

**UNITED STATES BANKRUPTCY COURT  
WESTERN DISTRICT OF TENNESSEE  
WESTERN DIVISION**

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**IN RE**

**WILLIAM DUNLAP CANNON III,**

**CASE NO. 94-21918**

**Debtor.**

**Chapter 7**

**GEORGE W. STEVENSON, TRUSTEE,**

**Plaintiff,**

**Adv. Pro. No. 96-0195**

**v.**

**Adv. Pro. No. 96-0196**

**JAMES REEDY,**

**Adv. Pro. No. 96-0197**

**Defendant.**

**Adv. Pro. No. 96-0199**

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**MEMORANDUM OPINION AND ORDER RE  
COMPLAINT TO RECOVER FRAUDULENT  
CONVEYANCES AND/OR PREFERENTIAL TRANSFERS  
AND FOR MONEY JUDGMENT**

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Coming to a resolution in these adversary proceedings has been, in the words of Paul McCartney, “a long and winding road.” There have been motions for summary judgment and motions to dismiss filed. The complaint has been amended. At the beginning of the case, there were four defendants, James Reedy, Union Planters Bank of Mississippi, Great Western Bank, and Glendale Federal Bank. By the time the November 24<sup>th</sup> trial rolled around, however, all three of the banks had settled their cases with the trustee, leaving only the current defendant, James Reedy, to appear before the court.

Although good arguments were made by both sides at trial, the Court today finds that the plaintiff's allegations are the stronger ones and the ones which the law more firmly supports. As a result, the plaintiff's complaint to recover fraudulent conveyances and/or preferential transfers is sustained.

This Court conducted a trial in this matter on November 24, 1997, pursuant to FED. R. BANKR. P. 7001. This is a core proceeding. 28 U.S.C. § 152(b)(2). After reviewing the testimony from the hearing and reviewing the record as a whole, the Court makes the following findings of fact and conclusions of law. FED. R. BANKR. P. 7052.

### **I. FINDINGS OF FACT**

After reading the parties' post-trial briefs, the Court finds that the facts and conclusions of law as set forth in the trustee's brief are the appropriate method of addressing the issues at bar today. Because of this, the Court hereby adopts the plaintiff's brief in whole as its own. The brief's facts and reasoning are set forth below.

The Trustee seeks to avoid certain transfers made by the debtor drawn on checks on the debtor's client real estate escrow account payable to Great Western Bank, Glendale Federal Bank and Sunburst Bank. All these payments were made by the debtor on account of loans made by each of these institutions to Mr. and Mrs. James Reedy. The debtor was neither a guarantor nor co-signature on the loans. The Trustee also seeks to recover for certain other transfers made by checks drawn on the debtor's escrow account payable to James Reedy.

In the fall of 1989, both Reedy and the debtor were experiencing financial difficulties. Cannon, a real estate closing attorney, had known Reedy, a realtor and real estate investor, since the late 1970's. Cannon, who had loaned Reedy money in the past, was aware that Reedy had cash flow problems with his properties. Cannon made Reedy aware that Cannon was overdrawn in his client escrow account and suggested that their mutual cash flow problems might be lessened by entering into a scheme whereby Reedy would refinance two properties owned by Mr. and Mrs. Reedy, located at 8654 Pepperbush and 1595 Kimbrook, and Cannon, acting as closing attorney, would divide up the loan proceeds without paying off the prior mortgages.

Both Cannon and Reedy understood the gravity of their conduct and hoped to payoff the existing first mortgages as soon as they could. After misappropriating the refinance loan proceeds, however, the financial problems of Reedy and Cannon continued, if not worsened.

For a period of time, Reedy collected rent payments on Kimbrook and Pepperbush and made the note payments on the various mortgages. By August of 1991, however, Reedy's financial condition had worsened and he was anticipating filing Chapter 11. Both Cannon and Reedy were concerned that, if the Pepperbush and Kimbrook properties were listed in Reedy's bankruptcy schedules, their scheme to refinance these properties without paying off the prior mortgages would be discovered.

