UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re:	Chapter 7 Case
SRC Holding Corporation, f/k/a Miller & Schroeder, Inc. and its subsidiaries, Debtors.	BKY Case Nos. 02-40284 to 02-40286 Jointly Administered
Brian F. Leonard, Trustee, Plaintiff, vs. Roger J. Wikner, Defendant.	ADV Case No.03-4153 **NOTICE OF HEARING AND MOTION FOR SUMMARY JUDGMENT**

To: Entities specified in Local Rule 9013-3.

1. Brian F. Leonard, Trustee, the Plaintiff herein ("**Trustee**"), by and through his undersigned attorneys, moves the Court for the relief requested below and gives notice of hearing.

2. The Court will hold a hearing on this Motion at 2:00 p.m. on May 5, 2004, before the Honorable Nancy C. Dreher, in Courtroom 7 West, U.S. Courthouse, 300 South Fourth Street, Minneapolis, Minnesota.

3. Any response to this Motion must be filed and delivered no later than April 28, 2004 which is seven (7) days before the time and date set for the hearing, or mailed and filed by April 23, 2004 which is ten (10) days prior to the hearing. UNLESS A RESPONSE OPPOSING THE MOTION IS TIMELY FILED, THE COURT MAY GRANT THE MOTION WITHOUT A HEARING.

4. This Court has jurisdiction over this Motion under 28 U.S.C. §§ 157 and 1334, Bankruptcy Rule 5005 and Local Rule 1070-1. This is a core proceeding. The petitions commencing these Chapter 7 cases were filed on January 22, 2002. The cases are now pending before this Court.

5. This motion arises under Bankruptcy Rule 7056 and Local Rule 9013. This motion is filed under Bankruptcy Rule 9014 and Local Rules 4001-2 and 9013-2 through 9013-4. Movant requests an order granting summary judgment against each Defendant James E. Iverson ("**Iverson**") in Adv. No. 03-4155 and Defendant Roger Wikner ("**Wikner**") in Adv. No. 03-4153. (Wikner and Iverson are collectively referred to as "**Defendants**" herein.)

6. At all times material herein, and through July 31, 1997, Defendants were significant shareholders of Debtor Miller & Schroeder, Inc. (now known as SRC Holding, Inc.) ("**MSI**") (MSI, as used herein, includes its subsidiaries), each owning approximately 49% of the shares of MSI.[1] Together, the Defendants were the controlling shareholders of the MSI. (Steve Erickson owned approximately 2% of the shares which were held in a voting trust which, in July of 1997, was controlled by Defendants.)

7. At all times material to this motion, in addition to being shareholders, Defendants were also directors and officers of MSI.

8. This action seeks to recover assets of MSI which were inappropriately used to fund the purchase of Defendants' stock and for which MSI received no value. As detailed herein, the subject transactions occurred when MSI was within the vicinity of insolvency.

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[1] MSI was the parent of Miller & Schroeder Financial, Inc. and Miller & Schroeder Investments, Inc.

9. Defendant Iverson owed MSI the sum of $1,190,951.50 as of June 20, 1997. This amount was owed for loans, advances and unearned bonuses. The loans were evidenced by promissory notes. The amounts owed are summarized on Exhibit A hereto, which is the Closing Statement Certificate and Receipt dated July 31, 1997. The subject debts have been marked with an "*" on Exhibit A. Iverson's cancelled promissory notes are contained in Exhibit C.

10. Defendant Wikner owed MSI the sum of $795,992.29 as of June 20, 1997. This amount was owed for loans, advances and country club dues. The "loans" were evidenced by promissory notes. Again, the amounts owed are detailed in Exhibit A and the subject debts are marked with an "*." Wikner's cancelled promissory notes are contained in Exhibit C.

11. Each Defendant has admitted that the amounts stated in Exhibit A were, in fact, due to MSI as of July 31, 1997.

12. On or about February 28, 1997, James F. Dlugosch, offered $16,400,000.00 for all the stock of MSI. Mr. Dlugosch's offer letter stated that, "In addition, $1,400,000 of the purchase price will be paid over a seven year period as compensation for consulting services and the execution of a non-compete agreement." That letter is attached hereto as Exhibit B.

13. Pursuant to a Stock Purchase Agreement signed July 31,1997, dated June 20, 1997 and effective June 1, 1997 ("**Stock Purchase Agreement**"), attached hereto as Exhibit C, Defendants sold their personal shares of stock in MSI to MI Acquisition Corporation ("**MIAC**"), for the amount of $7,310,725.55, each. The original purchase price for all of the shares of MSI sold under the Stock Purchase Agreement was $15,000,000.00.[2] (The price was subsequently adjusted

[2]A summary of the transaction is delivered in a diagram in Exhibit K, infra.

downward in December of 1997 by $1,274,874.10, bringing the total purchase price to $13,725,126.00.) James F. Dlugosch was the principal of MIAC.

14. Paragraph 5.5 of the Stock Purchase Agreement required Defendants to "at or prior to closing pay the full amount of the principal and interest on his outstanding notes and advances owed to the Company or any Subsidiary." Exhibit C at §5.5. This was also made a condition of closing. *Id.*, at §6.1(g). Each Defendant executed a "certificate of sellers" attesting that the warranties contained in the Stock Purchase Agreement were true and correct <u>as of closing</u>. Exhibit C.

15. <u>Notwithstanding the requirements of the Purchase Agreement, Defendants did not repay their debts to MSI</u>. Instead, Defendants walked away from MSI on July 31, 1997 without ensuring that their debts would be satisfied. This action directly harmed MSI by the sum of at least $1,986,942.70 (the "**Released Obligations**").

16. MSI received no consideration for the Released Obligations. As explained below, MSI, in effect, paid $1,986,942.70 of MIAC's purchase price of Defendants' shares.

17. After the closing on July 31, 1997, accounting records were created which purport to show MIAC owed MSI and its subsidiaries roughly $2.1 million dollars as an "advance." There are no real economic transactions underlying these entries. In other words, MIAC did not ever "advance" money or money's worth to MSI or vice versa. Mr. Dlugosch, President of MIAC, stated that the $2.1 million was "accounting treatment." Exhibit D (Dlugosch Deposition) at 60.

18. Mr. Dlugosch also provided the Trustee with a statement regarding this matter. That statement was attested to by Mr. Dlugosch at his deposition on February 10, 2004. Relevant portions of the deposition transcript and the statement, which was Exhibit 11 to his deposition, are

attached hereto as Exhibit D. Mr. Dlugosch admits that Defendants' debts were not repaid. Exhibit D, see Exhibit 11 thereto.

19. MIAC could not pay MSI $2 million dollars because all of its funds went to Wikner and Iverson in furtherance of the Stock Purchase Agreement. MIAC had no other funds. *Id.*

20. Attached hereto as Exhibit E is a "Settlement Agreement" dated December 11, 1997. It is believed that this document forms the basis of Defendant Wikner's defense of "release." It does not provide such a defense.

21. Subsequent to the Stock Purchase Agreement, and immaterial to this motion, MIAC and MSI merged on May 8, 2000, with MSI being the surviving corporation which then took on MSI's name ("**Miller & Schroeder, Inc.**"). Under the Articles of Merger, MIAC received all the assets and liabilities of MSI. These Articles at Merger are attached hereto as Exhibit F.[3]

22. MSI was in poor financial condition, vis a vis its potential liabilities and ongoing operations, on July 31, 1997. Evidence that MSI was within the vicinity of insolvency includes:

a. A statement provided by MIAC's counsel, created in furtherance of the Settlement Agreement, indicating that MSI's potential liabilities exceeded $14,000,000. This document was obtained from the files of Briggs & Morgan, MIAC's counsel, and is attached to the Affidavits of J. Patrick McDavitt (which are served and filed herewith). These potential liabilities were described in a more cursory fashion by Schedule 3.7 of the Stock Purchase Agreement. Exhibit C, Schedule 3.17. These potential liabilities, alone, exceed the shareholder's equity on July 31, 1997 which was stated to be roughly $10.5 million. See also, Exhibit N.

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[3]This document is included in this motion as it is believed that Defendants consider that this document provides a defense of some undetermined sort.

b. The closing book for the Stock Purchase Agreement, in its schedule 3.4, indicated that, "For the six month period ending April 30, 1997, the consolidated loss for [MSI] was ($556,269). Therefore, [MSI] sustained a consolidated net loss of $(784,486) since January 31, 1997. Exhibit C, Schedule 3.4 (p. 08).

c. The Debtors' schedules reflect that much litigation, either anticipated or not, was spawned from its Heritage bond offering. A summary was provided in Exhibit 4a to the Statement of Financial Affairs of Securities Resolution Corporation. Exhibit G hereto. MSI made the Heritage bond offerings from 1996 to 1999 and each of the eleven offerings, totaling over $130,000,000, defaulted. Mr. Dlugosch testified that the liabilities from Heritage caused MSI's demise. Exhibit D at p. 39-40.

d. At the combined §341 hearing for these debtors, Mr. David Reinhart appeared on the Debtors' behalf. He was asked about the downfall of the corporations. His response was two-part. First, he addressed a San Bernardino County corruption scandal. Next, he stated:

> MR. REINHART: The second event is the – what we call – refer to as Heritage. It's a **family of bond issues that were underwritten by Miller & Schroeder beginning, I understand, in 19 – late '96 or '97** all the way through 1999, 135 or so million dollars principal amount of debt represented by ten or eleven separate bond issues.
> These were first mortgage bonds, and these were assisted living facilities in California, Texas, a couple in Chicago, which defaulted and which essentially destroyed Miller & Schroeder's retail securities business. And, as a result, that business was later sold to Miller Johnson Steichen and Kinnard, what was left of it.
> . . .
> MR. LEONARD: When were those defaults on these bonds becoming apparent to Miller & Schroeder?
> MR. REINHART: I think that they became apparent in June of 2000.
> MR. LEONARD: **Now, was the entire aggregate issue of $135,000,000 already issued and out the door by that time?**
> MR. REINHART: **Yes.**

> MR. LEONARD: And how much of those ten or eleven separate issues went into default or were in default by June of 2000?
> MR. REINHART: I think that **they were all in default**. . . . The other impact was the genesis of what is now an accumulated approximately 30 to 31 separate claims that are currently in arbitration in the NASD arbitration forum . . . The result of those arbitration actions is that the company obviously has spent many, many, thousands of dollars of attorneys' fees on those cases, but also they represent a huge contingent liability.

