UNITED STATES BANKRUPTCY COURT
DISTRICT OF ALASKA

In re GOOD TASTE, INC., dba Saucy Sisters Catering, Debtor(s)	Case No. A00-00880-DMD In Chapter 7
LARRY D. COMPTON, Plaintiff(s) v. CONNIE S. BENNETT, Defendants(s)	ADV PROC NO A02-90061-HAR MEMORANDUM DECISION: (1) ALLOWING POC NO. 6 [Main Case]; (2) DENYING AVOIDANCE OF TRANSFERS TO BENNETT [Adversary]

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1. INTRODUCTION- This memorandum decision concerns: (a) the trustee's objection to Connie Bennett's $1.1 million Proof of Claim No. 6, and (b) his attempt to avoid several prepetition transfers from the debtor corporation to Bennett, its sole shareholder. I have ruled for Bennett on each matter.

In the main case, I conclude that Bennett's $1.1 million claim should be allowed because she has adequately (though far from perfectly) shown that it is approximately accurate. She has also satisfactorily proved that the advances were loans, not capital contributions, and therefore that they should not be subordinated to other general unsecured claims.

In the adversary proceeding, I conclude that the transfers to her will not be avoided, because:

- the transfer of a promissory note made to her by the debtor was not fraudulent under Alaska law[1] under the facts of this case; Alaska does not have a per se rule, like the Uniform Fraudulent Transfer Act, § 5(b), making a preferential transfer to an insider from an insolvent corporation a per se fraudulent transfer, although in a sufficiently egregious case a fraudulent transfer under state law can be found,[2] and,

- the trustee has not shown that various art work was transferred to the Bennett by the debtor; it is more probable than not that she always owned the art work herself.

Allowance of Connie Bennett's proof of claim will give her about 86% of the distribution to unsecured creditors (there are only three). The trustee recognized this possibility and prudently sought to have the claim objection decided first before addressing the avoidance action. He said he would have dismissed the avoidance action if Bennett's claim was allowed because the benefit to the estate of winning the avoidance action would have been minimal since most of the recovery, after costs, would have gone back to Bennett anyway.

Unfortunately, because Bennett was living in Italy, scheduling such a bifurcated procedure was not easy to arrange. Bennett returned from Italy for the trial on the claim objection and the avoidance action at the same time. The court issues this common memorandum decision on both matters together – one part of memorandum belongs in the main case and the other in the adversary.

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[1]AS 34.40.010, et seq.

[2]Nyrox Power Systems, Inc. v M-B Contracting Co., Inc., 54 P3d 791, 796 (Alaska 2002).

2. TRUSTEE'S OBJECTION TO PROOF OF CLAIM NO. 6 BY BENNETT [Main Case]-

2.1. Background- Connie Bennett was sole owner of the debtor corporation, Good Taste, Inc. (GTI), which was formed in 1986. Its principal business was food catering, and its biggest client was United Airlines (UAL) with which it had a three-year contract entered into in March 1988. GTI catered in-flight meals for UAL during 1988 and 1989. In 1989, UAL gave notice that it elected to terminate the contract with GTI effective August 15, 1989. Up to that time, GTI had a positive cash flow, but its cash flow turned negative after the UAL contract ended.

GTI had invested a substantial amount of money in ramping up for the UAL contract and, when UAL terminated on 90-days notice, GTI was left with large fixed costs for a lease at the Anchorage International Airport and a business loan from (or guaranteed by) the Small Business Administration, in addition to its accrued trade debt. GTI had a much smaller catering contract with a local airline, MarkAir, which was not sufficient to cover the fixed costs incurred for the UAL contract, and the MarkAir contract was, itself, terminated in May 1991. The loss of the UAL contract effectively destroyed GTI as a going concern.

GTI sued UAL in the superior court in Anchorage in 1991 for breach of contract and obtained a judgment of $3,600,000, with interest and costs.[3] UAL appealed and the judgment was reversed by the Alaska Supreme Court in 1999.[4] Eventually, a final judgement was entered against GTI in favor of UAL for attorney fees and costs of about $121,500.[5]

Notwithstanding its dire financial condition after the UAL contract was terminated, GTI managed pay off all of GTI's pre-1999 unsecured debts, other then the debt to Bennett herself. By the time GTI filed a chapter 7 bankruptcy on September 5, 2000, it had only three unsecured debts. Only three unsecured claims have been filed in the chapter 7 case:

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[3] United Airlines, Inc. v Good Taste, Inc., 982 P2d 1259, 1261 (Alaska 1999)

[4] Id.

[5] See, Final Judgment in Favor of UAL, entered by the Superior Court in Anchorage on October 5, 1999, a copy of which is attached to United Airlines, Inc.'s Proof of Claim No. 2.

- the UAL claim for attorney fees and costs awarded in October 1999 (filed for about $177,000);

- a debt incurred in May 1999, to Connie Bennett's sister and brother-in-law (Darryl and Cheri Jordan, filed for about $137,000, and allowed for $71,798[6]); and,

- to Bennett, herself, for $1.1 million, incurred before 1999.