In August of 1991, the Pepperbush and Kimbrook properties, as well as certain other properties belonging to Reedy, were transferred by Reedy to Manor Investments, Inc. ("Manor Investments"), a corporation formed by Cannon for the purpose of enabling Reedy to commit bankruptcy fraud by

transferring the properties out of Reedy's name at a time that Reedy was contemplating bankruptcy. The transfer helped to further conceal the refinancing fraud committed on the Pepperbush and Kimbrook properties. Both before and after Cannon's bankruptcy, Mr. and Mrs. Reedy exercised control over Manor Investments, Inc. Reedy used some of the Manor Investment properties as collateral for loans. The Reedys were in complete control over the ultimate resale of the Pepperbush and Kimbrook properties. In connection with those closings, Reedy signed the closing papers as President and sole shareholder of Manor Investments, Inc.

After the Kimbrook and Pepperbush properties were transferred to Manor Investments, Cannon made a number of payments to the pre-existing first mortgage holder (Sunburst Bank/Pepperbush loan and Glendale Federal/Kimbroke loan) and also made periodic payments to the banks which made the refinancing loans to Reedy (Sunburst Bank and Great Western Bank). The payments to Sunburst were made on account of two prior loans made to the Reedys which were secured by first mortgages on 8654 Pepperbush and 3068 Park Avenue and one loan made to the Reedys to refinance property they owned at 1595 Kimbrook, which was subject to an outstanding first mortgage in favor of Glendale Federal Bank. Cannon never received any part of the first mortgage proceeds on Pepperbush and Park Avenue and was not personally liable for either loan. Although the Park Avenue property was not part of the refinancing fraud involving Pepperbush and Kimbrook, Cannon made payments on the loan as requested by Sunburst out of concern that any problems with Reedy's loans at Sunburst might lead to discovery of refinancing fraud.

The payments to Glendale Federal were on account of a loan made by Glendale to the Reedys which was secured by a first mortgage on the Kimbrook property. Cannon was not a cosigner or guarantor of this loan and never received any proceeds of any loan. The refinancing fraud perpetrated against Sunburst and Great Western did not impair Glendale's lien. The payments made by Cannon to Glendale were made to prevent foreclosure on the Kimbrook loan and thus prevent discovery of the fact that the proceeds of one of Sunburst's loans to Reedy were not used to payoff the Kimbrook loan.

The payments to Great Western were on account of a loan made by Great Western to the Reedy's for the purpose of refinancing the Pepperbush property. Cannon testified that this check was endorsed in blank by Cannon and given to Reedy, who filled in the balance of the check.

Sunburst received payments from Cannon's escrow account totaling approximately \$41,855.88 consisting of \$16,836.35 on account of its Pepperbush loan (Note 6704), \$7,546.88 on account of its loan on the Park Terrace property (Note 5157), and \$17,472.65 on account of its refinancing loan on Kimbrook.

Glendale Federal received \$16,904.00 from Cannon's escrow account on account of its Kimbrook loan.

Great Western received \$11,743.67 from Cannon's escrow account on account of its loan to refinance Pepperbush.

Reedy pled guilty to defrauding Great Western Bank and Sunburst Bank with respect to the refinancing loans on 1595 Kimbrook and 8654 Pepperbush.

The source of funds used to pay Reedy's loans with Glendale, Sunburst and Great Western came from client funds held by Cannon in his escrow account. Cannon was not authorized by his clients to use funds to repay Reedy's loans or to conceal the refinancing fraud committed by Reedy and Cannon. Cannon pled guilty to defrauding his clients by misappropriation of funds in his real estate escrow account whereby Cannon would use loan proceeds tendered to him as closing attorney for specific closings to pay off loans on unrelated closings which had occurred weeks or months earlier for which Cannon had misappropriated these funds.