Exhibit H, Transcript of §341 meeting dated February 22, 2002 (relevant portion) (emphasis added).

e. **Many proofs of claim have been filed in these cases. A sampling of claims which arose to have arisen prior to the Stock Purchase Agreement are attached hereto as Exhibit I. These claims, each of which <u>includes a period predating the Stock Purchase Agreement</u>, total <u>$153,412,928</u>. This is more than 10 times what was paid for the Defendants' stock.**

23. The Trustee has reviewed the claims filed in this case and is familiar with the "Heritage Bond" issues which caused the Debtors' failure. By the time that the transaction at issue in this matter took place, the following Heritage bond offerings had been concluded:

Offering 1	Rancho Offering	$13,050,000	02/15/1996
Offering 2	Texas City Offering	$ 7,295,000	12/20/1996
Offering 3	Houston Offering	$10,370,000	03/03/1997
Offering 4	Ft. Worth Offering	$13,420,000	05/15/1997

24. The total of the foregoing is $44,135,000.00 and said funds were raised prior to the Stock Purchase Agreement. These offerings are relevant as they each defaulted and were in existence at the time of closing.

25. MSI acted as the investment banker and sole underwriter for all of the Heritage offerings. It appears that the Heritage offering was involved in a scheme with the funds raised from

each offering being used to improperly sustain the prior offerings. The Trustee possesses many complaints alleging impropriety, from the outset (1996), in the handling of the Heritage bond offerings.

26. Attached hereto as Exhibit J is a redacted version of the Consolidated Fourth Amended Complaint in the *Bekter v. U.S. Trust et al.,* matter venued in federal court in California. The Trustee has reviewed the complaint and, based on his knowledge of the Heritage matters, he believes that the facts alleged therein are true and accurate. It is submitted herein to give some insight as to the allegations related to the Heritage matter.

27. Defendants allowed the Stock Purchase Agreement to close without ensuring that their liabilities to MSI would, in fact, be satisfied. The only alleged evidence that the debts were "satisfied" are accounting entries of MIAC generated after the closing. There never was cash paid to MSI, there was never a real economic transaction and Defendants rely solely upon "accounting treatment."

28. Prior to closing on July 31, 1997, MSI had promissory notes and detailed accounting entries evidencing its entitlement to payment from two debtors (Defendants) who had, it appears, substantial assets. After the closing, MSI, was left with no means whatsoever to collect its debts. Defendants claim that their debts were supplanted by an accounting entry showing a debt owed by MIAC to MSI. However, MIAC had substantial debt and its only asset was its interest in MSI. Any MSI claim against MIAC would be futile.

29. Defendants each treated the money paid by MIAC as a capital gain. Neither reported forgiveness of debt for their obligation to MSI. This allowed each to achieve a substantially better tax rate (i.e., capital gain vs. ordinary income).

30. By virtue of causing their personal obligations to be released, the Defendants committed the most egregious acts which a fiduciary can commit, a waste of a substantial corporate asset. They walked away from closing on July 31, 1997 without ensuring that MSI would be made whole. MSI and its creditors lost a valuable asset.

31. The Trustee brings this motion seeking summary judgment on the issue of the Defendants' liability to Plaintiff in the amount of $1,190,451.50 (Iverson) and $795,992.29 (Wikner), which represents the damages suffered by the Debtors for the waste of corporate assets and the *ultra vires* acts committed by Defendants against the interests of MSI as described herein. In short, each Defendant violated his fiduciary duty owed to MSI. The Trustee submits that each should be accountable for the whole loss to MSI - $1,986,942.70.[4]

32. The Trustee has reviewed relevant corporate records and has found no corporate resolution approving the transaction at bar nor ratifying the same on the part of MSI. Additionally, there are no corporate records authorizing, nor other records substantiations, the "advances" upon which Defendants rely for their defense.

33. Attached hereto as Exhibit K is a summary (chart) of the transactions that are the subject of this motion.

34. <u>Prior</u> to the Stock Purchase Agreement, each Defendant had an employment contract with MSI. Those are attached hereto as Exhibit L. Each employment contract protected against use of proprietary information after employment (§ 3.1) and restricted employment for one year (§ 3.2).

35. At the closing of the stock sale, Defendants each executed new noncompetition agreements with MSI. These are included within Exhibit C. Whereas their preexisting

[4]Total of forgiven debt.

noncompetition agreements did not provide for compensation, the new noncompetition agreements provided that Wikner would receive four years of monthly payments of $14,585 ($700,080.00) and that Iverson would receive seven years of monthly payments of $1,200 ($100,800.00). Wikner received all of his payments ($700,080.00). Iverson received his payments through the bankruptcy filing on January 22, 2001 ($50,400.00). These noncompeition agreements were entered into between MSI and Defendants at the behest of MIAC. Exhibit D (Dlugosch deposition) at 28. There is no evidence that MSI, independently, was unsatisfied with its preexisting arrangement with Defendants.

36. The Trustee has reviewed MIAC's attorneys' records which show that the MIAC and Defendants initially were negotiating "consulting agreements" and that those morphed into noncompetition agreements. A draft of the consulting agreements is attached hereto as Exhibit M.[5] The Trustee submits that these noncompetition agreements were nothing more than a sham vehicle to have MSI pay part of MIAC's purchase price. The fact that the agreements started out as consulting agreements and switched to noncompetition agreements, together with the fact that each Defendant already had in place a noncompetition agreement with MSI, evidences the lack of sincerity in those agreements. Further, all witnesses have testified that the new noncompetition agreements were at the behest of MIAC - not MSI.

37. A purported balance sheet dated July 31, 1997, which was in the Debtor's records, is attached hereto as Exhibit N. The Trustee has not located any records supporting the $2.1 million "advance" entry. Defendants have never produced such records, either.

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[5]Note that it is version 5 (Wikner) and version 4 (Iverson). The parties spent a lot of time and effort on this vehicle before inexplicably switching to noncompetition agreements.

38. The Wikner deposition transcript is attached hereto as Exhibit O.

39. The Iverson deposition transcript is attached hereto as Exhibit P.

40. Each of the Debtors were insolvent in the year prior to filing. These cases have, in aggregate, in excess of $50 million in claims filed and the assets in these cases are, at present, approximately $500,000.00.

41. The payments to Defendants in the year prior to filing allowed them to receive more than they otherwise would receive as creditors of these estates pursuant to 11 U.S.C. § 547(b)(5).

42. The demand is calculated as follows:

Wikner forgiveness	$795,992.29
Wikner noncompete payments	$700,080.00
Iverson forgiveness	$1,190,951.50
Iverson noncompete payments	$50,400.00
TOTAL:	$2,737,423.70

43. The Trustee gives notice that he may testify, if required, at the hearing of this matter.

WHEREFORE, Movant requests that the Court enter an Order as follows:

1. Granting Movant partial summary judgment against Defendant Iverson in Adv. No. 03-4155 and against Defendant Wikner in Adv. No. 03-4153 in the amount of $2,737,423.70, together with prejudgment interest[6]; and,

2. For such other relief as is just and equitable.

[6]The Trustee is also requesting less than the entire relief pursuant to his preference counts.

LEONARD, O'BRIEN
SPENCER, GALE & SAYRE, LTD.

/e/ Matthew R. Burton

Dated: March 22, 2004

By______________________________

Matthew R. Burton, #210018
Attorneys for Plaintiff
100 South Fifth Street, Suite 1200
Minneapolis, Minnesota 55402-1216
(612) 332-1030

<u>VERIFICATION</u>

Brian F. Leonard, Chapter 7 Trustee of the above-referenced bankruptcy estate, declares under penalty of perjury that the foregoing is true and correct to the best of his knowledge, information and belief.

/e/ Brian F. Leonard

Dated: March 22, 2004

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Brian F. Leonard

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EXHIBITS TO BE FILED ON CD ROM

UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: Chapter 7 Case

SRC Holding Corporation,
f/k/a Miller & Schroeder, Inc.
and its subsidiaries,

Debtors.

BKY Case Nos. 02-40284 to 02-40286

Jointly Administered

Brian F. Leonard, Trustee,

Plaintiff,

vs.

