2013 IL App (3d) 120854-U

Order filed October 8, 2013

IN THE

APPELLATE COURT OF ILLINOIS

THIRD DISTRICT

A.D., 2013

HEARTLAND BANK AND TRUST COMPANY, an Illinois state bank,	)	Appeal from the Circuit Court of the 10th Judicial Circuit, Peoria County, Illinois,
Plaintiff-Appellee,	)	
v.	)	
DAVID A. GOERS and LYNN E. GOERS, as Trustee of Goers Trust 8909,	)	Appeal No. 3-12-0854 Circuit No. 10-L-16
Defendants-Appellants	)	
(Arthur Wayne Flittner, Mark J. Doolittle, and Charlene J. Devore,	)	Honorable David J. Dubicki,
Defendants).	)	Judge, Presiding.

JUSTICE LYTTON delivered the judgment of the court.
Justice O'Brien concurred in the judgment.
Justice Holdridge specially concurred.

ORDER

¶ 1 *Held*: (1) The trial court erred in ordering sheriff's sale of debtor's residence and turnover of proceeds under section 6 of the Uniform Fraudulent Transfer Act where the transfer of debtor's interest in residence owned with his wife in tenancy by the

entirety was an exempt asset under the Act.
(2) The trial court erred in ordering turnover of trust funds held in a bank account using the lowest intermediate balance rule where the bank failed to provide statements establishing the lowest balance in the account after the funds were fraudulently transferred.
(3) The trial court properly ordered turnover of remaining assets in trust based on fraudulent conveyance where debtor transferred assets after debtor's company was in default on note and debtor was insolvent.

¶ 2 Plaintiff, Heartland Bank and Trust Company, filed a citation to discover assets against judgment debtor, David A. Goers, to collect a judgment on a guarantee of a corporate business loan. Heartland moved for turnover of various assets held in Goers Trust 8909, claiming that Goers fraudulently transferred them into the trust in violation of the Uniform Fraudulent Transfer Act (Act) (740 ILCS 160/1 *et seq.* (West 2012)). The circuit court entered judgment in favor of the bank and ordered the turnover of Goers's interest in the marital home, as well as a trust fund bank account and other financial investment accounts. We reverse the court's order directing a sheriff's sale of the residence and turnover of the net proceeds. We also reverse the turnover order for the trust fund bank account. We otherwise affirm the trial court's order for turnover of assets.

¶ 3 In 2005, Heartland loaned Goers's company, Ross Advertising, Inc., a revolving line of credit in the amount of $650,000. In April of 2009, Heartland renewed the loan, despite that Ross's financial statement showed the company had a negative net worth and a negative working capital of $131,000. The bank extended Ross a $750,000 line of credit for one year. The loan was secured by a promissory note signed by Goers as the company's president. Goers and five other Ross shareholders also signed personal guarantees of the note.

¶ 4 The note provided that upon default, Heartland could declare the entire unpaid principal balance immediately due. It also listed various conditions which "shall constitute an event of default," including "[t]he dissolution or termination of [Ross's] existence as a going business" and "the insolvency of [Ross]." In addition, the note stated that Ross and any other party that guaranteed the note waived presentment, demand for payment and notice of default. The individual guaranty agreements included similar language.

¶ 5 Ross defaulted on the loan, and Heartland filed a complaint and confession of judgment against it for balance due. During the default proceedings, the parties deposed Don Shafer, a loan officer with Heartland. Shafer testified that he met with Goers and shareholder Mark Doolittle on July 27, 2009, to discuss recent changes that had taken place in the company. At the meeting, Goers gave Shafer a document indicating that Ross was taking several measures to deal with the downturn in the economy. The document indicated that Ross was experiencing financial difficulty. The next morning, Shafer sent Goers an email stating that Heartland would continue to support Ross, but given the financial state of the company, he was "sure" Heartland would require additional collateral in the form of cash, real estate or securities. During his deposition, Shafer admitted that Ross was current on its payments under the loan at that time and that Goers had not asked the bank for more money. Later that day, Shafer received Ross's financial statement for the period ending June 30, 2009. The statement indicated that Ross's total capital was negative $256,771.12. Shafer testified that when he learned that Ross had a negative net worth, he concluded that Ross was insolvent and that the bank considered it to be a default situation under the terms of the note.

¶ 6 On July 29, 2009, Shafer met with Goers and other company shareholders to discuss the need for additional collateral. Shafer informed the group that Heartland would required Ross to provide $500,000 in additional collateral, plus a cash infusion of approximately $300,000. At the time of the meeting, the outstanding principal on the loan was $690,000.