Cannon testified that, beginning as early as 1990, and continuing until his bankruptcy, his client escrow account was overdrawn by an amount which started at approximately \$500,000.00 and increased to approximately \$3,000,000.00 during the 1992-1993 time frame.

The Trustee stipulated that Cannon's "share" of the refinancing fraud proceeds was at least equal to the amount of repayments made to Sunburst, Glendale, and Great Western.

Cannon testified, however, that his share of the proceeds would have been consumed immediately in decreasing the shortage in his escrow account and that Cannon's clients in 1992 and 1993 did not receive any benefit from the refinancing fraud committed in 1989.

The Pepperbush and Kimbrook properties were not listed in Cannon's bankruptcy schedules. Cannon testified that he did not consider himself the owner of the properties.

At the time of the payments which are the subject of these adversary proceedings, Cannon was indebted to Zouhair Jabase and Rex Essary, both of whom were general unsecured creditors who would have had standing to challenge the transfers under T.C.A. § 66-3-101, *et seq.*

Separate and apart from transfers arising out of the scheme to defraud Sunburst Bank and Great Western Bank arising out of the refinancing of the Kimbrook and Pepperbush properties, Cannon would make loans to Reedy from time to time.

On January 30, 1991, Cannon wrote check number 1670 in the amount of \$10,100.00, drawn on funds in his real estate escrow account. Cannon testified that the check represented a loan from Cannon to Reedy, based on the fact that the check contains no notation for a property address, the check was for an even amount.

On July 5, 1991, Cannon transferred check number 2399 in the amount of \$10,270.95, payable to Reedy. The check was endorsed by Glassman and Jeter, Attorneys-at-Law. According to the testimony of Cannon and Deborah Reedy, this check was delivered to pay off a second mortgage on property owned by Mr. and Mrs. Reedy located at 1343 Poplar Estates in Memphis. According to the testimony of Deborah Reedy, this property was subsequently transferred to Manor Investments. Manor Investments subsequently sold the property at a loss and that Mr. Cannon received no benefit from the sale of this property.

On August 12, 1991, Cannon transferred check number 2598 to Mr. Reedy in the amount of \$3,000.00. Cannon testified that he could not tell exactly what the check was for but noted that it did not have a property address so it was probably either an advance on a closing or a loan.

In September of 1991, Cannon transferred check number 2811 in the amount of \$8,173.19 to Reedy. The check has the notation "400 Lipford". The settlement sheet for 400 Lipford indicates that Reedy was to receive \$4,361.60 from closing and another \$8,173.19.

On March 30, 1992, Cannon wrote check number 4482 in the amount of \$8,150.00 to Reedy. Cannon testified that the check appeared to be an advance for a loan as opposed to seller proceeds.

On September 10, 1992, Cannon wrote a check in his escrow account number 4637 in the amount of \$3,197.92. The check references "NcNeil". Cannon testified it appeared to be seller's loan proceeds.

## **II. CONCLUSIONS OF LAW**

### **1. Fraudulent Intent is an Issue of Fact**

The complaint alleges, *inter alia*, that all the transfers to the defendants were made with intent to hinder, delay, and defraud. Fraudulent intent is a question of fact. *In re Otis & Edwards, P. C.*, 115 B.R. 900 (Bankr. E.D. Mich. 1990); *Macon Bank & Trust Co. v. Holland*, 715 S.W.2d 347. Fraudulent intent must be proven by a preponderance of the evidence. *In re Hicks*, 176 B.R. 466 (Bankr. W.D. Tenn. 1995); *United States v. Kerr*, 470 F.Supp. 278 (E.D. Tenn. 1978). Whether or not a particular transfer is declared fraudulent is determined by the facts and circumstances of each case. See *Macon Bank & Trust Co. v. Holland*, 715 S.W.2d 347, 349 (Tenn.Ct.App. 1986).