Roger J. Wikner,

Defendant.

ADV Case No.03-4153

MEMORANDUM IN SUPPORT OF MOTION FOR SUMMARY JUDGMENT

INTRODUCTION

The facts relevant to this Motion are contained in the verified Notice of Hearing and Motion for Summary Judgment served and filed herewith.[1] The Trustee seeks summary judgment via the recovery of the forgiveness or release of personal debt, arranged by Defendants James Iverson ("**Iverson**") and Roger Wikner ("**Wikner**") (collectively referred to as "**Defendants**"), to facilitate the sale of their personal 98% stake in the stock in Miller & Schroeder, Inc. ("**MSI**") to M&I Acquisition Company ("**MIAC**") in June of 1997.[2] In short, Defendants permitted the MIAC transaction (the "**Stock Purchase Agreement**") to be structured so that <u>MSI "paid" a significant portion of MIAC's purchase price of Iverson's and Wikner's personal stock in MSI</u>. In other words,

[1]The Trustee is filing the identical memorandum in each adversary case (Wikner and Iverson). Only the caption has been changed.

[2]MSI was the parent of the various "Miller & Schroeder" subsidiaries. "MSI," as used herein, refers to MSI and its subsidiaries which were Miller & Schroeder Financial, Inc. and Miller & Schroeder Investments, Inc.

the Debtor was forced to pay Wikner and Iverson for their shares in the Debtors. **MSI received nothing at closing for the forgiveness or release of the debts owed to it by Wikner and Iverson.**

It should be noted that despite the existence of a 2% shareholder (Erickson), Defendants completely controlled the shares of the company as they held Erickson's shares pursuant to a voting trust. Defendants were controlling shareholders as they owned 98% of MSI's stock and acted in concert.

The transaction appears to be a typical stock purchase, but when the details are parsed through, it becomes apparent that Defendants structured the transaction in a way substantially detrimental to MSI. This is particularly problematic due to MSI's financial status at that time. Instead of repaying their significant, legitimate debts to MSI, which were created by such events as unearned bonuses, and exclusive club memberships, Defendants avoided their personal debts - hidden as a portion of MIAC's stock purchase. Properly, Defendants should have repaid their respective debts to MSI. They did not. Instead, they created an arrangement which breached the fiduciary duties each owed to MSI. <u>MIAC obtained a better price for Defendants' stock because Defendants evaded their fiduciary obligations to MSI (including its subsidiaries) and its creditors</u>. Notice of Hearing, Exhibit D, Dlugosch Statement. The damages for purposes of this motion, are the forgiven debts and amounts paid to Defendants pursuant to their noncompetition agreements.

A summation of the subject transaction is described in the following "before and after" analysis:

BEFORE TRANSACTION

<u>The Loans</u>

i. MSI has a valuable of asset of roughly $2,000,000 in the form of debt from Defendants, who have plenty of wealth from which to pay the debt;
ii. Defendants each have roughly a $1,000,000 liability.

The Noncompetition Agreements

i. MSI has in place more than adequate protection given the existing agreements, the law of agency and trade secret controls as to Defendants' post-employment behavior;
ii. Defendants are not due any additional compensation.

AFTER THE TRANSACTION

The Loans

i. MSI has lost a roughly $2,000,000 asset - the liability of real, wealthy obligors (Defendants) replaced by a meaningless paper transaction creating an obligation from an entity that has no assets to pay the obligation;
ii. Defendants walk away from their respective liabilities for the small price of paying capital gains tax:
    a. Capital gains is quite a savings to Defendants compared to the ordinary income that would have applied to debt forgiveness;
    b. More importantly from MSI's vantage point, the tax is paid to the government, not to the MSI whose assets the Defendants are despoiling.

The Noncompetition Agreements

i. Practically speaking, MSI has no meaningful new protections, given the law of agency and trade secrets and what MSI knew of Defendants' plans;
ii. MSI is saddled with new liabilities;
iii. Defendants walk away with more of MSI's assets.

The Trustee seeks summary judgment as to Defendants' waste of corporate assets in their role as shareholders, directors and officers of MSI.

STATEMENT OF UNDISPUTED FACTS

The Trustee submits that the following facts are undisputed in this matter:

1. At all times material herein, and through July 31, 1997, Defendants were significant shareholders of MSI, each owning approximately 49% of the shares of MSI. Together, the Defendants were the controlling shareholders of the MSI.

2. In addition to being shareholders, Defendants were directors and officers of MSI.

3. Defendant Iverson owed the Debtors the sum of $1,190,951.50 as of June 20, 1997. This amount was owed for loans, advances and unearned bonuses.

4. Defendant Wikner owed the Debtor the sum of $795,992.29 as of June 20, 1997.

5. Each Defendant has admitted that the amounts stated in the Closing Statement Certificate and Receipt were, in fact, due to MSI as of July 31, 1997.

6. On or about February 28, 1997, James F. Dlugosch, offered $16,400,000.00 for all the stock of MSI. Mr. Dlugosch's offer letter stated that, "In addition, $1,400,000 of the purchase price will be paid over a seven year period as compensation for consulting services and the execution of a non-compete agreement."

7. Pursuant to a Stock Purchase Agreement signed July 31,1997, dated June 20, 1997 and effective June 1, 1997 ("**Stock Purchase Agreement**"), Defendants sold their personal shares of stock in MSI to MI Acquisition Corporation ("**MIAC**"), for the amount of $7,310,725.55, each.

8. Paragraph 5.5 of the Stock Purchase Agreement required Defendants to "at or prior to closing pay the full amount of the principal and interest on his outstanding notes and advances owed to the Company or any Subsidiary." Exhibit C at §5.5. This was also made a condition of closing. *Id.*, at §6.1(g).

9. Each Defendant signed a "certificate of sellers" stating that the conditions of the Stock Purchase Agreement had been met. Notice of Hearing Exhibit C.

10. Notwithstanding the requirements of the Stock Purchase Agreement and their certificate, Defendants did not repay their debts to MSI. Instead, Defendants walked away from MSI on July 31, 1997 without ensuring that their debts would be paid. This action directly harmed MSI by the sum of at least $1,986,942.70.

11. MSI received no consideration for the foregoing released obligations.

12. After the closing on July 31, 1997, accounting records were created which purport to show MIAC owed MSI and its subsidiaries roughly $2.1 million dollars as an "advance." There are no real economic transactions underlying these entries.

13. MIAC could not pay MSI $2.1 million dollars because all of its funds went to Wikner and Iverson in furtherance of the Stock Purchase Agreement. MIAC had no other funds.

14. Subsequent to the Stock Purchase Agreement, and immaterial to this motion, MIAC and MSI merged on May 8, 2000, with MSI being the surviving corporation which then took on MSI's name.

15. MSI was in poor financial condition, vis a vis its potential liabilities and ongoing operations, on July 31, 1997. Evidence that MSI was within the vicinity of insolvency included:

I. A statement provided by MIAC's counsel, created in furtherance of the Settlement Agreement, indicating that MSI's potential liabilities exceeded $14,000,000. These potential liabilities, alone, exceed the shareholder's equity on July 31, 1997 which was stated to be roughly $10.5 million.

II. The closing book for the Stock Purchase Agreement, in its schedule 3.4, indicated that, "For the six month period ending April 30, 1997, the consolidated loss for the [MSI] and its Subsidiaries was ($556,269). Therefore, [MSI] and its Subsidiaries sustained a consolidated net loss of $(784,486) since January 31, 1997.

III. The Debtors' schedules reflect that much litigation, either anticipated or not, was spawned from its Heritage bond offering. MSI made the Heritage bond offerings from 1996 to 1999 and each of the eleven offerings, totaling over $130,000,000, defaulted. Mr. Dlugosch testified that the liabilities from Heritage caused MSI's demise.

IV. Mr. David Reinhart testified at the §341 meeting that the Heritage offerings commenced in "late '96 or '97" and that each defaulted resulting in $135,000,000 in liability.

V. The proofs of claim filed in this case include claims for the period of 1996 or later totaling, more than 10 times what was paid for the Defendants' stock.

16. The total of the Heritage bond offerings completed before the Stock Purchase Agreement were $44,135,000.00.

17. Wikner and Iverson allowed the Stock Purchase Agreement to close without ensuring that their liabilities to MSI would, in fact, be satisfied. The only alleged evidence that the debts were "satisfied" are accounting entries of MIAC generated after the closing. There never was cash paid to MSI, there was never a real economic transaction and Defendants rely solely upon "accounting treatment."

18. Prior to closing on July 31, 1997, MSI had promissory notes and detailed accounting entries evidencing its entitlement to payment from two debtors (Defendants) who had, it appears, substantial assets. After the closing, MSI, was left with no means whatsoever to collect on these debts. Defendants claim that their debts were supplanted by an accounting entry showing a debt owed by MIAC to MSI. However, MIAC had substantial debt and its only asset was its interest in MSI. Any claim against MIAC would have been futile.

19. Defendants each treated the money paid by MIAC as a capital gain. Neither reported forgiveness of debt despite the fact that their debts were never satisfied. This allowed each to achieve a better tax rate on the sale transaction (i.e., capital gain vs. ordinary income).