Bennett, herself, has filed three versions of her unsecured proof of claim in this case:

POC No.	Date Filed	Amount of Claim
3	07/26/2001	$416,065.00
5	09/06/2001	$1,098,670.00
6	08/14/2002	$1,098,670.00

Although the first proof of claim was for only $416,065 in 2001, GTI had previously listed her claim on the schedules which were filed on September 21, 2000, as $1,098,670.[7]

Proof of Claim No. 3 was only supported by statement of CPAs Alban, Fleischli & Morton, PC, dated November 7, 1999, and a Form 1120S, Schedule K-1 for GTI, showing as of December 31, 1998, showing a loan basis of $416,065.

Proof of Claim No. 5, amended Proof of Claim No. 3. It was supported by the affidavits of Thomas Yerbich, GTI's and Bennett's attorney at various times, and Al Albans, a CPA who worked for Bennett and GTI at various times. Mr. Yerbich's affidavit indicated:

- he was retained by Bennett in January 1994, for herself and GTI, Bennett's wholly-owned corporation;

- in 1995, Bennett was notified by the IRS that her 1991 was selected for audit;

[6] Main case Docket Entry 40, filed March 1, 2002.

[7] Main case Docket Entry 12.

- when he reviewed Bennett's personal and GTI tax returns for 1991, he found substantial errors, and upon reviewing the 1990 returns, he found those to be incorrect, also;

- he amended the 1990 and 1991 tax returns for Bennett and GTI, which the IRS accepted;

- the 1990 amended GTI tax return showed loans from Bennett at the end of 1990 of $591,400;

- the 1991 amended GTI tax return showed loans from Bennett of $866,961 at the end of the year;

- Yerbich prepared the GTI tax returns for 1992-1996, which showed loans from Bennett at the end of the calendar year as follows:

1992	$991,464
1993	$1,100,697
1994	$1,190,006
1995	$1,357,001
1996	$1,365,935

- Bennett made the following capital contributions to GTI by transferring real property to GTI (recorded as "paid-in capital"):

1993 . . . book value $558,901, subject to mortgages of $298,142
1994 . . . book value of $144,886, subject to mortgages of $74,104

- Yerbich prepared these returns after performing due diligence in reviewing GTI's and Bennett's records and, in his opinion, fully complying with IRS code and regulations, and state that the transactions between Bennett and GTI accorded with generally accepted accounting principles.

The affidavit of Al Albans, the CPA for Bennett and GTI for 1997 and 1998, in support of Proof of Claim No. 5, stated:

- The loans from Bennett to GTI were, and the end of the years:

1997	$1,319,158
1998	$1,298,937

- The financial books and records of GTI showed, after all credits and offsets, as of September 1, 2000, Bennett was owed $1,098,670.

Neither the affidavit of Mr. Yerbich, nor the one of Albans, supporting POC No. 5, contained any backup data in the form of cancelled checks or similar evidence, although POC No. 3 did have a shareholder's notice of her share of income, Schedule K-1, from the 1998 GTI tax return attached.

Upon the objection of the trustee, Judge MacDonald denied POC Nos. 3 and 5 without prejudice.[8] He held that Bennett, as an insider, had not satisfied the heightened scrutiny usually given to claims of insiders. Judge MacDonald suggested that Bennett might refile her claim or supplement an amended proof of claim with copies of the actual checks.[9]

After the denial of POC Nos. 3 and 5, Bennett filed a Declaration of Connie S. Bennett; Renewal of Claim No. 5 on July 25, 2002,[10] documenting four categories of loans. The largest category, direct loans to GTI, had attached copies of promissory notes, checks, drafts, etc. purporting to document unpaid loans to GTI at follows:

Category of Loan by Bennett to GTI	Amount
Direct loans to GTI since 1/1/89	1,117,395.15
Payments made on SBA loan	56,087.27
Miscellaneous payment	26,500.00
Payments made on Mt. Shasta property	7,935.00
Total	1,207,917.42

Bennett subsequently filed POC No. 6 for $1,098,670 on August 12, 2002. This claim was supported by the recently filed Bennett Declaration,[11] and contained only the summary lists totaling $1,207,917.42, without the exhibits. Proof of Claim No. 6 is poorly put together in the

[8] Main case Docket Entry 36, filed on October 29, 2001.

[9] Comments at hearing on September 12, 2001.

[10] Main case Docket Entry 42 [actually supporting Proof of Claim No. 6].

[11] Id.

sense that there is no explanation of the $109,000 discrepancy in the amount claimed and the larger amount documented (i.e. the $1,098,670 listed on the face of the claim, and the $1,207,917.42 loans identified in Bennett's declaration and the table attached to the proof of claim). Ironically, trustee's counsel provided a spreadsheet analyzing the proof of claim in his opposition to POC No. 6 which presents the information in a much more orderly fashion and has the unintended consequences of making her claim understandable[12].

The trustee argues that: (a) POC No. 6 still has not met the heightened burden for an insider's proof of claim against a debtor; and, (b) even if it is allowed, it should be treated as a capital contribution, not as a loan to the debtor.

Some of the points the trustee makes in support of his arguments, and Bennett's responses, are:

- Trustee's Argument: GTI did not pay interest on the advances, and Bennett did not demand interest.