¶ 7 Goers and three other shareholders testified that on September 11, 2009, they decided that Ross could not meet the bank's demands and would have to close the business. The shareholders met with Shafer on September 15 and told Shafer that the company would not be able to provide the additional collateral or cash. Later that day, Shafer terminated Ross's line of credit. On October 22, 2009, Heartland sent Ross and the guarantors a notice of default due to insolvency and closure of the business and demanded payment of the outstanding principal and interest under the note.

¶ 8 The trial court entered judgment by confession against Ross in the amount of $731,166.33, and denied its motion to vacate. Ross's motion to reconsider was denied, and we affirmed the trial court's judgment on appeal. See *Heartland Bank & Trust Co. v. Ross Advertising, Inc.*, 2012 IL App (3d) 100774-U (March 12, 2012) (unpublished order under Supreme Court Rule 23).

¶ 9 Heartland then filed a separate action against Goers and the other individual guarantors seeking to collect on the debt owed by Ross. The trial court granted Heartland's motion for summary judgment and entered judgment against Goers and three other guarantors. That order was also affirmed on appeal. *Heartland Bank & Trust Co. v. David A. Goers, et al.*, 2012 IL App (3d) 110030-U (March 26, 2012) (unpublished order under Supreme Court Rule 23).

¶ 10 Pursuant to the guarantor judgment, Heartland served Goers with a citation to discover assets on January 14, 2011. During his deposition, Goers acknowledged a joint personal financial statement dated April 15, 2008, which he used to renew the Ross loan in 2008. The statement showed that Goers and his wife jointly owed two vehicles worth $49,877, bank accounts and investments at Morgan Stanley Smith Barney worth approximately $181,249, and real estate (marital residence) worth $275,000. Goers stated that he transferred most of the assets listed on the financial statement into a trust established on August 26, 2009. The trust, known as the Goers Trust, named his wife, Lynn, as the trustee.

¶ 11 After reviewing the statement, Goers admitted that he transferred a money market account, mutual funds and common stocks into a trust account at Morgan Stanley Smith Barney (Smith Barney) in the name of the Goers Trust. According to the first statement issued by Smith Barney dated September 30, 2009, the sum of $101,401.54 was deposited that month. Goers also acknowledged that there was a withdrawal of $39,845 from his personal joint saving account at Citizens Equity First Credit Union (CEFCU) that was deposited into another CEFCU account in the name of the Goers Trust. At the time of his deposition testimony, the Goers Trust savings and checking accounts at CEFCU had a combined balance of $20,770.61. Goers further testified that he and his wife, Lynn, conveyed their interest in the marital home into the Goers Trust by deed in trust dated August 26, 2009.

¶ 12 On April 20, 2011, Heartland filed two motions for turnover orders: one against defendant Goers individually, seeking the turnover of the two vehicles owned jointly by Goers and Lynn, and one against Lynn, as trustee of the Goers Trust. The motion against the trustee alleged that at the end of August 2009, knowing that Ross was insolvent, Goers transferred all of his assets into the Goers Trust and that, given his guaranty of the Ross note, the transfers were fraudulent under section 5 or 6 of the Act (740 ILCS 160/5, 6 (West 2012)). The motion asked the court to set aside the transfers and to order Goers's share of the assets turned over to the bank in partial satisfaction of the guarantor judgment.

¶ 13 At the citation hearing, Heartland argued that the transfers into the trust should be avoided under section 6 of the Act. The trial court granted the bank's request and ordered the turnover of: (1) 50% of the amount originally transferred into the Smith Barney account ($50,700.77); (2) 50%

of the Goers Trust account at CEFCU, less a $4,000 statutory exemption (735 ILCS 5/12-101(b) (West 2012)) ($6,385.30); and (3) 50% of the proceeds of the sheriff's sale of the residence after satisfaction of the mortgage debt and the homestead exemption (735 ILCS 5/12-901 (West 2012)).[1]

¶ 14 ANALYSIS

¶ 15 The Goerses argue that the trial court erred in subjecting the residence to turnover under section 6 of the Uniform Fraudulent Transfer Act. They claim that the bank is not entitled to 50% of the residence because the transfer of a debtor's interest in real property owned with others in tenancy by the entirely is not subject to the Act.

