent transfers. We conclude that remedy was appropriate.

V.

Under the circumstances of this case, the Shirleys contend they were deprived of an impartial fact finder and due process of law because the trial judge called PCA's counsel to inquire if PCA wished to respond to the Shirleys' brief. PCA's counsel stated they did not, and the court specifically and in detail outlined its findings of fact and conclusions of law with legal authorities. The judge then directed PCA's counsel to prepare the decree and send it to the court. The court, after receipt of the same, made several corrections and then signed and filed the decree.

We are critical of a trial court's ex parte request for a proposed ruling. See Kroblin v. R.D.R. Motels, Inc., 347 N.W.2d 430, 435-36 (Iowa 1984). However, we find here that there was no finding of fact nor conclusion of law in the decree which is not supported by the evidence. Nothing in the record hints that the trial judge was not impartial in this case. The motion for a new trial and Shirleys' subpoena duces tecum were properly overruled by the trial court.

For the above reasons, we affirm the trial court on all issues.

AFFIRMED.

Oxberger, C.J., and Donielson and Hayden, JJ., concur; Habhab, J., specially concurs; and Sackett, J., dissents.

HABHAB, J. (specially concurring)

I specially concur.

SACKETT, J. (dissenting)

I dissent. I would dismiss the petition of plaintiff-appellee Production Credit Association at its cost. The question is whether defendants-appellants Bobby T. Shirley and Patricia Shirley should be required to turn over the PCA stock Shirleys purchased from Taylors for $90,000.

PCA had a substantial judgment against defendants-appellants Taylor Enterprise, Inc., and Lyle K. Taylor and Georgia Taylor. Taylors sold Shirleys stock in a closely held corporation for $90,000. The stock was encumbered by a security interest held by another judgment creditor of Taylors, namely, the Citizens State Bank of Marysville, Missouri. The $90,000 Shirleys paid went to Citizens Bank to reduce Taylors' indebtedness.

PCA sued defendants to set aside the stock transfer. After hearing the evidence, the trial court found there was a fraudulent transfer and ordered defendants to turn over to PCA all shares of stock in the closely held corporation a bank account, all rents the corporation received from Taylors, and all personal property owned by the corporation.

Defendants Shirley have appealed, contending the stock was sold for adequate consideration; PCA did not suffer prejudice because of the sale; or if the stock is ordered returned, they should have credit for the $90,000 they paid to purchase the stock.

Unfortunately, the complexity of the issues between the Taylors and PCA serve to confuse the issue between PCA and Shirleys. While PCA put considerable focus on the dealings of Taylors, I find them relevant to the issues between PCA and Shirleys only as evidence the Taylors' insolvency and Shirleys' knowledge of Taylors' dealings.

My de novo review of the evidence convinces me PCA has failed to show the price the Shirleys paid for the stock was so inadequate that the sale was fraudulent.

Before Shirleys became involved, Taylors had substantial debt to the Citizens Bank and to PCA. Citizens and PCA had settled claims between them and agreed generally that Citizens had prior interest to Taylors' security. PCA would benefit only when and if Citizens' claim of about $1,000,000 was paid in full.

Citizens was the only one of the two creditors holding a security interest in the stock and assets of the corporation sold to Shirleys.

The stock was sold by Taylors for $90,000 with Citizens' consent. The $90,000 was applied to Taylors' debt with Citizens. In applying it to the debt, 16 per cent interest ceased accruing on the $90,000.

PCA sought to recover under the doctrine of fraudulent conveyance. The doctrine of fraudulent conveyances advances the principle a debtor's property is a fund to pay his or her debts, and the debtor cannot hinder a creditor a

right to the fund. See Graham v. Henry, 456 N.W.2d 364, 366 (Iowa 1990). If the stock was sold for fair consideration, the fund would remain intact with money neplacing stock. There was consideration paid for the stock. PCA has the burden to prove the consideration was inadequate before there can be a finding the conveyance of the stock to Shirleys was fraudulent. The secured creditor, Citizens, agreed to the sale and received the money from the sale. When it did, the 16 percent interest on $90,000 of Taylors' indebtedness ceased to run. At the time of sale, Taylors had substantial other indebtedness to Citizens. This was a quick sale without title searches, and included the purchase of potential problems, as this law suit has evidenced. The sale was a cash sale. It was a net sale because there were no broker fees and other costs of sale paid by the Taylors.

The corporation's tax return for the calendar year of sale valued the corporation assets at $137,111. The corporation had a net operating loss of $8,721 for 1987 and a carry-forward loss of $4,168.

The major assets of the corporation were a house in Arizona, and one in Minnesota, and the furnishings in the houses. The evidence introduced by PCA to its claim the corporation was worth $200,000 was based on conveyance by fee simple title, reasonable time for exposure in an open market, available financing, and, in the case of the

Minnesota property, an opinion a sale would probably require twelve months. PCA attempted to establish the value of the stock at the time of the sale by valuing the real estate for sale under the best circumstances. There is no basis to assess the Taylor-Shirley sale under the most advantageous circumstances, rather it must be assessed under the circumstances of the actual sale.

In negotiations before the sale, Taylors represented to PCA the stock value was $200,000. However, to arrive at this value, Taylors valued the houses at $145,000 and showed the corporation had a $65,000 note receivable from Taylors. The record shows the note receivable of Taylors would have no value.

Considering the distressed conditions, the quick sale, the full cash payment, and the consent of the secured creditor in the stock, I find the consideration fair under the circumstances.

Even if the consideration were less than adequate, PCA cannot show prejudice. For a conveyance to be set aside as a fraud on a creditor, it is necessary to show the creditor was prejudiced even where there is a fraudulent intent. See C. Mac Chambers Co., Inc. v. Iowa Tae Kwon Do Academy, Inc., 412 N.W.2d 593, 598 (Iowa 1987). This means the creditor must show what it lost by virtue of the conveyance. Id. The money went to Citizens who applied it to the debt and, in doing so, the 16 percent interest they

were charging on the $90,000 ceased to run. Citizens foreclosed a $727,000 debt against remaining assets which PCA representative Steve Stanton testified had an equity of $866,000 at the October 27, 2988 sheriff's sale. Despite the fact the assets exceeded the first lien, PCA did not protect its interest in bidding. Furthermore, the most that was lost on the sale was the difference between what was paid for the stock and the fair market value at the time of sale. Even if the trial court is affirmed, the stock ordered to PCA should be transferred subject to a $90,000 lien in Taylors' favor.