20. There is no corporate resolution approving the transaction at bar nor ratifying the same on the part of MSI. Additionally, there are no corporate records authorizing, nor other records substantiations, the "advances" upon which Defendants rely for their defense.

21. <u>Prior</u> to the Stock Purchase Agreement, each Defendant had an employment contract with MSI. Each Employment Contract protected against use of proprietary information after employment (§ 3.1) and restricted employment for one year (§ 3.2).

22. At the closing of the stock sale, Wikner and Iverson each executed new noncompetition agreements with MSI. Whereas their preexisting noncompetition agreements did not provide for compensation, the new competing agreements provided that Wikner would receive

four years of monthly payments of $14,585.00 ($700,080.00) and Iverson would receive seven years of monthly payments of $1,200.00 ($100,800.00). Wikner received all of his payments ($700,080.00). Iverson received his payments through the bankruptcy filing on January 22, 2001 ($50,400.00). These noncompetes were entered into between MSI and defendant at the behest of MIAC. There is no evidence that MSI, independently, was unsatisfied with the preexisting arrangement.

23. MIAC's attorneys' records which show that the MIAC and Defendants initially were negotiating "consulting agreements" and that those morphed into noncompetition agreements.

24. There are no records supporting the $2.1 million "advance" entry in MIAC's records which Defendants allege establishes that their debts were satisfied.

25. Each of the Debtors were insolvent in the year prior to filing. These cases have, in aggregate, in excess of $50 million in claims filed and the assets in these cases are, at present, approximately $500,000.00.

26. The payments to Defendants in the year prior to filing allowed them to receive more than they otherwise would receive as creditors of these estates pursuant to 11 U.S.C. § 547(b)(5).

WIKNER'S STATEMENTS RELATED TO THE TRANSACTION

Wikner was approached in early 1997 about the sale of his stock in MSI by James Dlugosch. Wikner did not believe that Dlugosch had the ability to make an offer and did not take him seriously. In fact, Wikner was surprised that the transaction actually closed. See, Notice of Hearing, Exhibit O (Wikner Deposition Transcript) at pages 28 to30.

Wikner was asked, "What actions did you take as a shareholder of those companies to ensure that they would be repaid the amounts stated in the Stock Purchase Agreement?" His response was, "I mean, I don't – I don't know. I don't remember what I did." *Id.*, at 83. When asked about whether the board of directors was presented with the issues, Wikner responded, "I don't believe so. I don't remember is the better answer. We may have done so. I don't know. I don't recall that we did anything formally." *Id.*, at 87-88. Wikner could not identify how the companies were repaid. *Id.,* at 90.

Wikner is unaware of any aspect of the transaction which was designed to ensure repayment of the substantial debts that he owed to MSI and, instead, "presumed" that they would be taken care of at closing.

IVERSON'S STATEMENTS RELATED TO THE TRANSACTION

Iverson was deposed on January 23, 2004. He stated that at the time of the MIAC transaction, he was 62 years old, had a heart problem and was interested in selling his stock. Notice of Hearing, Exhibit P, (Iverson Deposition Transcript) at 19-20. Iverson had little involvement in the transaction which was negotiated by MIAC's counsel, Mo Sherman at Leonard Street & Deinard. *Id.*, at 20. Iverson stated, "I didn't sit in on any document discussions or any of that." *Id.*

When asked about repaying his obligations to MSI, Iverson stated that, "I believe they netted it out." *Id.*, at 38. When asked what he did to ensure that the conditions of closing occurred, one of which was the repayment of his debt, Iverson stated, "I wasn't involved." *Id.*, at 39.

Mr. Iverson testified that any board meetings relating to MSI's involvement in the MIAC transaction would be in the board minutes. *Id.*, at 37. The Trustee has been unable to locate any MSI board meetings relating to the transaction.

ARGUMENT

I. STANDARD FOR SUMMARY JUDGMENT

Bankruptcy Rule 7056 provides that Rule 56 of the Federal Rules of Civil Procedure applies in adversary proceedings in bankruptcy cases. Rule 56 states:

> That judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Rule 56(c), Federal Rules of Civil Procedure.

Summary judgment plays a very important role in the judicial proceedings by allowing the judge to "pierce the pleadings and to assess the proof in order to see whether there is a genuine need for trial." Fed. R. Civ. P. 56, Advisory Committee note. Summary judgment is properly regarded not as a disfavored procedural shortcut, but rather as an integral part of the federal rules as a whole, which are designed "to secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett*, 477 U.S. 317, 327 (1986).

The initial burden is on the party seeking summary judgment. To that end, the movant discharges its burden by showing that the record does not contain a triable issue and by identifying that part of the record which supports the moving party's assertion. *Id.*, 477 U.S. at 323; *City of Mt. Pleasant, IA v. Assoc. Electric Co-op, Inc.* 838 F.2d 268, 273 (8th Cir. 1988). Once the movant has made its showing, the burden of production shifts to the non-moving party. The non-moving party must present specific, significant and probative evidence supporting its case, *Johnson v. Enron Corp.*, 906 F.2d 1234, 1237 (8th Cir. 1990), which is sufficient enough "to require a judge to resolve the parties' different versions of the truth at trial." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986) (quoting *First National Bank of Arizona v. Cities Service Co.*, 391 U.S. 253, 288-89 (1968)).

Fiduciaries always have the burden of proof of establishing the fairness of their dealings with trust property. *Perlman v. Feldman*, 219 F.2d 173, 177 (2nd Cir. 1955).

Based upon the law and facts presented herein, the Trustee is entitled to summary judgment in this matter.

II. CHAPTER 7 TRUSTEE'S STANDING

The estate created pursuant to 11 U.S.C. § 541 succeeds to any right that a debtor corporation may have to recover damages for misconduct, mismanagement, or neglect of duty by a corporate officer or director. 4 Collier on Bankruptcy ¶ 541.10 at 541-679 (15^{th} ed.). The role of a trustee in bankruptcy is to collect money and other assets that may be owing to the debtor. See, *Steinberg v. Buczynski,* 40 F.3d 890, 891 (7th Cir.1994). Among those powers, the trustee may bring claims against the debtor's fiduciaries. *In re DeMert & Dougherty, Inc.*, 27 B.R. 821, 838 (Bankr. N.D. Ill. 2001), citing, *Koch Refining v. Farmers Union Central Exchange, Inc*., 831 F.2d 1339, 1343 (7th Cir.1987), *cert. denied,* 485 U.S. 906 (1988) ("rights of action against officers, directors and shareholders of a corporation for breaches of fiduciary duties, which can be enforced by either the corporation directly or the shareholders derivatively before bankruptcy, become property of the estate which the trustee alone has the right to pursue after the filing of a bankruptcy petition"); *Official Committee of Unsecured Creditors of Toy King Distributors, Inc. v. Liberty Savings Bank, FSB (In re Toy King Distributors, Inc.),* 256 B.R. 1, 167 (Bankr. M.D. Fla. 2000).

The Trustee has a standing to assert the claims herein.

III. DUTIES OWED TO MSI AND ITS CREDITORS WHILE IN VICINITY OF INSOLVENCY

Under Delaware law, directors and officers owe a fiduciary duty to the corporation's creditors "at a point short of actual insolvency, that is, when the corporation is 'in the vicinity of insolvency.'" *Pereira v. Cogan*, 294 B.R. 449, 519 (S.D. N.Y. 2003) (citations omitted). At least one court has stated that the <u>concept of "zone" of insolvency refers to the extent of the risk that creditors will not be paid, rather than to balance sheet insolvency</u>. *In re Ben Franklin Retail Stores Inc.*, 225 B.R. 650, 655 (Bankr. N.D. Ill. 1998).

In an article entitled Advising the Board of Directors published January 12, 2004 by the Practicing Law Institute, the current law as to directors' duties when a corporation is at or near insolvency was stated as:

> Recent cases have extended the time period when directors owe duties to creditors to include situations where a corporation is in the "zone" or "vicinity" of insolvency. *In Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp*., 1991 WL 277613 (Del. Ch. Dec. 30, 1991), the court held that the board of a corporation "operating in the vicinity of insolvency... is not merely the agent of the residue risk bearers, but owes its duties to the corporate enterprise." *Id*. at *34. These duties obligate the board to "maximize the corporation's long-term wealth creating capacity." *Id*. **Courts have also held that directors have duties of loyalty and care owing to creditors even in the absence of a corporation being in the zone of insolvency where a proposed transaction may render the corporation insolvent. *Brandt v. Hicks, Muse & Co. (In re Healthco Int'l, Inc.)*, 208 B.R. 288, 300-01 (Bankr. D. Mass 1997).** In determining whether a company is in the "zone of insolvency," courts tend to combine the "balance sheet" and "equitable insolvency" tests, such that if insolvency is expected to occur under either standard, a director's fiduciary duties expand to include creditors. Martin J. Bienenstock and Robert L. Messineo, Financial Woes Affect Director's Roles, New York Law Journal, Oct. 22, 2001 at 14.

Advising the Board of Directors, 1404 PLI/Corp. 197, 268 (Jan. 12, 2004).