  Bennett's Response: Both Bennett and Yerbich testified that GTI was an S Corporation solely owned by her and that her accountants told her that interest payments and receipt, in her case, was a wash and she should disregard it to simplify the accounting.

- Trustee's Argument: Bennett's proof of claim was not sufficiently detailed to justify allowance because it did not show all her loans, GTI's repayments of some of them, and give sufficient support to come up with a number that could be tracked in the books of GTI.

  Bennett's Response: Bennett testified she relied on her accountants and attorneys to keep her straight. She has lived in Italy for several years; her records and GTI's were (to the extent not turned over to the trustee) in a garage at her sister's home in Anchorage and that she scoured them as best she could to provide information. Yerbich testified that the amount claimed was consistent with his independent review as an attorney and tax

[12] See, Exhibit A to Trustee's Renewed Objection to Proof of Claim No. 5 Filed by Connie Bennett, Docket Entry 62, filed June 10, 2003 [the court treat's Proof of Claim No. 6 by Connie Bennett as the operative one, so this objection really applies to Proof of Claim No. 6].

preparer in about 1994 and that Bennett had loaned substantial sums to GTI, in an amount close to what is now claimed. He stated that in defending GTI in a federal income tax audit in 1995, he was very careful at that time to make sure that all material amounts on the balance sheet of GTI were justified, and this included the loan from Bennett to GTI.

- Trustee's Argument: In 1992, the books of GTI showed only a $411,001.27 in loan from Bennett,[13] but the trustee's analysis of POC No. 6 shows that she is now claiming $725,119.58 as of approximately the same date.[14]

  Bennett's Response: Yerbich testified that he redid the tax returns for that year and the ones prior because Mikunda & Cotrell had incorrectly lumped Bennett's separate real estate ventures and business under GTI. Although he did not precisely remember the $411,001.27 figure at the time of his testimony (he testified telephonically from California), he did recall that the figure shown in the later proofs of claim, totaling about $1,100,000 were the amounts that the revised income tax returns of GTI justified.

2.2. Issues- The issues presented by the trustee's claim objection are: (a) has Bennett supported her claim with adequate backup information; and (b) should her claim be subordinated other general unsecured creditors or treated as a capital contribution?

2.3 Analysis-

2.3.1. Subordination of Bennett's Claim Not Warranted- Under the facts of this case the trustee has not shown that Bennett's advances to GTI should be treated as capital contributions, as opposed to loans, (a) under either the federal income tax test for analyzing the issue, or (b) because Bennett engaged in some type of inequitable behavior or misconduct giving her an unfair advantage justifying subordination under 11 USC § 510(c).

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[13] Trustee's Trial Exhibit 18, at page 15 of 29 (a printout titled "Adjusted Trial Balance for the period ending December 31, 1992, included in papers turned over to the trustee by Thomas Yerbich when he discovered he had them).

[14] Page 1 of Exhibit A to Trustee's Renewed Objection to Proof of Claim No. 5 Filed by Connie Bennett, Docket Entry 62, filed June 10, 2003.

In support of the "income tax test," the trustee relies principally on the Second Circuit federal tax case, Roth Steel Tube Co. ,[15] for the proposition that Bennett, an insider, should be held to a heightened degree of scrutiny in determining that her claim was really for capital contributions, and not loans. If the advances in the Roth case had been treated as loans, the taxpayer could have deducted them as losses, but if they were treated as capital contributions the advances would be treated as long-term capital losses which were of much more limited use by the Roth in minimizing its taxes.

Bennett disputes the power of the bankruptcy court to subordinate her claim using the income tax theory. She cites the 9th Circuit BAP case, Pacific Express:[16]

> While the Code supports the court's ability to determine the amount and the allowance or disallowance of claims, those provisions do not provide for the characterization of claims as equity or debt. The result achieved by such a determination, i.e. subordination, is governed by 11 U.S.C. Section 510(c). Where there is a specific provision governing these determinations, it is inconsistent with the interpretation of the Bankruptcy Code to allow such determinations to be made under different standards through the use of the court's equitable powers. [citation omitted]

The Sixth Circuit has held to the contrary, and applied the Roth income test in determining if a claim should be subordinated.[17]

Even assuming that the trustee can overcome the holding in Pacific Express, the facts surrounding Bennett's claim are much different than those in the Roth case and recharacterization of her advances as capital contributions is not warranted.

The Roth court said the factors which a court should consider in determining if an insider's claims were legitimate are:

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[15] Roth Steel Tube Co. v Commissioner of Internal Revenue, 800 F2d 625 (2nd Cir 1986), cert den 107 SCt 1888 (1987).

[16] In re Pacific Express, Inc., 69 BR 112, 115 (9th Cir BAP 1986).

[17] In re Autostyle Plastics, Inc., 269 F3d 726, 747-49 (6th Cir 2001).