In the present case, Cannon's testimony coupled with his guilty plea concerning embezzlements out of his client trust account demonstrate that Cannon had the requisite fraudulent intent under § 548(a)(1) or under the Uniform Fraudulent Conveyance Act with respect to the transfers at issue. See e.g., *In re Mark Benskin and Company, Inc.*, 161 B.R. 644 (Bankr. W.D. Tenn. 1993) (Debtor's intent to defraud creditors established by guilty pleas to related criminal charges); see also *In re Randy*, 189 B.R. 425 (Bankr. N.D. 111. 1995); *In re Hicks*, 176 B.R. 466,472 (Bankr. W.D. Tenn. 1995) (Guilty plea to perjury charge relating to transfer evidenced intent to defraud). In *Randy*, the debtor was engaged in a Ponzi scheme, part of which involved the debtor paying commissions to various brokers in order to solicit new customers as a part of the scheme. After the debtor's bankruptcy, the trustee sought to avoid

payments of the commissions as a fraudulent conveyance. The court found that, where intent to run a Ponzi scheme is proven, the court can infer that the debtor had actual intent to hinder, delay or defraud creditors when the debtor paid broker's commissions for their efforts to market the Ponzi scheme. Notwithstanding the fact that the debtor agreed to compensate the brokers for signing up new investors, the court found the debtor had fraudulent intent to defraud, regardless of whether the brokers knew the extent of the debtor's scheme. Citing *In re Benskin, supra*, with approval, the court found that the debtor's convictions established that the debtor had actual intent for the purposes of § 548.

It is also clear that where a transfer has been made with fraudulent intent, it makes no difference that a conveyance was made for a valuable consideration, if it was made for the purpose of hindering, delaying or defrauding creditors. *Matter of Beachwood Medcenter of Flint, Inc.*, 23 B.R. 939 (Bankr. E.D. Mich. 1982). If a transfer is made with intent to hinder and delay present or future creditors, it is voidable even if the transferee was owed a valid debt by the, debtor. *M & N. Freight Lines v. Kimbel Lines*, 170 S.W.2d 186 (Tenn. 1943).

Defendant's argument that Plaintiff must prove specific "badges of fraud" is misplaced. Since parties rarely admit to fraud, courts have resorted to identifying badges of fraud from which the court may infer fraudulent intent. A badge of fraud means only a fact that tends to shift the burden of proof and which, if not explained on grounds of innocence, would sustain the charge of fraud. *Bank of Blount County v. Dunn*, 10 Tenn.App. 95 (1929). Where, however, the complained of conduct is plainly criminal or where such fraudulent conduct is admitted to, it is unnecessary for the court to infer fraudulent intent through a "badge of fraud" analysis.

## **2. The Good Faith of Transferees**

Under § 548(c) and 548 (a)(2), defendants may have a defense to a fraudulent conveyance suit to the extent they gave value and in good faith. Furthermore, the concept of "fair consideration" under T.C.A. § 66-3-303 incorporates a requirement that any fair equivalent value be given in good faith.

In the present case, Reedy appears to argue that he is not liable to the Trustee because he shared

his loan proceeds from the Sunburst and Great Western refinance loans with Cannon pursuant to a criminal conspiracy. As a result, Reedy argues that Cannon became liable not only to the lenders whose money was diverted (Sunburst and Great Western) but also on the loans which were unaffected by the illegal conduct (Glendale Federal and Sunburst). In addition, Reedy appears to argue that somehow Cannon became liable to Sunburst to repay Reedy's loan from Sunburst secured by a first mortgage on the Park Avenue property, which was not refinanced by any bank. Reedy argues that Cannon, by sharing in the refinancing loan proceeds on two loans, is now liable on five loans.