What constitutes the "vicinity of insolvency" has not been well-defined. However, some guidance has been provided as follows:

> A sense of the meaning of "vicinity" may be gleaned from distinctions made in statutes and case law between "insolvency in a bankruptcy sense"-- negative equity or a present deficit in net worth --and "equitable insolvency." Under Delaware state law, "insolvency" is defined to exist "when the present fair salable value of [the debtor's] assets is less than the amount that will be required to pay [its] probable liability on [its] existing debts as they become absolute and matured." Thus, in *Geyer v. Ingersoll Publications Co.*, the court found that a fiduciary duty to creditors arises upon "insolvency in fact"--that is, when the corporation has liabilities in excess of a reasonable market value of assets held--not merely upon the filing of a bankruptcy petition. The Geyer case found the "ordinary meaning" of the word "insolvency" to be as follows: "An entity is insolvent when it is unable to pay its debts as they fall due in the usual course of business. That is, an entity is insolvent when it has liabilities in excess of a reasonable market value of assets held."

Director and Officer Liability: Indemnification and Insurance, Olson and Hatch, Dir. & Off. Liab § 1:42

The fiduciary duty owed to creditors is particularly acute when the total debts of the corporation exceed the value of the corporation's assets. *Ed Peters Jewelry Co., Inc. v. C & J Jewelry Co., Inc.*, 51 F.Supp 2d 81, 99 (D. R.I. 1999). <u>It is of no importance that the director did not know the corporation was insolvent or believed it to be solvent</u>. *In re Shultz*, 208 B.R. 723, 729 (Bankr. M.D. Fla. 1997).

MIAC was willing to pay $15 million for the stock of MSI. MSI's books claim to show assets valued at about $44 million, liabilities of $34 million and shareholder's equity of $10.5 million as of July 31, 1997. Notice of Hearing, Exhibit N. Evidence of insolvency is a comparison of actual and potential liabilities to the value of the assets. *In re Transworld Airlines*, 134 F.3d 188, 197 (3rd Cir. 1998). The potential liability, of the claims filed in this case, alone, total over $150 million. See, Notice of Hearing, Exhibit I.[3] The schedules for the closing evidence that over $14 million in claims could be expected. That $14 million is not believed to represent the Heritage-related items. However, it exceeds the shareholders' equity and the stock purchase price. MSI was certainly well on its way down the slope of insolvency in July of 1997.

[3]A proof of claim filed in accordance with Bankruptcy Rules constitutes *prima facie* evidence of validity and amount of claim. *In re Finley, Kumble, et al.* (Bankr. S.D. N.Y. 1994) 92 B.R. 352, aff'd, 194 B.R. 728.

IV. WASTE OF ASSETS OF MSI CREATES INDEFENSIBLE CLAIM AGAINST WIKNER AND IVERSON

A. IVERSON AND WIKNER BREACHED THEIR FIDUCIARY DUTIES BY COMMITTING A WASTE OF THE CORPORATE ASSETS

1. WASTE IS A BREACH OF FIDUCIARY DUTY

Waste is one of the most egregious breaches of a duty owed to a corporation. A waste entails an exchange of corporate assets for consideration so disproportionately small as to lie beyond the range at which any reasonable person might be willing to trade. *Lewis v. Vogelstein*, 699 A.2d 327, 336 (Del. Ch. 1977), citing, *Saxe v. Brady*, 184 A.2d 602, 610 (Del. Ch. 1962), *Grobow v. Perot*, 539 A.2d 180, 189 (Del. Supr. 1988). Most often, the claim is associated with a transfer of corporate assets that serves no corporate purpose; or for which no consideration at all is received. *Id.* The essence of a claim of waste of corporate assets is the diversion of corporate assets for improper or unnecessary purposes. *Michelson v. Duncan*, 407 A.2d 211, 217 (Del. 1979). It is common sense that a transfer for no consideration amounts to a gift or waste of corporate assets. *Id.*

In this case, Wikner and Iverson caused MSI to "gift" to them a release of the substantial obligations owed by each to the corporation. In this case, the release of debt, was a classic "waste" of corporate assets. This was the result of each Defendant violating his respective duties as a shareholder, director and officer of MSI. More specifically, the waste in this case is the release of Wikner and Iverson from their obligations to MSI as part of MIAC's stock purchase price paid to Wikner and Iverson.

Transactions involving corporations and their executives are to be regarded with skepticism and closely scrutinized. See, *Snyder Elec. Co. v. Fleming*, 305 N.W.2d 863 (Minn. 1981). MIAC and the sellers (Wikner, Iverson and Erickson) created a transaction in which a disinterested party

(MSI) controlled by Wikner and Iverson, paid part of MIAC's $15,000,000.00 purchase price and received absolutely nothing in return.[4]

Another way to look at the matter, and the way that the Trustee does look at the matter, is from the viewpoint of MSI. On July 31, 1997, Wikner and Iverson left without ensuring that their debts would be paid. Whatever else occurred after July 31, 1997 occurred independently of Wikner and Iverson. In other words, Defendants did absolutely nothing to ensure satisfaction of their debts to MSI. The only evidence of payment is MIAC's self-serving, post-closing, "advance" entry. MSI was left to the mercy of the parties to the Stock Purchase Agreement.

2. BREACH OF FIDUCIARY DUTY AS A SHAREHOLDER

In order to establish a claim which would show breach of fiduciary duty, a "plaintiff must allege facts which show that the action attacked is so far opposed to the true interests of the corporation as to lead to the clear inference that no officer thus acting could have been influenced by an honest desire to secure such interests." *Westgor v. Grimm,* 318 N.W.2d 56, 59 (Minn. 1982), citing, *Warner v. E.C. Warner Co.*, 226 Minn. 565, 33 N.W.2d 721 (1948).[5]

Fiduciary duties are also imposed on majority shareholders to the extent that they exercise any control over corporate affairs. *Pepper v. Litton*, 308 U.S. 295, 306 (1939); *Jones v. H.F. Ahmanson & Company*, 1 Cal.3d 93, 81 Cal. Rptr. 592, 599-600, 460 P.2d 464, 471-72 (1969). It has been stated that:

[4]The Trustee also claims that the noncompete agreements provided to Wikner and Iverson are "waste" and fraudulent.

[5]In the case of *In re Dygert*, 2000 WL 630833, this court stated: "In general, defalcation refers to a breach of fiduciary duty." *Tudor Oaks Ltd. Partnership v. Cochrane* (*In re Cochrane*), 179 B.R. 628, 635 (Bankr. D. Minn.1995). Defalcation does not require an intentional wrong or bad faith. *Cochrane,* 124 F.3d at 984. *Kondora,* 194 B.R. at 208. It can include innocent or negligent misdeeds as well as ignorance. *Cochrane,* 124 F.3d at 984; *Kondora,* 194 B.R. at 208; *Cummins,* 166 B.R. at 354. In short, a defalcation is proven by the simple failure to meet the duties imposed by nonbankruptcy law. *Minnesota Trust Co. v. Yanke* (*In re Yanke*), 225 B.R. 428, 437 (Bankr. D. Minn.1998).

> [Dominating or controlling shareholder's] dealings with the corporation are subjected to rigorous scrutiny and where any of their contracts or engagements with the corporation is challenged the burden is on the director or stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein. * * * The essence of the test is whether or not under all the circumstances the transaction carries the earmarks of an arm's length bargain. If it does not, equity will set it aside.

Pepper v. Litton, 308 U.S. at 306, quoted in *In re Fergus Falls Woolen Mills Co.*, 41 F.Supp. 355, 364 (D. Minn.1941). The transactions at issue do not convey such earmarks.

Finally, <u>controlling stockholders cannot jeopardize the interest of the corporation by allowing their self-interest in the planned disposition of their personally owned stock to be the indispensable condition precedent to a sale of assets</u>. *Levy v. Manget*, 308 F.2d 248, 255 (5th Cir. 1962). In this case, Iverson and Wikner made the sale of their stock conditioned on the waste of corporate assets.

Evidence that Wikner and Iverson put their own interests ahead of those of the corporation is found in the Stock Purchase Agreement, itself. Section 5.1 governs the conduct of the business of MSI from the date of the agreement through closing. In that section, Wikner and Iverson, in furtherance of the sale of their personal stock, agreed that MSI would restrict the conduct of its affairs. Therefore, Defendants agreed that the company would be governed in accord with their own personal concerns as opposed to MSI's best interests. This underscores that MSI did not much matter to Defendants. This transaction was about Defendants using the corporation to facilitate a sale of their personal stock.

Section 5.6 of the Stock Purchase Agreement addresses access to MSI's employees pending the closing of the stock sale. These are issues which are not, in normal circumstances, within the purview of the shareholders' concern. Defendants permitted MIAC access to employees to further their own personal interests. It may not have been in the best interest of MSI to have MIAC contacting its employees. However, that was not an impediment to Defendants.

Also, the <u>Stock Purchase Agreement, in sections 5.5 and 6.1, contemplates that Defendants' debts would be satisfied.</u> However, when the Closing Statement is reviewed, it becomes evident that this did not occur. There is not one actual transaction or writing which ensured that the debts would be satisfied.

Further, despite already being subject to noncompete agreements, Defendants executed new such agreements with MSI, which paid them each a substantial sum, at the behest of MIAC. MSI did not need new noncompete agreements. MIAC and the Defendants wanted the new noncompetition agreements simply to require the Debtor to pay a portion of the stock sale price (in addition to the debt forgiveness portion).