> This court has identified a number of factors to be used in making the capital contribution versus loan determination: (1) the names given to the instruments, if any, evidencing the indebtedness; (2) the presence or absence of a fixed maturity date and schedule of payments; (3) the presence or absence of a fixed rate of interest and interest payments; (4) the source of repayments; (5) the adequacy or inadequacy of capitalization; (6) the identity of interest between the creditor and the stockholder; (7) the security, if any, for the advances; (8) the corporation's ability to obtain financing from outside lending institutions; (9) the extent to which the advances were subordinated to the claims of outside creditors; (10) the extent to which the advances were used to acquire capital assets; and (11) the presence or absence of a sinking fund to provide repayments. [citations omitted][18]

The court also said that "the question of whether advances to a corporation constitute capital contributions or loans is a question of fact" to be reviewed under the clearly erroneous standard.[19]

Although Roth gives a convoluted history of the finances of the company bought by the taxpayer, Roth Steel Tube, which was in the position analogous to Bennett's, a distillation of the pertinent facts shows the factual distinctions between Bennett's case and Roth.

In Roth, the taxpayer purchased a toy company (Remco) in August 1972 that had, by year end, a $6 million negative net worth and whose current liabilities exceeded current assets by $2.7 million. The situation continued to deteriorate from the beginning.

Roth made unsecured cash advances to Remco of $3,420,000 over the course of a year, beginning several months after purchasing the company. The loans were to provide working capital; no interest was actually paid on the loans; Roth booked these advances as a receivable, not a capital contribution; accrued interest was booked by Roth; and, and some of it was reported on its tax returns. Although notes were authorized to be issued by the borrower, they were not issued.

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[18] Roth, at 630.

[19] Roth, at 629.

The IRS disallowed interest and loss deductions, alleging that the advances were capital contributions, not loans.[20] The trial court held for the IRS, declaring the advances to be capital contributions, rather than loans. Its reasoning is summarized in the following table:

Factor in Determining If Loan or Capital	Finding in Roth Case	Favoring Capital	Favoring Loan
1- Identity of interest between creditor and stockholder	Roth only owned 62% of interest. and loans not proportionate. Strongly indicative of loan.		x
2- Adequacy or inadequacy of capitalization	Remco's debt to equity ratio was 300-1	x	
3- Source of repayment	Depended on business success or payment from earnings [Query[21]]	x	
4- Name given instrument evidencing indebtedness	Although Roth reported most of advances as loans on their accounting records, absence of notes strongly indicates capital and booking as receivable is of little support[22]	x	
5- Presence or absence of fixed maturity date and schedule of payment	Only initial advances had these	x	
6- Presence or absence of fixed rate of interest and interest payments	Only indication was that Remco would pay what Roth had to pay its lenders; absence of fixed interest rate a strong indication of capital contribution	x	
7- Presence or absence of security	Absence of security is strong indication of capital contributions, rather than loans	x	
8- Inability to obtain outside financing	Fact that no reasonable creditor would act in the same manner as Roth is strong indication of capital contribution	x	
9- Subordination of advances	Subordination is strong evidence of capital contribution	x	

[20] Roth ,at 627.

[21] Estate of Mixon v United States, 464 F2d 394, 405 fn 15 (5th Cir 1972) calling payment from earnings to be an indication of a capital contribution "anomalus" since a majority of loans are repaid out of earnings.

[22] Estate of Mixon v United State, at 403 cited for this proposition in Roth, at 631, is not nearly as dogmatic or positive as Roth indicates.

Factor in Determining If Loan or Capital	Finding in Roth Case	Favoring Capital	Favoring Loan
10- Presence or absence of sinking fund	Looking solely to earnings, and failure to establish a sinking fund is strong evidence of capital contribution	x	
11- Extent to which advances were used to acquire capital assets	Remco borrowed for day-to-day operations rather than purchase of capital goods indicative of bona fide loans		x

Curiously, Roth did not mention the intention of the parties as a pertinent factor, though other cases do, making intent a factor, even if not alone determinative.[23]

Giving Roth a fair reading, the court found that notwithstanding the fact that the advances were made by only a partial shareholder and were not made for capital expenditures - both calling for a characterization as "debt," as opposed to "equity" – the fact that debt to equity ratio was 300-1 inclined the court to conclude the opposite.

In the case a bar, the facts are very different from those in Roth, leading me to conclude Bennett's treatment of her advances over many years as loans should not be disregarded to pay lip service to a number of boilerplate rules which have little application to GTI's situation. The facts in the GTI case show:

- GTI had a successful venture of catering on-flight meals for UAL during 1988-1989.
- No evidence was offered by the trustee about a lack of adequate capital during this period.
- Bennett's sworn statement indicates that in 1988-1989, GTI had a positive cash flow.[24]

[23] Stinnett's Pontiac Service, Inc. v C.I.R., 730 F2d 634, 641 (11th Cir 1984); Raymond v United States, 511 F2d 185, 190 (6th Cir 1975).

[24] Declaration of Connie S. Bennett Renewal of Claim No. 5 [treated as POC No. 6], Docket Entry 42, filed July 25, 2002, at ¶ 12.

- The termination of the UAL contract was unexpected by GTI and created a financial crisis for GTI which could not compensate with another contract (a smaller contract with MarkAir ended in 1991).[25]

- GTI had fixed costs for an SBA loan and lease payments at the Anchorage International Airport which were ongoing, plus other trade debt which had to be paid after the UAL contract was terminated.