In *Randy, supra*, the court found that amounts paid to brokers in a Ponzi scheme was avoidable as a fraudulent conveyance. The court found that the brokers did not provide any reasonable value to the debtor under § 548 (a)(2) or (c) to justify retention of their commissions. The *Randy* court found that for purposes of § 548(c), reasonably equivalent value is the same as the value under § 548(a)(2). The court concluded that where the debtor's underlying obligation is based on an illegal transaction, the court will not enforce an illegal contract where the party seeking enforcement of the contract is involved in wrongdoing. In the present case, the underlying contract giving rise to fraud was a loan from the defendant banks to Reedy. Cannon was not a party to these contracts. As between Reedy and Cannon, however, there was an illegal enterprise to defraud the lending banks. To cover up this fraud, Cannon misappropriated client funds deposited into his client escrow account in order to cover up their fraud. It is clear that, under any circumstances, Reedy cannot be deemed to have acted in good faith. Reedy, an active participant in the refinancing fraud, had actual knowledge of Cannon's shortage in his escrow account and had actual knowledge that payments were being made with checks drawn on the escrow account. To allow Reedy the benefits of § 548(a)(2) or § 548(c) or to find he acted in good faith under state law would be to reward his fraud.

It is clear that, under applicable state law, Reedy and Cannon, as joint criminal coconspirators, were not entitled to any legal contribution against each other. *See American Cas. Co. v. Billingsley*, 260 S.W.2d 173 (Tenn. 1953); *Knox-Tenn Rental Co. v. Jenkins Ins. Inc.*, 755 S.W.2d 33 (Tenn. 1988).

Reedy's lack of good faith is further demonstrated by the fact that Cannon and Reedy conspired to transfer title to the Pepperbush and Kimbrook properties to Manor Investments, Inc., in order to evade Reedy's creditors and the supervision of the bankruptcy court in Reedy's Chapter 11 case. Moreover, although Cannon filed the incorporation papers for Manor Investments, Inc., Cannon's testimony suggests that the corporation was merely a shell to hide the assets from Reedy's bankruptcy. Neither Manor Investments, Inc., nor the Pepperbush or Kimbrook properties were claimed by Cannon to be assets in Cannon's bankruptcy. More significantly, however, is the fact that both before and after Cannon's bankruptcy, Mr. and Mrs. Reedy exercised control over Manor Investments, Inc., and were in complete control over the ultimate resale of the properties. In connection with those closings, Reedy signed the closing papers as President of Manor Investments, Inc.

With respect to Reedy, his criminal conduct in committing bank fraud and bankruptcy fraud, negates any notion that any reasonable equivalent value was given in good faith. Further, the record reflects that Reedy had actual knowledge of the deficiency in Cannon's account, yet he knowingly accepted checks drawn on that account to pay the various banks as well as for loans made to him personally. The acceptance of payments under these circumstances cannot be deemed to be in good faith.

### **3. Benefits to Creditors**

Defendants argue that the net effect of the transactions between Reedy, Cannon, and the bank defendants was beneficial to Cannon's creditors. The problem with this argument is that defendants have not shown how Cannon's clients, whose funds were used to repay Reedy's mortgages, benefitted at all. The money received by Cannon was consumed immediately in 1989 and was not an asset available for creditors in 1992-93. Transcript pp 32-33. In the present case, the transfers made by Cannon to defendants defrauded Cannon's creditors. Cannon's creditors received no corresponding benefit from the pay-down of Reedy's mortgages to Glendale Federal, Sunburst Bank or Great Western. Neither Reedy's Park Avenue property nor the Pepperbush and Kimbrook properties transferred to Manor Investments, Inc. were part of the debtor's estate. Subsequent to the debtor's bankruptcy, it was Reedy, not the debtor,

who exercised dominion over these properties. In light of the foregoing and based on the record, no benefit was received by Cannon's creditors with regards to the payments at issue. To hold otherwise, would be to conclude that Cannon had the right to misappropriate client funds in 1992-93 to cover up a fraud committed in 1989 for which creditors in 1992-93 could not have received any benefit.

