United States Bankruptcy Court
Western District of Wisconsin

Cite as: [Unpublished]

In re Air Improvement Resources Corp., Debtor
Bankruptcy Case No. 97-33453-7

United States Bankruptcy Court
W.D. Wisconsin, Madison Division

January 7, 1999

J. David Krekeler, Krekeler & Scheffer, S.C., Madison, WI, for debtor.
Paul Ode, Maplewood, MN, for Paul Ode.
Peter M. Gennrich, Susan V. Kelley, Lee, Kilkelly, Paulson & Kabaker, S.C., Madison, WI, for trustee.

Robert D. Martin, United States Bankruptcy Judge

MEMORANDUM DECISION

Air Improvement Resources Corporation (Debtor) filed a Chapter 11 case on July 10, 1997, which was converted to Chapter 7 on March 2, 1998. The Chapter 7 trustee brought this action to avoid Paul Ode's security interest in the debtor's accounts receivable claiming it to be a preference to an insider .

Ode lent $80,829.87 to the debtor on December 27, 1995. A promissory note in the amount of $100,000, a security agreement in the amount of $80,297.87 and a financing statement were duly executed and delivered. The financing statement was not filed immediately. All three documents were prepared by the Hessian McKasy law firm. Ode asserted that the firm was representing both parties in the loan transaction and was responsible for filing the financing statement but failed to do so.

In the fall of 1996, after Ode recovered from an illness, Debtor engaged him to take a more active role with the corporation. At the November 21, 1996 meeting of Debtor's board of directors,

Ode appeared as a special guest and presented to the board his assessment of the opportunities for Debtor to raise capital. Ode made several proposals. He offered to market Debtor after Debtor's business plan had been revised (the revision apparently was to be conducted with Ode's involvement), to convert the debt owed him to common stock after Debtor received outside investment or to extend for six months the due date of his loan to the debtor. He also expressed interest in serving as Debtor's chief financial officer.

Ode attended the December 27, 1996 board of directors meeting, again being noted in the minutes of the meeting as a special guest. The minutes of the meeting are substantially identical to the minutes of the November 27, 1996 meeting. At the December meeting, the nominating committee recommended Ode to serve on the board of directors and Ode expressed openness to the idea.

Ode and Robert Singleton, President of Debtor, signed an undated agreement titled "Corporate Chief Financial Officer." The agreement set forth the duties to be performed by Ode, the compensation to be received for these duties and the treatment of the loan. The list of duties included coordinating Debtor's efforts to raise capital, completion of a business plan, communication with investors and, in the event of reorganization, communication with creditors. The agreement indicates that Ode was to serve on the board of directors. Nothing entered into evidence indicates that Singleton had sole authority to elect or appoint an officer,[1] although there is considerable evidence he initiated most corporate decisions.

As of December 31, 1996, Debtor had assets of $600,163.23 and liabilities of $1,350,608.68. On January 7, 1997, Ode filed the financing statement. On the same day, Singleton and Ode attended

---

[1]The minutes of the October 14, 1995 board of directors meeting indicate that Singleton had been given authority to hire a "temporary Chief Financial Officer." Ode's Exh. 11. (Not received).

a meeting at Farmers State Bank. Singleton and Brian Richardson, President of Farmers State Bank, testified that at the meeting Ode presented himself as the chief financial officer of Debtor. At the meeting, Richardson received from Ode a business card bearing the debtor's logo with Ode's name and the title "CFO" typed on it.

11 U.S.C. § 547(g) places the burden of proof on the trustee in an action to avoid a transfer. Section 547(b) requires the trustee to prove six elements: 1) a transfer of an interest in property of the debtor; 2) to or for the benefit of a creditor; 3) for or on account of an antecedent debt; 4) while the debtor is insolvent; 5) within 90 days preceding the petition, or between 90 days and one year if the creditor was an insider at the time of the transfer; and 6) the creditor has received more than what the creditor would have received under Chapter 7. See Matter of Smith, 966 F.2d 1527 (7th Cir. 1992); In re McLaughlin, 183 B.R. 171 (Bankr. W.D. Wis. 1995).

Five of the elements were easily proved. Giving a security interest in property constitutes a transfer of property of the debtor. See In re Melon Produce, 976 F.2d 71, 74 (1st Cir. 1992). If a security interest is not perfected within 10 days after the interest becomes enforceable, the date of perfection is the date of transfer. 11 U.S.C. § 547(e)(2)(B). Ode received an enforceable security interest in Debtor's accounts in December 1995, which was not perfected until the financing statement was filed on January 7, 1997. Thus, the transfer which the trustee seeks to avoid was made on January 7, 1997. Debtor's statement of financial condition on December 31, 1996, compels the inference that Debtor was insolvent 7 days later. In this Chapter 7 case, it is evident that enforcement of the security interest would allow Ode to receive more than he would as a general creditor.