¶ 16 Under the Act, a transfer is fraudulent as to a creditor (1) if, whether the creditor's claim arose before or after the transfer, the debtor made the transfer with actual intent to hinder the creditor, or (2) if the creditor's claim arose before the transfer and the debtor was insolvent or became insolvent as a result of the transfer. 740 ILCS 160/5, 6(a) (West 2012)); *Falcon v. Thomas*, 258 Ill. App. 3d 900 (1994). The Act defines a "transfer" as "any manner of parting with or disposing of an 'asset' or interest" in the same. 740 ILCS 160/2(l) (West 2012). Section 2(b) defines an "asset" as:

> "property of a debtor, but the term does not include:
>
> * * *
>
> (3) an interest in property held in tenancy by the entireties to the extent it is not subject to process by a creditor holding a claim against only one tenant." 740 ILCS 160/2(b) (West 2012).

To avoid a transfer, the complaining party must prove the statutory elements by a preponderance of

[1] The trial court also ordered the turnover of both vehicles, which the Goerses do not appeal.

the evidence. *In re Jumer's Castle Lodge, Inc.*, 329 B.R. 837 (Bankr. C.D. Ill. 2005).

¶ 17 It is undisputed that in 2009, prior to the transfer of the personal residence, David and Lynn owned their home in tenancy by the entirety. On August 29, 2009, they transferred the residence to the Goers Trust. Thus, at the time of transfer, Goers's interest in the property was held in tenancy by the entirety.

¶ 18 The question we must consider is whether that interest was "subject to process by a creditor holding a claim against only one tenant," namely Goers. Under Illinois law, any real property interest held in tenancy by the entirety "shall not be liable to be sold upon judgment entered on or after October 1, 1990 against only one of the tenants." 735 ILCS 5/12-112 (West 2012). Thus, a preexisting interest in a tenancy by the entirety is not an asset that can be fraudulently transferred as against a creditor of only one of the owners because it is already protected by statute from the creditor.

¶ 19 The bank recognizes this provision of the Code of Civil Procedure (Code) (735 ILCS 5/12-112 (West 2012)) but claims that the rule is not absolute. It argues, for example, that if the tenancy is broken by death or dissolution of judgment, a judgment creditor is entitle to enforce its judgment through the sale of the property. See 765 ILCS 1005/1(c) (West 2012); *In re Tolson*, 338 B.R. 359 (Bankr. C.D. Ill. 2005). It also notes that any income derived from property held in tenancy is not exempt from the garnishment process, regardless if judgment has been rendered against only one tenant. See 735 ILCS 5/12-112 (West 2012).

¶ 20 We agree that certain circumstances may override the exempt status of property held in tenancy by the entirety, but those circumstances do not apply here. In this case, tenancy by the entirety was not broken by death or divorce, as contemplated in the Code. The property was held in tenancy until it was transferred to the trust. Also, the property was not used to generate income; it was not rented to a third party or used as a business. Thus, Goers's interest in the couple's residence held in tenancy by the entirety is not subject to process by a creditor. It is therefore exempt from a fraudulent transfer claim under the Act.

¶ 21 II

¶ 22 The Goerses also argue that the order directing the turnover of funds in the CEFCU trust account was against the manifest weight of the evidence. Specifically, they maintain that the bank failed to show that the funds that remained in the CEFCU account in 2011 were part of the funds originally deposited in August of 2009. In response, the bank argues that the trial court properly considered the remaining funds in the account to be those funds fraudulently transferred by utilizing the "lowest intermediate balance" rule.

¶ 23 In its motion for turnover, Heartland requested that the trial court consider the "lowest intermediate balance" rule in determining the appropriate award of the CEFCU trust account. Courts typically apply the lowest intermediate balance rule when tracing proceeds fraudulently transferred from one account to another. See *Marquette National Bank v. B.J. Dodge Fiat, Inc.*, 131 Ill. App. 3d 356 (1985); *C.O. Funk & Sons, Inc. v. Sullivan Equipment, Inc.*, 89 Ill. 2d 27 (1982); *People ex rel. Nelson v. Peoples Bank & Trust Co.*, 353 Ill. 479 (1933). Under the rule, the fraudulently transferred funds are considered the last funds to be used in the account. The rule creates a presumption that transferred proceeds remain in the account as long as the account balance is equal to or greater than the amount of the proceeds deposited. *C.O. Funk & Sons*, 89 Ill. 2d at 31. The transferred dollars are identified by presuming they remain in the account even if other funds are paid out, and the lowest balance at any time after the initial deposit is the amount that can still be claimed.

