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Claim estimation  
ORS 60.361  
FRBP 3018

In re United Ironworks, Inc.

699-61211-fra11

1/7/2000

Alley

Unpublished

Three creditors ("Claimants") filed a combined proof of claim for amounts loaned to the corporation. The Debtor-in-Possession objected to the claim in both amount and as to its secured status. The Claimants filed a motion asking that their claim be temporarily allowed for purposes of voting on the Plan of Reorganization. A hearing was held and evidence presented to the court.

The Claimants had loaned money to the debtor corporation and made equity contributions, becoming directors and obtaining a minority ownership position in the corporation. The Claimants thereafter called a board meeting and voted to install one of themselves as President to replace the majority owner, Gary Dannar (who is also a director) who did not attend the meeting, and voted to secure their previously unsecured loan against most of the assets of the corporation. The debtor corporation thereafter filed bankruptcy and the Claimants filed their proof of claim for their secured loans.

The court determined that under ORS 60.361, a corporation can void an action of the board which constitutes a conflict of interest to one or more board members if the action 1) failed to receive a majority vote of disinterested board members, 2) failed to receive a majority of the shares entitled to vote, and 3) is not fair to the corporation. The court found that the board's action constituted a conflict of interest by all three Claimants and was voided by the DIP. The claim was held to be unsecured. The court also made a temporary estimation of the amount of the claim for purposes of voting on the Plan of Reorganization.

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF OREGON

In Re: ) Bankruptcy Case No.  
          ) 699-61211-fra11  
UNITED IRONWORKS, INC. )  
  ) MEMORANDUM OPINION  
Debtor. )

I. BACKGROUND

Creditors Leonard Apple, John DeFalco, and Earl Salter (hereinafter "Claimants") seek an estimation of their claims for the purpose of voting on the Plan of Reorganization proposed by the Debtor-In-Possession. Fed.R.Bankr.P. 3018. I find that the Claimants' claim should be valued at \$448,091 and treated as unsecured.

Claimants are creditors and Directors of the Debtor/Corporation. They have filed a proof of claim asserting that they are owed roughly \$750,000, and that the claim is secured by most of the assets of the corporation. The Debtor-In-Possession has filed a proposed Plan of Reorganization classifying the Claimants, and one other shareholder, together in Class 5. The plan proposes to distribute stock in return for the debt.

1 The Debtor-In-Possession and the Claimants dispute the  
2 validity of the claim, both in amount and secured status. The  
3 Claimants filed a motion seeking temporary allowance of the secured  
4 claim notwithstanding the objection. Fed.R.Bankr.P. 3018(a). The  
5 matter was heard by the Court on December 9, 1999.

## 6 II. FACTS

7 United Ironworks, Inc., is an Oregon corporation created in  
8 1995. In July, 1997 the Claimants first acquired their interests in  
9 the corporation. At a joint shareholders and directors meeting on  
10 November 7, 1997, a stock split was approved, with Gary D. Danner  
11 holding 100,000 shares and Messrs. Salter, DeFalco and Apple holding  
12 8,700 shares each. The Claimants' total investment was \$300,000.<sup>1</sup>  
13 On or about April 15, 1998, the parties entered into a "Shareholder  
14 Financing Agreement." Under the agreement the Claimants would  
15 extend a line of credit to the corporation for up to \$300,000. It  
16 was specified in the agreement that the source of the funding of the  
17 line of credit would be money borrowed by the Claimants from third  
18 party sources. Interest was to accrue on the line of credit at the  
19 same rate that interest accrued on the underlying debt incurred by  
20 the Claimants to finance the line of credit, and was to be paid  
21 monthly "or as payments are required on the underlying loan obtained  
22 by the lenders to finance the line of credit if payable more  
23 frequently than monthly." It was further specified that the line of

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25 <sup>1</sup> The \$300,000 is part of the \$750,000 claim. The Claimants  
26 concede that this investment is equity, and did not give rise to a  
claim, and that the \$300,000 should be deleted from their allowed  
claim.

1 credit would be used to finance company obligations and day-to-day  
2 operations.

3 In consideration of the establishment of the line of credit  
4 it was agreed that the company would issue 22,070 shares to each of  
5 the Claimants. As a result of this distribution the Claimants  
6 together owned 48% of the corporation's outstanding stock, with the  
7 remaining 52% held by Mr. Dannar.

8 The line of credit agreement contained the further provision  
9 that all funds of the corporation would be controlled by the  
10 Claimants. An account in the name of the corporation was  
11 established at the Union Bank of California. The Claimants borrowed  
12 from Southern California Bank, of Downey, California, and  
13 transmitted those funds to the corporation's Union Bank account.  
14 The other source of funding for the Union Bank account was the  
15 corporation's paid receivables. As the company incurred  
16 obligations, notice of those obligations would, in theory, be  
17 transmitted to Norwalk Business Service, in Norwalk, California,  
18 which was acting as the Claimants' financial agent. Norwalk  
19 Business Service was to see that the accounts were timely paid.