Proof of the remaining element depends on whether the 90 day or one year time period applies. The challenged transfer took place more than 90 days prior to Debtor filing bankruptcy. For the

trustee to avoid the perfection of the security interest he must prove that Ode was an insider of Debtor on January 7, 1997. The Code defines an insider of a corporation in § 101(31)(B):

> (31) "insider" includes--
> . . .
> (B) if the debtor is a corporation--
> (i) director of the debtor;
> (ii) officer of the debtor;
> (iii) person in control of the debtor;
> (iv) partnership in which the debtor is a general partner;
> (v) general partner of the debtor; or
> (vi) relative of a general partner, director, officer, or person in control of the debtor;

By using the non-limiting term "includes," the definition "is intended to be illustrative rather than exhaustive." Matter of Krehl, 86 F.3d 737 (7th Cir. 1996) (citing 11 U.S.C. § 102(3); In re Schuman, 81 B.R. 583 (9th Cir. BAP 1987); In re Newcomb, 744 F.2d 621 (8th Cir. 1984)). The trustee argued that Ode either was a person included in the enumerated categories of insider or had a relationship with Debtor that satisfied the inclusive definition of insider established by the courts.

1. Ode as an officer, director or person in control of Air Improvement Resources.

Corporate officers and directors are appointed or elected in accordance with state law and the corporation's bylaws and charter. No evidence was offered or received which suggests the debtor's state of incorporation or the contents of its bylaws or charter. Without that evidence it cannot be determined whether Ode was duly appointed as an officer of the debtor.

In some but not all states a person performing the functions of an officer or director of a corporation although improperly appointed or elected may be considered a de facto officer. See 18B Am. Jur. 2d Corporations § 1415 (1985). But, finding a person to be a de facto officer requires the application of state law as well. Without the state of incorporation or the bylaws in evidence, it cannot

be determined whether Ode served in the capacity of a de facto officer or director of the debtor.

Trustee cites In re Baker & Getty Financial Services, Inc., 88 B.R. 792 (Bankr. N.D. Ohio 1988); In re Eeco Incorporated, 138 B.R. 260 (Bankr. C.D. Cal. 1992); and In re NMI Systems, Inc., 179 B.R. 357 (Bankr. D. D.C. 1995) which in turn cites C.R.A. Realty Corp. v. Crotty, 878 F.2d 562 (2d Cir. 1989), as persuasive authority that an officer's title is insufficient to confer officer status absent performance of important executive duties. None of these three cases is persuasive. Ode's activities and involvement with Debtor do not place him in the same categories with the parties determined to be insiders in Baker & Getty or Eeco. Ode's actions appear to have more in common with the transferee in NMI who was found to be not an insider.

The third subparagraph of the definition of insider, "person in control," provides a slightly more flexible definition than "officer." 11 U.S.C. § 101(31)(B)(iii); see also In re UVAS Farming Corp., 89 B.R. 889, 892 (Bankr. D.N.M. 1988) (noting that control has no fixed definition and is "often defined by example and by an examination of the facts"). Courts generally have required a significant amount of control over a debtor for a person to fit within the definition. See, e.g., In re N & D Properties, Inc., 799 F.2d 726 (11th Cir. 1986) (finding minority shareholder-claimant "in control" where she acted unilaterally after lender called loans to corporation; shareholder-claimant retained counsel and business consultant who reported to her and made decision to file bankruptcy without consulting majority shareholder); In re Sullivan Haas Coyle, Inc., 208 B.R. 239 (Bankr. N.D. Ga. 1997) (finding consulting firm not "in control" where firm was involved in daily decisions regarding cash management, but held no "stranglehold" on debtor); In re UVAS Farming Corp., 89 B.R. 889 (shareholders who participated actively in corporation, but without day to day control or stranglehold, not "in control" of debtor; court looked at whether the facts indicated an opportunity to self-deal or exert more control

over debtor than other creditors). Some courts have established a floor of at least a controlling interest in the corporation, In re Louisiana Industrial Coatings, Inc., 31 B.R. 688 (Bankr. E.D. La. 1983) or sufficient authority to unqualifiedly dictate corporate policy. In re American Lumber, 5 B.R. 470 (D. Minn. 1980).