- GTI borrowed over $1.2 million from Bennett, as shown in the trustee's recap of Bennett's documentation to support her claim[26]; this borrowing was not for capital expenditure, but to pay for GTI's accruing expenses which GTI did not have the revenue to pay itself.[27]

- The accountant for both Bennett and GTI advised her that, since she was the sole shareholder of a Sub-S corporation, she did not have to document her loans with notes or be concerned about interest since the interest would be a wash for tax purposes (any deduction by GTI would be income to her in exactly the same amount and since the accounting features would flow through the Sub-S corporation, and ignoring interest would simplify the accounting without creating a substantive difference).

- GTI won a $3,607,843.57 judgment based on a jury verdict against UAL, probably in about 1996; the court was not presented with a balance sheet at this date, but infers that this collectable judgment against UAL made GTI solvent by several million dollars in the mid-1990s.

- The judgment was reversed by the Supreme Court of Alaska in 1999.[28]

- GTI paid all of unsecured claims against it by the time it filed a chapter 11 case in September 2000, except those of UAL and the Jordans which were incurred in1999, and Bennett's claim for advances which had accrued from 1989 through 1998.

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[25] Id., at page ¶ 11.

[26] See, Trustee's Summary of claimed loans from Connie Bennett to Good Taste, Inc., Exhibit A to Trustee's Renewed Objection to Proof of Claim No. 5 Filed by Connie Bennett [which the court treats as referring to Bennett's Proof of Claim No. 6], Docket Entry 62, filed June 10, 2003.

[27] See, Declaration of Connie S. Bennett Renewal of Claim No. 5 [eventually refiles as POC No. 6], filed July 25, 2002.

[28] United Airlines, Inc. v Good Taste, Inc., 982 P2d 1259 (Alaska 1999).

- The claim of the Jordans results from May 1999 advances to GTI;[29] Ms. Jordan is Connie Bennett's sister, and the trustee has inferred that the Jordans' and Bennett's interest in the matter are the aligned and they are both insiders, and the court will do so too; the only "adverse" unsecured creditor, then, is UAL.

- It was not until October 1999, that UAL got a judgment for costs and attorney fees of $121,509.69;[30] this was long after Bennett's advances were used to pay all of GTI's creditors that existed before that date (except the unknown accrued debt for UAL's attorney fees and costs).

- Bennett filed a personal chapter 11 bankruptcy in 1994 in this district, Case No. A94-00041-HAR; although she did not disclose the loan to GTI, she confirmed a full-payment plan, which she has fully performed, and a final decree has been entered.

- Thomas Yerbich, a local bankruptcy attorney and tax practitioner, reviewed the tax returns and financial records of GTI and Bennett, and concluded that they showed loans in excess of a $1 million balance from 1992; GTI's loan balance from Bennett at the end of 1991 was about $865,000; these returns have not been challenged by the IRS; his analysis was after exhaustive review of the books and records of GTI for 1991-1996.

- Bennett traveled to Anchorage from Italy to personally plead her case on December 22, 2003, since the court (on objection by the trustee) would not accept telephonic testimony; she testified that her records and those of GTI were in some disarray and stored in a garage in a rather haphazard manner; she said she has done the best she can under the circumstance (she was over eight months pregnant at the time of the hearing) to document her claim.

This is not the picture of debtor and insider shareholder that got into an undercapitalized business venture and left a number of creditors of the business hanging out to dry. To the contrary, Bennett, through some extraordinary means, saw to it that GTI met its obligations as they existed prior to the Supreme Court reversal.

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[29] See, Proof of Claim No. 4.

[30] See, attachment to Proof of Claim No. 2, filed by United Airlines, Inc.

The court sees no reason to disregard Bennett's intention (expressed years before 1999) that her advances to GTI be treated as loans. Bennett's advances as shown on Proof of Claim No. 6 will be treated as loans.

If the case against Bennett is not persuasive using a Roth Steel Tube analysis, it is weaker using 11 USC § 510(c).

> "Equitable subordination requires that: (1) the claimant who is to be subordinated has engaged in inequitable conduct; (2) the misconduct results in injury to competing claimants or an unfair advantage to the claimant to be subordinated; and (3) subordination is not inconsistent with bankruptcy law." . . . "[A] Bankruptcy Court is a court of equity, and subordination requires some showing of suspicious, inequitable conduct beyond mere initial undercapitalization of the enterprise." [citations omitted][31]

The trustee apparently has not attempted to make a case under § 510(c).

2.3.2. Claim is Adequately Documented by Bennett- The documentation Bennett gave in support of her first two proof of claims, POC Nos. 3 and 5, was found to be inadequate by Judge MacDonald.[32] Subsequently, Bennett provided a slew of back-up data, but somewhat akin to person presenting her accountant a shoe box full of documents at tax time. The documents are attached to Bennett's declaration in a table in Docket Entry 42, which she filed in support of Proof of Claim No. 6.[33] There are a number of weaknesses in the presentation: (a) the numbers do not foot to the $1,098,670 she is claiming (they show a larger claim); (b) she did not adequately disclose them in her 1994 personal bankruptcy; (c) there is no orderly bookkeeping record of GTI or Bennett herself showing money in-money out which was kept on a timely basis.