20 This system broke down quickly. Each side complains that the  
21 other was not holding up its end of the deal: Mr. Dannar, speaking  
22 on behalf of the corporation, complains that the agreement was not  
23 funded in a timely manner, and that the Claimants in California were  
24 slow in discharging the corporation's obligations. The Claimants,  
25 for their part, allege that the company was not earning -or at least  
26 was not remitting- enough money to cover its burgeoning expenses.

1           The parties had a meeting in July of 1998 to discuss these  
2 issues. The Claimants assert that there were discussions at that  
3 time of a security agreement to secure repayment of the line of  
4 credit. Mr. Dannar and other corporate agents steadfastly deny that  
5 there was any such discussion. Whether or not there were  
6 discussions, what is clear is that no security agreement was entered  
7 into at that time.

8           On September 2, 1998, Mr. Leonard Apple, acting as Vice  
9 President of the corporation, issued a notice that the Board of  
10 Directors would meet at 9:00 a.m. at Norwalk Business Services,  
11 Inc., in Norwalk, California, for the following purposes:

- 12           1. Status of employment contract.
- 13           2. Status of President, General Manager, Sales  
14           Manager, Secretary of Corporation [i.e., Mr.  
15           Dannar].
- 16           3. Refusal [by Mr. Dannar] to let Board of Directors  
17           inspect corporation records as requested.
- 18           4. Other matters in the best interest of corporation.

19           The notice was issued pursuant to paragraph 2(d) of the  
20 Bylaws of the corporation which provides that:

21           (d) Special Meetings. Special meetings of the Board  
22           of Directors may be called by or at the request of the  
23           President or any one or more Directors. The person or  
24           persons authorized to call special meetings of the  
25           Board of Directors may fix any place, either within or  
26           without the state of Oregon, as the place for holding  
          any special meeting of the Board of Directors called  
          by such person or persons.

          The Bylaws further provide that notice of any meeting be given at  
least two days previous thereto by written notice delivered  
personally or mailed to each Director at the Director's business  
address, or by telegraph. "If mailed, such notice shall be deemed

1 to be delivered when deposited in the United State Mail, so  
2 addressed, with first class postage paid." Finally, the Bylaws  
3 provide that parties may participate in Directors' meetings by  
4 telephone.

5 Mr. Dannar testified that he received the notice on the 3<sup>rd</sup> of  
6 September. He did not travel to California for the meeting, or  
7 participate by telephone. His testimony strongly suggests that he  
8 made no effort to do either.

9 The meeting was attended by each of the Claimants, in his  
10 capacity as Director. At the meeting the Directors removed Mr.  
11 Dannar as President, and authorized Mr. Apple, on behalf of the  
12 corporation, to enter into a security agreement securing "certain  
13 shareholder loans in the approximate amount of \$450,000, and also to  
14 secure any and all other liabilities, direct or indirect, absolute  
15 or contingent, now existing or hereafter arising from debtor to the  
16 secured party [that is, Messrs. Salter, Apple and DeFalco]." The  
17 collateral specified in the security agreement consisted of  
18 virtually all of the corporation's tangible and intangible property.  
19 A financing statement was signed and duly filed with the Oregon  
20 Secretary of State.

21 Mr. Dannar, the majority shareholder, was notified of these  
22 developments, but took no action to undue the effect of the meeting.

### 23 III. DISCUSSION

24 The hearing to estimate the claim of the Claimants was  
25 intituted in response to their motion asking the court to  
26 temporarily allow their claim for purposes of voting on the Plan of

1 Reorganization in this case. Estimation of the claim consists of  
2 two parts: determination of the secured/unsecured nature of the  
3 claim and estimation of the amount of the claim. Fed.R.Bankr.P.  
4 3018 allows the court to "temporarily allow [a] claim or interest in  
5 an amount which the court deems proper for the purpose of accepting  
6 or rejecting a plan." "The merits of a claim may be finally  
7 adjudicated under an estimation procedure." In re C.F. Smith &  
8 Assoc., Inc., 235 B.R. 153, 160 (Bankr. D. Mass. 1999) (citing Midway  
9 Motor Lodge v. Innkeepers Telemanagement & Equip. Corp., 54 F.3d 406  
10 (7<sup>th</sup> Cir. 1995)).

11 Because the question of the secured nature of the claim was  
12 fully litigated and sufficient evidence was presented on this  
13 matter, I can make a final ruling on the secured status of the claim  
14 for allowance purposes. As the evidence concerning the amount of  
15 the claim is ambiguous, my ruling as to the amount of the claim will  
16 be only for temporary allowance of the claim for the purpose of  
17 voting on the Plan of Reorganization.