The foregoing demonstrates that Defendants' actions in consummating the Stock Purchase Agreement were entirely for their own self interests and without regard to MSI's interests or their fiduciary duties.

3. BREACH OF FIDUCIARY DUTY AS DIRECTORS AND OFFICERS

Directors of a corporation have a fiduciary duty to exercise their powers solely for the benefit of the corporation and its shareholders. *See, Diedick v. Helm*, 217 Minn. 483, 14 N.W.2d 913, 919 (1944); *Ritchie v. McGrath*, 571 P.2d 17, 22 (Kan. Ct. App. 1977). (Corporate directors and officers are under a very strict fiduciary duty in their relations to the corporation.); *CSFM Corp. v. Elbert & McKee Co.,* 1988 WL 93957, *2 (N.D. Ill. 1988) (officers of a corporation occupy a position of trust and confidence and owe a fiduciary duty to the corporation.); *Westgor*, 318 N.W.2d at 58 ("It is clear that a director or controlling shareholder stands in a fiduciary relationship to the corporation").

Officers and directors must use corporate property only for proper purposes. *Lussier v. Mau-Van Development, Inc.*, 4 Hawaii App. 359, 667 P.2d 804, 814 (1983). The unauthorized withdrawal of funds constitutes the tort of conversion and breach of fiduciary duty. *Gray v. Sutherland*, 124 Cal. App.2d 280, 268 P.2d 754, 761 (1954). In this case, Defendants' efforts to cause MSI to forgive about $2 million dollars in debt owed by them, in exchange for which MSI received nothing, was a breach of the fiduciary duty owed by each to MSI.[6]

Breaches of fiduciary duty have been found in asset sales involving wrongfully appropriated corporate assets. *Ritchie*, 571 P.2d at 22, citing *McDaniel v. Painter*, 418 F.2d 545, 548 (10th Cir. 1969). In the case of *Emergency Patient Service, Inc. v. Crisp*, 602 S.W.2d 26 (Mo. Ct. App. 1980), a director was accused of misappropriating a mobile telephone which was an asset of the corporation. The court noted that, "Since a director occupies a fiduciary relation with a corporation . . ., he may not personally profit by virtue of the relationship at the expense of the corporation. . . " *Id*. at 28 (citations omitted); see also, *General Automotive Mfg. Co. v. Singer*, 120 N.W.2d 659, 662-63 (Wis. 1963) (Fiduciaries are not permitted to use their positions for their own personal gain). It is certain that, as a general proposition, neither the executive officers nor the directors of an incorporated company have the right to convert its assets to their own use, or give them away, or make any self-serving disposition of them against the interest of the company. *Id.*

Minnesota has codified the forgoing principals. Minn. Stat. §302A.251, subd. 1 provides for standards for directors. That statutes provides:

> A director shall discharge the duties of the position of director in good faith, in a manner the director reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person who so performs those duties is not liable by reason of being or having been a director of the corporation.

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[6]Defendants may allege that in lieu of the forgiveness, they could have distributed the equivalent amount to themselves to then satisfy their debts. However, given that MSI was already in the vicinity of insolvency, these distributions would have been subject to recapture under Minn. Stat. §302A.557 and Defendants would have been liable for the same as directors under Minn. Stat. §302A.559.

Minn. Stat. §302A.251, subd. 1.

The Reporter's Notes to this statute add further guidance. Those provide that, "Directors have great powers over the corporation, and few restrictions. The most important restriction on their power is the duty to comply with the standard of conduct set forth in this section." *Id.*, Reporter's Notes.

Likewise, Minnesota has codified the standards for an officer's conduct in Minn. Stat. §302A.361. That section provides:

> An officer shall discharge the duties of an office in good faith, in a manner the officer reasonably believes to be in the best interests of the corporation, and with the care an ordinarily prudent person in a like position would exercise under similar circumstances. A person exercising the principal functions of an office or to whom some or all of the duties and powers of an office are delegated pursuant to section 302A.351 is deemed an officer for purposes of this section and sections 302A.467 and 302A.521.

Minn. Stat. §302A.361

At times material hereto, each Defendant was both an officer and director of MSI (as well as a shareholder). It is hard to envision how an officer or director could be acting in good faith (i.e., "honesty in fact") when allowing the sacrifice of a corporate asset in order to facilitate a shareholders' personal stock sale.[7] *A fortiori*, the officer or director could not be acting in the reasonable belief that his conduct was in the best interests of the corporation. Under Minnesota law, a corporate officer or director is personally liable for all damages caused by self-dealing in breach of his or her fiduciary obligations. See, *Foy v. Klapmeier*, 992 F.2d 774 (8th Cir. 1993); *Lake Harriet State Bank v. Venie*, 138 Minn. 339, 165 N.W. 225 (1917) (Directors of a corporation are liable for losses resulting from abuse of their authority).

[7]"Good faith" is generally defined as honest in fact, *White Stone Partners v. Piper Jaffray Cos.*, 978 F. Supp. 878, 881 (D. Minn. 1997).

In this case, each Defendant testified that they allowed the attorneys to handle the closing and that they gave the transaction very little thought. Wikner was surprised that the closing even occurred! These Defendants allowed their obligations to MSI be replaced with a novation. The fact that they allowed this to occur, at a time when MSI had substantial potential liabilities, breached their duties of care and loyalty. Defendants were cashing out and did not give MSI a lot of thought.

Defendants breached their fiduciaries duties owed to MSI as directors and officers of that company.

4. DEFENDANTS ARE NOT PROTECTED BY RATIFICATION

Generally, a director may garner protection from claims against him or her by seeking ratification of the shareholders of the corporation. Minn. Stat. §302A.255(1). However, void acts are said to be non-ratifiable because the corporation cannot lawfully accomplish them. *Harbor Finance Partners v. Huizenga*, 751 A.2d 879, 896 (Del. Ch. 1999); *Aronoff v. Albanese*, 446 N.Y.S.2d 368, 370 (N.Y.A.D. 1982) (A void act is not subject to ratification). Such acts are often described in conclusory terms such as "*ultra vires*," or "fraudulent" or as "gifts or waste of corporate assets." *Id.* "Because at first blush it seems it would be a shocking, if not theoretically impossible, thing for stockholders to be able to sanction the directors in committing illegal acts or acts beyond the authority of the corporation, it is unsurprising that it has been held that stockholders cannot validate such action by directors, even on an informed basis." *Id.* (citations omitted). Stated another way, "[a]n unconscionable deal between directors personally and the corporation they represent could not become conscionable merely because most of the stockholders were either indifferent or actually in sympathy with the directors' scheme." *Aronoff* at 370, citing, *Gottlieb v. Heyden Chem. Corp*. 90 A.2d 660, 665 (Del. Ch. 1952).

In the case of *Fidanque v. American Maracaibo Co.*, 92 A.2d 311 (Del. Ch. 1952), dissenting shareholders complained the corporation had granted a consulting contract to a former officer who was now too old and ill to perform. *Id.*, at 320-21. The Court held that such a contract, based on the facts presented, was a gift. *Id.,* at 321. The Court noted that since the payment (for consulting) "constitutes an illegal gift of corporate funds and amounts to waste, the fact that the contract was ratified by the stockholders . . . does not cure its illegality." *Id.*

The Trustee sees no evidence that the shareholders of MSI ratified the forgiveness of debt. However, it would not matter if they had as such an illegal act could not be ratified. Further, the three selling shareholders were "interested" in the transaction. Only votes controlled by stockholders who are not "interested" in the transaction at issue are eligible for ratification effect. Minn. Stat. §302A.255(1); *Harbor Finance*, 751 A.2d at 900.; *Pereira v. Cogan*, 2001 W.L. 243537, *17 (Shareholder ratification of a self-dealing transaction must be done by disinterested shareholders). That is, only the votes of those stockholders with no economic incentive to approve a wasteful transaction count. *Id.*

The release of debt was for no consideration to MSI and could not be ratified. If such a transaction could be ratified, it would emasculate the "zone of insolvency" doctrine whenever a closely held corporation is involved and the shareholders act in concert. Accordingly, the Trustee may recover the waste committed from these directors.

V. THE MERGER OF MSI AND MIAC DOES NOT BAR THESE CLAIMS

Defendant Iverson asserts a cryptic defense of setoff which implies that the 2002 merger of MSI and MIAC extinguished the Trustee's ability to assert these claims.

The Articles of Merger of MSI into MIAC are dated May 5, 2000. See, Exhibit E to verified Notice of Hearing and Motion. In Article V of the same, the following is stated:

> [MIAC] will thenceforth be responsible and liable for all liabilities and obligations of [MSI], <u>and any claim existing or action or proceeding pending **by** or against [MSI] may be prosecuted as if the Merger had not taken place</u>, or [MIAC] may be substituted in its place.

Notice of Hearing, Exhibit C, at Article V.

The Trustee, as the Chapter 7 Trustee of this estate, holds all rights of action belonging to each of the merged corporations. 11 U.S.C. §541. The merger of MSI and MIAC has no effect on the analysis of this matter. See also, Minn. Stat. §302A.641, subd. 2. Accordingly, Defendant Iverson's defense of setoff must fail.