First Wisconsin Financial Corp v. Yamaguchi, 812 F. 2d 370 (7th Cir. 1987). The party seeking to recover the deposited funds bears the burden of proving the lowest intermediate balance. *In re Chicago Lutheran Hospital Ass'n*, 89 B.R. 719 (Bankr. N.D. Ill. 1988). In support of its claim, the plaintiff must produce evidence of bank balances during the commingling period. *Marquette National Bank*, 131 Ill. App. 3d at 364.

¶ 24 In this case, Goers testified that his initially deposited funds had been depleted and that the source of the $19,900 in the account at the time of his deposition was a recent gift that his mother-in-law made to the trust just months before his testimony. To recover that amount under the lowest intermediate balance rule, the Heartland had to establish that $19,900 was the lowest balance at any time between the initial deposit and the date of the testimony or service of the citation to discover assets. The bank failed to provide any evidence as to the various balances during this period, nor did it claim that the trust failed to produce bank statement that prevented it from doing so. Since Heartland did not prove the lowest intermediate balance in the CEFCU trust account between the first deposit in August of 2009 and Goers's deposition in March of 2011, the presumption does not arise. Thus, the trial court erred in relying on the lowest intermediate balance rule. We therefore reverse that portion of the court's order instructing the trustee to turn over those funds.

¶ 25 III

¶ 26 The Goerses contend that the trial court's finding that the remaining assets were fraudulently transferred into the trust was against the manifest weight of the evidence.

¶ 27 There are two provisions for liability under the Act: section 5, in which the creditor's claim arose either before of after the transfer, and section 6, where the creditor's claim arose only before the transfer. 740 ILCS 160/5, 6(a) (West 2012). In this case, counsel for the bank emphasized at the citation hearing that it was proceeding under section 6 of the Act. And in considering the case, the trial court also stated that it was applying section 6. We will therefore review the issue under that section.

¶ 28 Under section 6, a transfer is fraudulent as to a creditor if: (1) the creditor's claim arose before the transfer; (2) the debtor made the transfer without receiving a reasonably equivalent value in exchange for the transferred property; and (3) the debtor was either insolvent at the time of the transfer or became insolvent as a result of the transfer. 740 ILCS 160/6(a) (West 2012)). It is the burden of the complaining party seeking to set aside or avoid a transfer as fraudulent to prove the statutory elements by a preponderance of the evidence (*Casey National Bank v. Roan*, 282 Ill. App. 3d 55 (1996)), and we will not reverse a trial court finding that a transfer was fraudulent in violation of the Act unless it is against the manifest weight of the evidence (*Falcon*, 258 Ill. App. 3d at 909)).

¶ 29 The Goerses claim that Heartland failed to establish two of the statutory elements: (1) that its claim arose before the transfer; and (2) that Goers was insolvent at the time of the transfer.

¶ 30 A

¶ 31 Under section 6, a creditor must first establish that a "claim" existed before the judgment debtor transferred assets. 740 ILCS 160/6(a) (West 2012). Section 2 of the Act defines a "claim" as "a right to payment, whether or not the right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 740 ILCS 160/2(c) (West 2012). Courts treat the term "claim" broadly:

> "Indeed a claim is a right to payment. The claim may or may not be reduced to judgment. It may be liquidated or unliquidated. It may be fixed or contingent. It may be matured or unmatured. It may be disputed or undisputed. It may be legal or

equitable. It may be secured or unsecured." *Falcon*, 258 Ill. App. 3d at 909.

A claim based on a guaranty of the payment of an obligation of another is "an absolute undertaking imposing liability upon the guarantor immediately upon the default of the principal debtor." *Hensler v. Busey Bank*, 231 Ill. App. 3d 920, 927 (1992).

¶ 32 Here, Goers's obligation on his guaranty arose immediately upon the default of Ross. The note listed various conditions which would constitute default, including insolvency. Ross had a negative net worth on June 30, 2009, and was considered insolvent by the bank's loan officer in late July of 2009. Thus, the bank had a claim against Goers, as the guarantor on the note, before he transferred his assets on August 26, 2009. See *International Supply Co. v. Campbell*, 391 Ill. App. 3d 439, 449 (2009) (guarantor's secondary liability is triggered by a default of the debtor on the obligation the debtor owes to the creditor).