In the present case, Robert Singleton was the chief executive officer of the debtor at all relevant times and testified that he made the decisions. There is no evidence that anyone else was in control, certainly none that Ode was.

2. The broader definition of insider.

Beyond the enumerated categories, many courts have applied a two part assessment in ascertaining insider status. The two factors are: 1) the closeness of the relationship between the transferee and the debtor; and 2) whether the transactions between the transferee and the debtor were conducted at arm's length. In re Holloway, 955 F.2d 1008, 1011 (5th Cir. 1992) (finding ex-spouse to be insider of debtor); see also Matter of Krehl, 86 F.3d 737, 742 (7th Cir. 1996) (finding former president to be insider of corporation); In re Schuman, 81 B.R. 583, 586 (9th Cir. BAP 1987) (finding ex-spouse not to be insider of debtor).

In Holloway, Holloway had given his ex-wife, Allison, a security interest in the proceeds of a judgment as security for prior loans Allison made to Holloway. 955 F.2d at 1009. The Fifth Circuit applied the two parts of the test, first finding the evidence presented demonstrated that the relationship was sufficiently close to require careful scrutiny and only then scrutinizing the relevant transactions carefully to determine if they were made at arm's length. The finding of sufficient closeness was based on the amicable relationship between the former spouses. Determination that the transactions were not at arm's length rested on four facts: 1) the loans were initially unsecured, 2) Allison knew Holloway was

insolvent at the time of the initial loans and at the time of the transfer of the security interest, 3) the loans were not commercially motivated, and 4) Holloway sided with Allison in the priority dispute that lead to the case. Finding that Allison satisfied the articulated test, the court held that Allison was an insider of Holloway and set aside the transfer of the security interest as a fraudulent conveyance.

Other courts have applied some variation of the test set out in Holloway. See, e.g., In re Friedman, 126 B.R. 63, 70 (9th Cir. BAP 1991) (transferee is an insider where the business or professional relationship with debtor is "close enough to gain an advantage attributable simply to affinity rather than to the course of business dealings"); Matter of Lemanski, 56 B.R. 981, 983 (Bankr. W.D. Wis. 1986) (transferee "is an insider if, as a matter of fact, he exercises such control over the debtor as to render their transaction not at arms-length").

Some courts have looked at access to inside information in determining insider status. See Krehl, 86 F.3d at 743 (7th Cir. 1996) (citing In re Papercraft Corp., 187 B.R. 486, 496 (Bankr. W.D. Pa. 1995, Fitzgerald), rev'd on other grounds 211 B.R. 813 (W.D. Pa. 1997); In re Locke Mill Partners, 178 B.R. 697, 702 (Bankr. M.D. N.C. 1995, Stocks); In re Allegheny Int'l Inc., 118 B.R. 282, 298 (Bankr. W.D. Pa. 1990, Cosetti)). In Krehl, the Seventh Circuit looked at the information available to the former president of the debtor in holding that the former president continued to be an insider after his resignation. While the court did emphasize that the inside information was alone sufficient to categorize the former president an insider, it is not clear if the same information would suffice if the transferee had at no time been an insider.

Two of the other inside information cases cited in Krehl also rely on a combination of facts to support the determination of insider status. In Papercraft, an officer of the transferee corporation served on the board of the debtor as a representative of the transferee corporation at the time of the

transfer. It was through this conduit that the transferee corporation received its inside information. As the court wrote in a footnote, through its officer the transferee corporation "was a de facto director and therefore was in a position to exercise some control." Similarly, the court in Locke Mill noted that in the determination of insider status it is not necessary that there be actual control in the sense of legal decision making power. However, in that case the court found that there was both the potential for and exercise of significant influence by the insider over the other party.

One case cited in Krehl does base a finding of insider status primarily on access to and abuse of inside information. In Allegheny, a plan proponent was categorized as an insider because of its efforts to receive and its receipt of inside information from the debtor after the bankruptcy filing. The plan proponent then exploited the inside information received in an effort to influence the debtor's actions and exert control over the corporation. These actions lead the court to deem the plan proponent both an insider and a fiduciary.

However, in this case Ode's access to information was not clearly established. While he was working on a plan to attract new investors, there was no clear description of the information he had or used in doing so, and no specific statement that the information was not generally available to the public, including the prospective investors. While there is a coincidence in the events leading up to bankruptcy and the perfection of Ode's security interest, it is no more likely under the evidence received that Ode filed the financing statement because he knew something special about the debtor than because he had just learned that it had not previously been filed.

The burden of proof in this matter lies with the trustee and the burden has not been met. An order dismissing the complaint may issue.