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[31] Paulman v Gateway Venture Partners, III. L.P. (In re Filtercorp, Inc.), 163 F3d 570. 583 (9th Cir 1998); In re Pacific Express, Inc., 69 BR 112, 116 (9th Cir BAP 1986).

[32] Main case Docket Entry 36, filed on October 29, 2001.

[33] Named, however, Declaration of Connie S. Bennett; Renewal of Claim No. 5, Docket Entry 42, filed July 25, 2002.

On the other hand, she testified she was at least owed about $1.1 million which had not be repaid by GTI. GTI was not active as a catering company after 1991 when the MarkAir contract was lost. GTI's records, today, to the extent they have not been delivered to the trustee, are in boxes in a relative's garage and are not neatly indexed and sorted. Bennett was relying on relatives and others to help her find backup. She did this while living out of the country for the past several years. And, most persuasively, her attorney and accountants reviewed the records and books of GTI and Bennett in 1995 for the years from 1990-1995, and found a claim of over a million dollars then. I have no reason to doubt their truthfulness.

In the last analysis, the question is whether she put about $1.1 million into GTI to pay its debts, for which she has not been compensated. I find it more probable than not that she did and she is owed something in excess of the amount she is claiming in POC No. 6. I overrule the objection and allow Bennett's claim in the amount she requested, $1,098,670.[34]

3. TRUSTEE'S AVOIDANCE ACTION AGAINST BENNETT [Adversary Proceeding]-

3.1. Background- The background set out under section 2.1 of this memorandum is reiterated here, with the following additional background information added.

Although GTI had, at one time, had a substantial operating business, by the time it filed bankruptcy, its operations had ceased, and it listed few assets consisting of some inconsequential artwork valued at $150.

In this adversary proceeding, the trustee seeks, using his avoiding powers, to recover assets which he contends that GTI transferred to Bennett. They are:

- An escrow and promissory note in the face amount of $152,500, secured by a deed of trust from the sale of real property in Anchorage, Alaska to the Poeschels; Bennett had collected about $10,556 before the trustee demanded that the escrow holder not pay any more to Bennett, and pay

[34] 11 USC § 502(b); 5 Collier on Bankruptcy, ¶ 502.03[1][c] (15th ed rev 2004).

the trustee instead; the trustee has collected the full balance of the note and holds $164,321.05, subject to proving his right to the funds;[35]

- Various items of artwork, the exact description and worth of which was not identified, except that GTI's corporate tax returns from 1995-1998 had listed artwork in the balance sheet section as $80,645.

The transfer from GTI to Bennett of Poeschel note on August 1999, was just before UAL got a judgment for $121,000 in attorney fees against GTI, in October 1999, after Bennett's $3.6 million judgment against UAL was reversed in July 1999.[36] GTI filed bankruptcy on September 5, 2000, just over a year after the transfer, listing only $150 in assets. It is likely that the bankruptcy was, in part, to forestall the effort of United Airlines to seek avoidance of various transfers to Bennett in the state court proceeding.[37] While the transfers paid a legitimate debt of GTI to Bennett, it is hard to escape the conclusion that the property was transferred out of GTI to Bennett in August 1999, to avoid having it subject to UAL's collection efforts.

Bad as these conclusions might sound in the abstract, they have given no litigation advantage to Bennett, because her actions are judged by the same principals of state law as she would have faced in state court, subject to the additional hurdles imposed on her by GTI's bankruptcy.

And, unlike many cases in which insiders favor themselves, Bennett had paid almost every other debt of GTI with funds she provided from other sources as GTI's operations diminished and in amounts far greater than the two other remaining unsecured claims.

With respect to the art work valued at $80,645 in the tax returns of GTI, Bennett testified that this was the result of her accountants erroneously mixing her personal business and the corporate affairs of GTI in the early 1990s, and it never being straightened out. She testified

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[35] Affidavit of Larry D. Compton, Trustee [For Trial Monday, December 22, 2003]. ¶ 11, Docket Entry 51, filed December 17, 2003.

[36] United Airlines, Inc. v Good Taste, Inc., 982 P2d 1259 (Alaska 1999).

[37] See, the allegations in ¶¶ 14-18 of the complaint in this adversary proceeding, Docket Entry 1, filed September 4, 2002.

that no substantial artwork had ever been purchased for GTI, and the trustee was not been able to do more than point to a number on a tax return ($80,645) to establish that the artwork existed and was fraudulently transferred to Bennett.

3.2. Issues- Can the trustee avoid the transfers of the Poeschel escrow under the state fraudulent conveyance statute[38] because Bennett, an insider, preferred her own claim to those of other unsecured creditors when GTI was insolvent? Also, is there sufficient evidence to show she transferred artwork worth $80,645 to herself in a manner which can be avoided by the trustee?

3.3 Analysis- The trustee relies principally on his rights under 11 USC § 544(b)(1) to avoid the transfer of the Poeschel note to Bennett, which he says is avoidable under Alaska law.[39] He cites the Alaska Fraudulent Conveyance Act, AS 34.40.010, which provides:

> Except as provided in AS 34.40.110 , a conveyance or assignment, in writing or otherwise, of an estate or interest in land, or in goods, or things in action, or of rents or profits issuing from them or a charge upon land, goods, or things in action, or upon the rents or profits from them, made with the intent to hinder, delay, or defraud creditors or other persons of their lawful suits, damages, forfeitures, debts, or demands, or a bond or other evidence of debt given, action commenced, decree or judgment suffered, with the like intent, as against the persons so hindered, delayed, or defrauded is void.