#### **4. Transfers Made Without Fair Consideration**

At all times relevant to the transfers at issue, Cannon was insolvent. With respect to the six checks payable to Reedy, which are not related to the refinancing fraud involving Kimbrook and Pepperbush, the record demonstrates with respect to check number 1670 (\$10,100.00), check number 2399 (\$10,270.95) and check number 2811 (\$8,173.19), that there was no evidence to suggest that Cannon received any consideration for the transfers. According to Cannon, check number 1670 in the amount of \$10,100.00 was a loan from Cannon to Reedy. There is no evidence of repayment. Debra Reedy testified that she assumed that this check which was dated January 30, 1991, was related to a closing which took place on December 19, 1990. Neither the deposit slips nor the closing statements correspond with this assumption. It is undisputed, however, that Cannon would frequently loan Reedy money, with the only evidence being the canceled check.

With respect to check number 2399 in the amount of \$10,270.95, it is uncontradicted that this check was written by Cannon to pay off a second mortgage loan owed by the Reedys on property located at 1343 Poplar Estates. It is uncontradicted that at the time of this payment, the property was owned by the Reedys, and not Cannon. Although Mr. Reedy testified that this property was subsequently transferred to Manor Investments, there is no evidence to suggest that Cannon received any consideration as a result. To the contrary, the testimony indicates that all properties transferred to Manor Investments were properties belonging to the Reedys, and not Cannon. Moreover, when 1343 Poplar Estates was subsequently sold, the property sold at a loss of \$6,757.56, and not a profit.

With respect to check number 2811 in the amount of \$8,173.19, the check has the notation "400 Lipford" on it but does not correspond to the settlement sheet on Lipford, which indicated that Reedy should only receive \$4,361.60 from closing of Lipford. Check number 2811 is dated in September of 1991, whereas the settlement sheet for 400 Lipford is dated 10/4/91. Cannon testified that he would frequently give Reedy an advance against funds expected to be received at closing and that, on occasion, the advances would exceed the amount actually realized at closing. Assuming *arguendo* that check number 2811 was an advance against the Lipford closing, it is apparent from the settlement sheet that Reedy received \$3,811.59 more than he should have received.

With respect to check number 4482 in the amount of \$8,150.00, check number 4637 in the amount of \$3,197.92, and check number 2598 in the amount of \$3,000.00, Cannon was unable to testify exactly what the checks were for. Accordingly, the Trustee cannot recover on account of these three checks. With respect to the remaining checks, the record demonstrates that Cannon did not receive a fair consideration in exchange for the transfers. Further, to the extent the transfers were loans or advances in excess of any amounts legitimately due Reedy in connection with a bona fide real estate closing, the checks themselves were written upon Cannon's escrow account. Thus, Reedy had actual knowledge that any loans which he received from Cannon or advances in excess of closing amounts were being made with funds belonging to Cannon's clients, rather than Cannon.

### **III. ORDER**

It is therefore ORDERED that the transfers made by the debtor to the defendant, James Reedy, are avoidable by the trustee pursuant to 11 U.S.C. §§ 544(b) and 550 and T.C.A. §§ 66-3-101, 66-3-305, 66-3-306, 66-3-307 and 66-3-308.

It is FURTHER ORDERED that judgment is entered against James Reedy in adversary proceeding no. 96-0195 in the amount of \$28,544.14, plus prejudgment interest; in adversary proceeding no. 96-0197 in the amount of \$41,855.88, plus prejudgment interest; in adversary proceeding no. 96-0196 in the amount of \$16,904.00, plus prejudgment interest; in adversary proceeding no. 96-0199 in the amount of \$11,743.67, plus prejudgment interest.

**IT IS SO ORDERED.**

**BY THE COURT,**

**G. HARVEY BOSWELL**  
**United States Bankruptcy Judge**

**Date: February 6, 1998**