18 A. SECURED/UNSECURED NATURE OF CLAIM

19 ORS 60.361 reads in relevant part as follows:

20 (1) A conflict of interest transaction is a  
21 transaction with the corporation in which a director  
22 of the corporation has a direct or indirect interest.  
23 A conflict of interest transaction is not voidable by  
24 the corporation solely because of the director's  
25 interest in the transaction if any one of the  
26 following is true:

24 (a) The material facts of the transaction and the  
25 director's interest were disclosed or known to the  
26 board of directors . . . and the board of directors  
. . . approved or ratified the transaction;

1 (b) The material facts of the transaction and the  
2 director's interest were disclosed or known to the  
3 shareholders entitled to vote and they authorized,  
4 approved, or ratified the transaction; or

5 (c) The transaction was fair to the corporation.

6 \* \* \*

7 (3) For purposes of subsection (1)(a) of this  
8 section, a conflict of interest transaction is  
9 authorized, approved or ratified if it receives the  
10 affirmative vote of a majority of the directors on the  
11 board of directors . . . who have no direct or  
12 indirect interest in the transaction. A transaction  
13 may not be authorized, approved or ratified under this  
14 section by a single director. . . .

15 (4) For purposes of subsection (1)(b) of this  
16 section, a conflict of interest transaction is  
17 authorized, approved or ratified if it receives the  
18 vote of a majority of the shares entitled to be  
19 counted under this subsection, voting as a single  
20 voting group. . . .

21 There is no question that the transaction giving rise to the  
22 Claimants' security interest gave rise to a conflict of interest  
23 with respect to the Claimants/Directors. Each of the Claimants in  
24 this matter had a direct financial interest in the debtor  
25 corporation granting a security interest to the Claimants to secure  
26 their pre-existing loans to the corporation. The transaction was  
not approved by a majority of disinterested directors on the board,  
nor was it approved by a majority of shares in the corporation  
entitled to vote. Moreover, the transaction cannot be considered  
fair to the corporation in that previously unsecured debt of the  
corporation became secured by encumbering all of the assets of the  
corporation. Accordingly, the transaction granting a security  
interest to the Claimants is voidable by the corporation as a



1 conflict of interest transaction under ORS 60.361. For voting and  
2 confirmation purposes, I find that the Claimants' claim is  
3 unsecured.

4 B. AMOUNT OF CLAIM

5 The Claimants filed a proof of claim in the amount of  
6 \$790,091. As disclosed previously, the Claimants concede that  
7 \$300,000 of this amount represents an investment in equity of the  
8 corporation and should be deleted from the claim, leaving a balance  
9 of \$490,091. The Claimants state that approximately \$450,000 of  
10 this amount represents money lended and the remainder is interest of  
11 \$16,091 from September 1, 1998 to the petition date and an  
12 additional \$24,000 obligation to claimant Apple. The Debtor-In-  
13 Possession counters that the claim should not exceed \$381,759 less  
14 \$7,005 in United Ironworks' funds used to pay the Claimants' own  
15 individual debts for a total claim of \$374,754. The Debtor-In-  
16 Possession excludes \$68,000 in "bank originated items" which the  
17 Claimants assert were used for the Debtor's benefit, the \$16,091  
18 interest calculation, and the \$24,000 additional obligation to  
19 Apple.

20 The Claimants stated that the \$68,000 in expenditures was the  
21 amount expended for the Debtor's benefit from two lines of credit of  
22 \$25,000 each. The Debtor-In-Possession disputes that any of this  
23 money was used for the Debtor's benefit. I will allow the claim to  
24 include the amount of the alleged lines of credit, or \$50,000. I  
25 will exclude from the claim the \$24,000 additional "obligation to  
26 Apple" because of the vagueness of the description. While it is

1 unclear how the interest calculation of \$16,091 was calculated, it  
2 is clear that some interest is allowable on the claim up to the  
3 petition date. Even though the interest claimed may be inaccurate,  
4 I will allow it in the amount claimed. Debtor-In-Possession's  
5 contention that at least \$7,005 in funds was used by the Claimants  
6 for their own benefit may have merit, but until it is proven at a  
7 hearing or stipulated to, I will not reduce the claim by that  
8 amount.

9 By my calculation, that leaves a claim in the amount of  
10 \$448,091 (\$490,091 - \$24,000 - \$18,000). I reiterate that this  
11 amount is only an estimate (and a rough one at that) to be used for  
12 the purpose of voting on the Plan of Reorganization. For purposes  
13 of allowance and distribution, the amount of the claim as filed  
14 still governs, subject to further hearing on the objection to claim  
15 made by the Debtor.

#### 16 IV. CONCLUSION

17 For purposes of voting, allowance, and confirmation the  
18 Claimants' security interest is void and their claim is unsecured.  
19 For the purpose of voting on the Debtor's Plan of  
20 Reorganization, the amount of the Claimants' claim is estimated to  
21 be \$448,091. An order consistent with the foregoing will be  
22 entered.

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24  
25 FRANK R. ALLEY III  
26 Bankruptcy Judge