Under § 544(b)(1), so long as there is at least one unsecured creditor who could have avoided a transfer on the date the bankruptcy case was commenced, the trustee can invoke those rights, not only for the one creditor who possessed avoidance rights under state law, but for the benefit of the estate, including all unsecured creditors. And, despite the fact Bennett might

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[38] AS 34.40.010 et seq.

[39] Compare, Butler v. Nationsbank, N.A., 58 F3d 1022 (4th Cir 1995) (applying North Carolina fraudulent conveyance law); In re Jones, 184 BR 377 (Bankr DNM 1995) (applying New Mexico law); In re McFarland, 170 BR 613 (Bankr. SD Ohio 1994) (applying Ohio law).

have been owed a majority of the unsecured debt of GTI herself, the trustee can (if his avoidance action is good) recover the entire transfer, not just a pro rata share.[40]

At trial, the trustee has all but abandoned his claims of preference and fraudulent transfer under the bankruptcy code,[41] and relied on § 544(b)(1) and his allegation of a fraudulent transfer based on his interpretation of the Nerox case.[42] In that case, the court distinguished its holding in Blumenstein that the preferring the of one creditor with a payment over another is, outside of bankruptcy or a statutory prohibition, an acceptable practice:[43]

> Yet the rule is settled that in the absence of bankruptcy laws or express statutory prohibition, an insolvent debtor may convey property to one creditor, even if it means that the debtor's assets will thereby be depleted, and that the claims of other creditors will be defeated.

In Nerox, William Artus, an attorney and officer of one of the Nerox companies, claimed to be owed money for attorney fees and loans. He took a deed of trust on the mining claims owned by Nerox, which were recorded prior to the mechanics liens of M-B Contracting and other creditors.

In a suit to foreclose the mechanics liens, the trial judge subordinated Artus' deed of trust to the subsequently recorded mechanics liens because she found Artus' debt had been previously paid by the issuance of stock in Nerox, and that Artus, as a director, had a fiduciary duty to protect the rights of creditors and not prefer his own interest as a shareholder to those of legitimate creditors of the corporation. This was done at a time when Nerox was grossly

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[40] 5 Collier on Bankruptcy, ¶ 544.09[6] (15th ed rev 2004), Moore v Bay, 284 U.S. 4, 52 SCt 3, 72 LEd 133 (1931),

[41] 11 USC §§ 547 and 548.

[42] Nerox Power Systems, Inc. v M-B Contracting Company, Inc., 54 P3d 791, 796-97 (Alaska 2002).

[43] Blumenstein v Phillips Insurance Center, Inc., 490 P2d 1213, 1221 (Alaska 1971).

undercapitalized. This, the trial judge found to have been inequitable conduct, constituting a fraudulent conveyance.[44]

Having already decided the issue against Artus, the Supreme Court chose to go beyond the actual findings of the trial judge and said the trial judge could have subordinated Artus' deed of trust even if he had only been a creditor. The court said:[45]

> The law supports this conclusion. Federal courts have recognized three types of misconduct that constitute "inequitable conduct": (1) fraud, illegality, or breach of fiduciary duties; (2) undercapitalization; and (3) claimant's use of the debtor as a "mere instrumentality" or alter ego.[16] [footnote 16 in the original]

The court did not adopt a bright line test and say a director who is a creditor can not orchestrate payment his or her own claim in preference to outsider creditor when a company is insolvent, but instead said that whether or not this rises to the level of fraud is a factual determination, often resolved by looking for badges of fraud.[46] And, the court somewhat confused the issue by again alluding, in this part of the opinion, to the fact that the "loan" by Artus was actually a capital contribution.[47]

Did the court mean that a director who is a legitimate creditor has a automatic duty to subordinate his or her own interest to those of other legitimate creditors? Probably not. It is often a good thing that insiders are willing to support a business with loans, for which they

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[44] Nerox Power Systems, Inc. v M-B Contracting Company, Inc., 54 P3d at 795-96.

[45] Id, at 796, and fn 16:

> [16]In re Mobile Steel Co., 563 F.2d 692, 702-06 (5th Cir.1977); rule summarized by In re Missionary Baptist Found. of America, Inc., 712 F.2d 206, 212 (5th Cir.1983); see also In re 604 Columbus Ave. Realty Trust, 968 F.2d 1332, 1353 (1st Cir.1992); In re Toy King Distrib., 256 B.R. 1, 198-99 (Bankr.M.D.Fla.2000).
> Once inequitable conduct is found, equitable subordination can be employed as long as there is either an injury to the creditor or an unfair advantage conferred to the claimant and as long as the remedy does not violate bankruptcy law. Mobile Steel, 563 F.2d at 700; Fabricators, 926 F.2d at 1464-65.

[46] Id, at 796-97.

[47] Id at 797, fn 22.

should not automatically face subordination.[48] More likely, the court meant that when a corporation is in financial difficulty, it cannot favor its insiders unfairly.