VI. THE TRUSTEE IS ENTITLED TO RECOVER DAMAGES

When a corporate director holds such property in trust, he is liable to the victims of his fiduciary breach for any profits made, *or* for the value of the property at the time of the breach, plus interest. *Pavladis v. New England Patriots Football Club, Inc.*, 675 F.Supp. 701, 702 (D. Mass. 1987). The actual damages herein was the forgiveness of debt which, for Iverson, totaled $795,992.29. For Wikner, the total is $1,190,951.50. The Trustee would include in this "waste" his claims for the noncompetition payments. Each should be held jointly liable for the whole. Each should also be held accountable for the payments made under the noncompetition agreements.

Section 549.09 of the Minnesota Statutes governs prejudgment interest.[8]

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[8]The Trustee submits that the statute allows for his recovery of interest against Iverson at the following rates for the following years: 1997 5%, 1998 5%, 1999 4%, 2000 5%, 2001 6%, 2002 2% and 2003 4%.

VII. DEFENDANTS' DEFENSES FAIL

A. IVERSON'S DEFENSES FAIL

1. STATUTE OF LIMITATIONS ARGUMENT FAILS

Iverson alleges the statute of limitations as defense in his Answer. However, that is not a bar as to the claims herein.

A breach of fiduciary duty claim has a six-year statute of limitations, meaning the actions must be commenced within six years. Minn. Stat. § 541.05, subd. 1(1), (6). The limitation period begins to run when the cause of action accrues, unless a statute provides otherwise. Minn. Stat. § 541.01. The subject agreement was dated June 20, 1997, effective June 1, 1997 and was actually executed on July 31, 1997. July 31, 1997 has to be that is used for this calculation as that was the date that the Defendants actually took action. See, *Caldwell v. U.S.*, 57 Fed. Ct. 193 (Fed. Cl. 2003). The case against Iverson was commenced on June 13, 2003. Accordingly, the statute of limitations is not a bar to this action and Iverson's defense fails.

2. "SETOFF" DEFENSE FAILS

Iverson claims in paragraph 4 of his Affirmative Defenses that he is entitled to a setoff. It appears as though the facts alleged in that paragraph relate to the corporate merger. However, the Trustee understands that Iverson is also claiming setoff as to the underpayment of his purchase price by MIAC, now the Debtor. These arguments are addressed herein.

a. Setoff is not Available as a Defense to a Breach of Fiduciary Duty Claim

As the Trustee understands it, Iverson's argument will be that, assuming that all of the Trustee's allegations are true, that Iverson, in turn, would have a claim against MIAC (which is now the Debtor by way of merger) for its failure to pay Iverson the full purchase price. While it is questionable as to whether this defense was truly pled, the Trustee will address this claim of setoff.

The common law doctrine of setoff, as recognized under §553 of the Bankruptcy Code, grants a creditor the right "offset a mutual debt owed by such creditor to the debtor" so long as both debts arose before the commencement of the bankruptcy action and are indeed mutual. *In re Knedlik*, 192 B.R. 559, 561 (Bankr. D. Kan. 1995), citing, *In re Davidovich*, 901 F.2d 1533, 1537 (10th Cir. 1990) (citing §553(a)). Courts strictly construe mutuality to insure that a debtor's claim in one capacity is not setoff against a claim asserted by a party in a different capacity. *Id.*, citing, *In re Lakeside Community Hosp., Inc.*, 151 B.R. 887, 891 (N.D. Ill. 1993). Where the liability of the party claiming the right of offset [Iverson] arises from a fiduciary duty . . ., the requisite mutuality of debts or credits does not exist, so that such party may not offset against such liability a debt owing from the debtor stemming from a different relationship. *Id.*, citing, *In re Matsroeni*, 57 B.R. 191, 193 (Bankr. S.D. N.Y. 1986);

Case law precludes an individual, who has breached his fiduciary duty, from offsetting the arising liability against the claim of another, who has been harmed by such breach. *Ducker v. Lohrey*, 33 B.R. 973, 976 (Bankr. D. Ohio 1983); see also, *Darr v. Muratone*, 8 F.3d 854, 860 (1st Cir. 1993) (Where the liability of the party seeking the setoff arises from breach of a fiduciary duty, mutuality of debts does not exist and therefore no setoff is available) (citations omitted). Finally, "setoff is allowed in very narrow circumstances in bankruptcy." *In re Knedlik*, 192 B.R. at 561, citing, *In re B&L Oil, Co.*, 782 F.2d 155, 157 (10th Cir. 1986).

In this case, the Trustee asserts that there is no genuine issue of material fact as to Iverson's standing as a fiduciary to MSI in 1997 (and at all times material herein). If the Court determines that

Iverson breached a fiduciary duty, then he cannot avail himself to the defense of setoff.

b. The Articles of Merger Preserved All Claims

MIAC and MSI merged in 2000. At that time, MIAC changed its name to "Miller & Schroeder, Inc." The Articles of Merger kept all rights of MSI alive. See, Section IV, above.

Based on the foregoing, all claims which belonged to MSI, such as the claim at bar, survived the merger.

B. WIKNER'S DEFENSES FAIL

Wikner's Answer provides two defenses relevant to this motion. They are found in paragraphs 5 and 6 of his Affirmative Defenses. Each defense fails.

1. ALLEGATION THAT PLAINTIFF'S CLAIMS ARE RELEASED.

Wikner alleges that the claims herein have been released. Plaintiff presumes that this allegation is based on the Settlement Agreement dated December 11, 1997 which is attached as Exhibit E to the verified Notice of Hearing and Motion herein. This Settlement Agreement is nothing more than a price adjustment pursuant to paragraph 2.3 of the Stock Purchase Agreement based on a change in book value.

The Settlement Agreement provides a release only as to the price paid to Wikner and Iverson for their stock. See, Ex. E at par. 5. All of the remaining terms of the Stock Purchase Agreement were left unaffected. Included in those unaffected terms were the Defendants' respective obligations to repay the indebtedness to MSI. Accordingly, Wikner's defense of "release" fails.

2. WIKNER'S OTHER DEFENSE FAILS

Wikner's other affirmative defense, found in paragraph 6 of his affirmative defenses, asserts:

> As to the Trustee's allegations relating to the "Released Obligations" and the other Transfers alleged to be avoidable under Counts II and III of the Complaint, states that MIAC deducted such "transfers" from amounts otherwise required to be paid to Wikner at closing resulting in netting out at closing, which resulted in payments of the Released Obligations to Miller

> & Schroeder, Inc.[9]; further states that on or about May 8, 2000, Miller & Schroeder, Inc. merged with MIAC. The net result of these events is that the Released Obligations were paid by Wikner to Miller & Schroeder, Inc. by reason of which Miller & Schroeder, Inc. did not make a transfer for which it received less than adequate consideration or without receiving reasonably equivalent value or which left the Debtor Miller & Schroeder, Inc. inadequately capitalized. In fact, the Debtor Miller & Schroeder, Inc. received equivalent value for the released obligations.

Wikner's Answer at par. 6 (emphasis added).

The Trustee will make a few points regarding this alleged defense:

1. First, this defense appears to relate only to Counts II and III, which are fraudulent transfer counts. Count IV addresses a breach a of fiduciary duty.

2. Despite the allegations, Defendant Wikner can point to no consideration received by MSI for its release of debt (but for accounting treatment with no underlying reality); and,

3. All claims of MSI survived the merger. See, Exhibit E, verified Notice of Hearing and Motion and this Memorandum, supra.

Wikner's defense is simply an attempt to confuse and emasculate the issues in this case. However, analysis reveals that the allegations are meaningless and not a defense to this summary judgment motion.

3. NEITHER DEFENDANT HAS ALLEGED PAYMENT AS A DEFENSE

The Defendants' arguments, essentially, in that they, somehow, "paid" their debts to MSI. However, despite being a required pleading, neither Defendant has alleged "payment" as an affirmative defense. As such, that defense has been waived. Bankr. Rule 7008; *Gray v. Bicknell*, 86 F.3d 1472, 1480 (8th Cir. 1996) (an affirmative defense must be "raised in the pleadings or [it is] waived"].

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[9] There is no evidence that this, in fact, occurred.

Even if they had alleged "payment," the only evidence that either Defendant possesses is a self-serving accounting entry premised upon a fictional transaction. (Again, Mr. Dlugosch testified that MIAC did not actually pay Defendants' debt to MSI.) The accounting entry, alone, does not establish payment.

In McCormick & Ray, Texas Law of Evidence § 557, p. 709, it is stated: "It is obvious that account books and entries therein are not admissible in the absence of some showing by preliminary evidence as to what the proffered books and entries are and under what circumstances they have been kept. The books do not prove themselves." *Sam Bloom Advertising Agency v. Brush*, 284 S.W.2d 265, 270-71(Tex. Civ. App. 1955).

It has been held that an entry of credit in account without proof of actual payment is sufficient evidence in itself. See, *In re Smith's Estate*, 63 Pa. D & C 416, 417 (1947). Books of original entry admitted in evidence are prima facie but not conclusive evidence of the matter they record. *Id.*, at 418. The Trustee submits that while outside accountant's statements show a post-closing advance to MIAC, that the entries are based on a fiction. MIAC did not have the money to advance to MSI in the first instance. Secondly, there were never true economic transactions between the parties which effected a payment of the debt. And, lastly, the entries, based on fiction, are self-serving to MIAC and the Defendants to these adversary proceedings. The Court should not consider the accounting treatment, alone, sufficient to establish satisfaction of the Defendants' debts to MSI.