¶ 33 We reject the Goerses' argument that Heartland's "claim" on the guaranty merged into the default judgment once the bank obtained a confession judgment against Ross. See *Apollo Real Estate Investment Fund, IV, L.P. v. Gelber*, 403 Ill. App. 3d 179 (2010). In *Apollo*, the plaintiff was the assignee of an out-of-state judgment that was entered after the fraudulent transfer occurred. The court applied the merger doctrine and held that an assignee of a judgment could not use a claim date from before the date of judgment because the plaintiff did not have a claim until the judgment was assigned. *Id.* at 192. Here, unlike the creditor in *Apollo*, the bank was not an assignee; it had a claim against the debtor as soon as Ross defaulted on the note, which occurred before Goers transferred his assets into the Goers trust. See *International Supply Co.*, 291 Ill. App. 3d at 448-49. Thus, although Heartland's claim had not been reduced to judgment at the time of the transfer, it still had a claim under the Act before the transfer.

¶ 34 B

¶ 35 Further, the evidence was sufficient to establish that Goers was insolvent when he transferred his assets. The Act provides that a debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation." 740 ILCS 160/3(a) (West 2012). This definition is similar to the definition of insolvency under the United States Bankruptcy Code. An entity is insolvent for purposes of bankruptcy when the sum of its debts is greater than all of its property, at a fair valuation. 11 U.S.C. §101(32)(A) (2010). Under the Bankruptcy Code, courts have interpreted the definition of insolvency to require the consideration of contingent liability, like a guaranty. See *Covey v. Commercial National Bank of Peoria*, 960 F.2d 657 (7th Cir. 1992).

¶ 36 The record demonstrates that in late July 2009, Ross was insolvent and in default under the terms of the note. Thus, Goers was obligated, as one of the individual guarantors, to satisfy the company's debt. The record further establishes that when Shafer met with Goers on July 29, 2009, the outstanding balance on the Ross note was $690,000. According to his financial statement of August 31, 2009, Goers had cash in the amount of $11,645, marketable securities worth $255,465, and ownership in two vehicles valued at $49,877. His net worth was substantially less than the outstanding amount due on the note. Moreover, after August 31, 2009, Goers deposited $110,401.54 into the Smith Barney trust account. Thus, Goers's debt, including his obligation to satisfy the Ross note, was greater than the sum of his assets. Accordingly, the trial court's finding that he was insolvent at the time of the transfer was not against the manifest weight of the evidence.

¶ 37 CONCLUSION

¶ 38 We reverse the order of the circuit court directing the sheriff's sale of the residence and ordering the turnover of 50% the CEFCU bank account. We otherwise affirm the judgment for turnover of assets.

¶ 39 Affirmed in part and reversed in part.

¶ 40 JUSTICE HOLDRIDGE, specially concurring.

¶ 41 I agree with the majority's judgment in all respects. I write separately to address the bank's suggestion the Goerses' residence was subject to turnover under section 6 of the Uniform Fraudulent Transfer Act (740 ILCS 160(6)(a) (West 2012)) because the Goerses did not convey their interest in the residence to the Goers Trust as a tenancy by the entirety. Section 1005/1c of the Joint Tenancy Act currently provides that, when property is conveyed or transferred into a trust, the estate created shall be deemed to be in tenancy by the entirety when "the instrument of devise, conveyance *** or transfer *expressly declares that the devise or conveyance is made to tenants by the entirety.*" (Emphasis added.) 765 ILCS 1005/1c (West 2012). The Deed in Trust conveying the Goerses' interest in the residence to the Goers Trust did not state that the conveyance was made to tenants by the entirety. Relying on section 1005/1c, the bank suggests that the resulting interest was not a tenancy by the entirety, and therefore not exempt from turnover under section 6(a) of the Act.

¶ 42 I disagree. The dispositive question is whether the residence was subject to turnover at the time of the transfer, not thereafter. As the Majority correctly notes, the Goerses' interest in the property was held in tenancy by the entirety at the time of the transfer and was therefore protected from creditors and not subject to turnover. See *supra* ¶¶ 16-20 (citing 740 ILCS 160/2(b) (West 2012; 735 ILCS 5/12-112 (West 2012)). That remains true regardless of how the interest was transferred or conveyed. Section 1005/1c of the Joint Tenancy Act is, therefore, irrelevant.

¶ 43 Regardless, even if that were not the case, the portion of section 1005/1c upon which the bank relies would not apply here. The language relied upon by the bank (and quoted above) was added to the statute on January 1, 2011, more than 16 months after the Goerses transferred their interest in the residence into the Goers Trust.