An example of a bright line test is the one drawn by the Uniform Fraudulent Transfers Act, § 5(b), which has been adopted in a number of states, but not Alaska:

> A transfer made by a debtor is fraudulent as to a creditor whose claim arose before the transfer was made if the transfer was made to an insider for an antecedent debt, the debtor was insolvent at that time, and the insider had reasonable grounds to believe that the debtor was insolvent.

Under this statute, GTI's transfer to Bennett would clearly have been fraudulent. It should be noted that some major states have adopted the UFA without adopting § 5(b), including California, Arizona, and Pennsylvania.[49]

The Comment to the Uniform Fraudulent Transfer Act, § 5(b), explains the reason for the section as follows:

> (2) Subsection (b) renders a preferential transfer--i.e., a transfer by an insolvent debtor for or on account of an antecedent debt--to an insider vulnerable as a fraudulent transfer when the insider had reasonable cause to believe that the debtor was insolvent. This subsection adopts for general application the rule of such cases as Jackson Sound Studios, Inc. v. Travis, 473 F.2d 503 (5th Cir. 1973) (security transfer of corporation's equipment to corporate principal's mother perfected on eve of bankruptcy of corporation held to be fraudulent); In re Lamie Chemical Co., 296 F. 24 (4th Cir. 1924) (corporate preference to corporate officers and directors held voidable by receiver when corporation was insolvent or nearly so and directors had already voted for liquidation); Stuart v. Larson, 298 F. 223 (8th Cir. 1924), noted 38 Harv.L.Rev. 521 (1925) (corporate preference to director held voidable). See generally 2 G. Glenn, Fraudulent Conveyances and Preferences 386 (Rev. ed. 1940). Subsection (b) overrules such cases as Epstein v. Goldstein, 107 F.2d 755, 757 (2d Cir. 1939) (transfer by insolvent husband to wife to secure his debt to her sustained against attack by husband's trustee); Hartford Accident & Indemnity Co. v.

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[48] 5 Collier on Bankruptcy, ¶ 510.05[3][c] (15th ed rev 2004); In re Bellanca Aircraft Corporation, 850 F2d 1275, 1282 (8th Cir 1988).

[49] Uniform Laws Annotated, Uniform Fraudulent Transfer Act, 1984 Act, Variations from Official Text (References & Annotations)

> Jirasek, 254 Mich. 131, 139, 235 N.W. 836, 839 (1931) (mortgage given by debtor to his brother to secure an antecedent debt owed the brother sustained as not fraudulent).

Under the UFA § 5(b), an insider is not only a corporate director, officer or shareholder – a spouse also qualifies.[50]

Alaska is in the camp which gives discretion to a court to determine if the insider's activities have gone beyond the pale and turned into a fraudulent act. It does not adopt a bright line test by case law. In Sylvester v Sylvester,[51] the Alaska Supreme Court said that a transfer of property to a bona fide creditor, even by an insolvent transferor, is not per se grounds for finding a fraudulent transfer.

While there is some inequity in the fact that Bennett had control of GTI's payment which preferred her, it would also have equally, if not more, inequitable to require her to stand by while UAL collected its $121,000 plus debt in full from GTI (or, as much as GTI could pay of it), while requiring Bennett could not collect on her $1.1 million debt, which was just as legitimate.[52]

Given the facts of this case as reiterated in Parts 2 and 3, I determine that Bennett's behavior was not sufficiently egregious to find it fraudulent with respect to the Poeschel transfer. Rather, it is closer to the legitimate type of preference permitted under Blumenstein. I will therefore deny the trustee's complaint regarding the Poeschel note, and order that the trustee turn over the funds he has collected on the note to Bennett. In a case which was equally as close on the facts, the Alaska Supreme Court upheld the discretion of the trial judge in allowing a transfer of substantial assets to a wife in a marital property settlement which looked

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[50] See, 37 AmJur2d, Fraudulent Conveyances and Transfers, § 73, Transfers to Insiders by Insolvent Debtor Under Uniform Fraudulent Transfer Act (2003).

[51] Sylvester v Sylvester, 723 P2d 1253, 1258 (Alaska 1986).

[52] See, discuss in Part 2 of this memorandum decision allowing Bennett's claim for $1.1 million.

somewhat suspicious to prime the rights of a bankruptcy trustee claiming the settlement was a fraudulent transfer.[53]

With respect to the art work valued at $80,645 by the trustee, he has not persuaded the court by a preponderance of evidence that GTI every really owned such artwork or that it has been transferred to Bennett fraudulently.

4. CONCLUSION- The court will enter a separate order and judgment in the respective matters: (a) allowing Proof of Claim No. 6 as a general unsecured claim for $1,098,670, and (b) dismissing the trustee's adversary complaint seeking to avoid transfers of the Poeschel promissory note and proceeds and the artwork mentioned in the complaint, and requiring the trustee to turn over to Bennett the proceeds of the Poeschel note which he has collected.

DATED: March 31, 2004

HERB ROSS
U.S. Bankruptcy Judge

[53] First National Bank of Fairbanks v Enzler, 537 P2d 517, 521-25 (Alaska 1975).