VIII. FRAUDULENT TRANSFER

The applicable law in this case is Minn. Stat. § 513.44 (available to the Trustee pursuant to 11 U.S.C. § 544), which is Minnesota's fraudulent transfer statute. It provides:

> (a) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
> (1) with actual intent to hinder, delay, or defraud any creditor of the debtor; or

> (2) **without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor**:
> (i) **was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction**; or
> (ii) intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

Minn. Stat. § 513.44(a).[10]

The court must first examine whether the events complained of qualify as a "transfer" within the meaning of the act. *See In re Butler*, 552 N.W.2d 226, 231 (Minn. 1996) (recognizing that whether a particular event qualifies as a "transfer" under the Act is a threshold question). "Transfer" means every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with an asset or an interest in an asset, and includes payment of money, release, lease and creation of a lien or other encumbrance. Minn. Stat. § 513.41 (12).

The Trustee alleges that the following are fraudulent transfers herein:

1. The "release" of Wikner and Iverson from their debts to MSI;
2. The execution of new noncompete agreements with MSI; and,
3. The payments on the noncompete agreements.

Each of these items is a transfer under Minn. Stat. 513.41 (12). The issues, for fraudulent transfer purposes, are (a) whether MSI received reasonably equivalent value and (b) whether MSI was "engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction." The Trustee submits that MSI did not receive reasonably equivalent value and MSI, for the reasons articulated earlier in this Memorandum, was engaged in triggering transactions.

[10] Creditors' claims are established by both the schedules to the Stock Purchase Agreement (Notice of Hearing Ex. C) and the proofs of claim filed in these cases (Notice of Hearing, Ex. I) together with other exhibits and testimony.

A. MSI DID NOT RECEIVE REASONABLY EQUIVALENT VALUE

Whether a transfer is made for a reasonably equivalent value is a question of fact: the court must consider all aspects of the transaction and measure the value of all benefits and burdens to the debtor. *Metro. Steel Fabricators, Inc. v. Mikulski (In re Metro. Steel Fabricators, Inc.)*, 191 B.R. 150, 154 (Bankr. D. Minn.1996). When analyzing the fairness of consideration the court assumes a creditor's perspective. *In re Consolidated Capital Equities,* 143 B.R. 80, 87 (Bankr. N.D. Tex. 1992); *Chemical Bank v. Dana*, 234 B.R. 585, 594 (D. Conn. 1999) ("Value" is to be determined in light of the purposes of the Act to protect a debtor's estate from being depleted to the prejudice of the debtor's unsecured creditors").

Minnesota's statutes provide that, "Value is given for a transfer or an obligation if, in exchange for the transfer or obligation, property is transferred or an antecedent debt is secured or *satisfied*, but value does not include an *unperformed promise* made otherwise than in the ordinary course of the promissory's business to furnish support to the debtor or another person." Minn. Stat. §513.43(a). In this case, as to the Wikner and Iverson debts - they were not satisfied. At the time of closing, when their obligations to pay disappeared, there was no evidence that the same would be repaid. In fact, James Dlugosch has stated that they were not paid nor was there an intention to pay them. Accordingly, the Debtors could not have received reasonably equivalent value for those items.

Under the Bankruptcy Code's fraudulent conveyance section, §548, the benefits to be received "if not satisfying or securing a present or antecedent debt of the debtor, must be property. If property, it must appear on the debtor's balance sheet and be marketable." *Consolidated Capital*, 143 B.R. at 87. In this case, at best, the debt was assigned to insolvent shell corporation, MIAC. The only asset of MIAC was its stock in MSI. Any creditor pursuing the obligation as an asset of

MSI would end up, at best, with MIAC's stock in MSI. Further, the claim of MSI against MIAC was in no way marketable. First, there is not a real economic transaction underlying MIAC's "advance to subsidiary" entry. Secondly, "marketable" is defined as "those for which a buyer may be found." Black's Law Dictionary (5th ed. 1979) at p. 875. It is hard to imagine that an accounting entry, which is merely "accounting treatment," could in any way be marketable.

As to the noncompetition agreements, these were requirements of MIAC, not MSI. MSI already had noncompetition agreements in place. The Trustee believes that the new noncompetition agreements, which originally started out as consulting agreements, were truly just a vehicle to pay an additional portion of MIAC's purchase price. For the same reason, MSI (even after its merger with MIAC), did not receive reasonably equivalent value for the payments that it made on the noncompetition agreements.

B. MSI WAS ENGAGED OR WAS ABOUT TO ENGAGE IN A TRANSACTION FOR WHICH THE REMAINING ASSETS OF MSI WERE UNREASONABLY SMALL IN RELATION TO THE TRANSACTION

In the verified Notice of Hearing and Motion and earlier in this Memorandum, the Trustee has put forth facts demonstrating that the Debtor was in a precarious financial condition at the time of the MIAC transaction. While Wikner, Iverson, and MIAC may not have realized the magnitude of the looming issues, that does not detract from the fact that the Heritage bond debacle was underway. MSI had already made almost half of the offerings at the time of the stock sale. That half of the offerings totaled over $150 million. Again, MIAC purchased MSI's assets for less than $14 million.

Based on the foregoing, the Trustee believes that he has demonstrated that the transfers at issue herein may be avoided pursuant to Minn. Stat. 513.47.

IX. CONVERSION

Conversion is defined as "an act of willful interference with the personal property of another which is inconsistent with the rights of the person entitled to the use, possession or ownership of the property." *Dain Bosworth Inc. v. Goetze*, 374 N.W.2d 467, 471 (Minn. App. 1985). Stated alternatively, "the elements of common-law conversion are (a) the plaintiff had property interest and (b) the defendant deprived the plaintiff of that property interest." *Siler v. Principal Financial Securities, Inc.*, 2000 W.L. 1809048, *4 (Minn. App. 2000), citing, *Lassen v. First Bank Eden Prairie*, 514 N.W.2d 831, 838 (Minn. App. 1994), review denied (Minn. June 29, 1994).

Prior to the closing with MIAC, MSI had a right to collect debts from Defendants. The two ways of looking at what occurred are: (a) Wikner and Iverson deprived MSI of that right and did not repay MSI, in which case a conversion occurred, or (b) MSI retains the right to collect from Wikner and Iverson. There being no real economic transaction evidencing that MSI has been paid, conversion remains a viable count for the Trustee.

X. UNJUST ENRICHMENT

Unjust enrichment is an equitable remedy available when a party knowingly receives a benefit that, under the circumstances, would be unjust to retain. *Southtown Plumbing, Inc. v. Har-Ned Lumber Co.*, 493 N.W.2d 137, 140 (Minn. App. 1992). The remedy is appropriate when a party receives money or property of another that in equity and good conscience should be repaid. *Klass v. Twin City Fed. Sav. & Loan Ass'n*, 291 Minn. 68, 71, 190 N.W.2d 493, 494-95 (1971) (quotation omitted).

The Trustee believes that he has established that Wikner and Iverson had debts to MSI which were not repaid. He believes that the evidence also indicates that the noncompete agreements together with payments thereon were made at the insistence of MIAC and not MSI. Those arrangements caused Wikner and Iverson to receive benefits which MSI should not have been made to transfer. As such, the release from debt and the payments under the noncompete agreements caused Wikner and Iverson to be unjustly enriched.

XI. PREFERENCE

A. DEFENDANTS SHOULD BE CONSIDERED INSIDERS OF THESE DEBTORS

To constitute a preference, the transfer must take place within 90 days of filing of the bankruptcy petition or within one year if the creditor receives a transfer as an insider. 11 U.S.C. §547(b). The extended time period applies if the person receiving the transfer was an insider at the time of the transfer. 11 U.S.C. §547(b)(4)(B).

The term "insider" under Bankruptcy Code is defined at 11 U.S.C. §101(31). Since these debtors are corporations, the term "includes" a:

I. director of the debtor;
II. officer of the debtor;
III. person in control of the debtor; . . .

11 U.S.C. §101(31)(B).

In this case, Defendants were, at the time of the execution and effective date of the Stock Purchase Agreement in 1997, directors, officers and shareholders of MSI. Further, Defendants were in control over these debtors at that time by virtue of their shareholder status.

B. WITH RESPECT TO THE NONCOMPETE PAYMENTS, DEFENDANTS REMAINED INSIDERS

The Trustee believes that the evidence before this Court amply demonstrates that Defendants were insiders at the time that the Stock Purchase Agreement and noncompete agreements were executed. Defendants argue, of course, that their "insider" label stopped there.

Prior to their resignation, there was no doubt that Defendants were insiders. The law is well established in that where a transfer is part of a larger single transaction, the transferee is an insider--and subject to the one year period--for the entire time it takes to consummate the deal. *In re Consolidated Industries* Corp., 2002 WL 32074882, *7 (N.D. Ind. 2002), citing, *In re EECO Inc.,* 138 B.R. 260, 264 (Bankr. C.D. Cal.1992); *In re Trans Air Inc.,* 79 B.R. 947 (Bankr. S.D. Fla.1987); *In re F & S Central Mfg. Corp.,* 53 B.R., 842, 849 (Bankr.E.D.N.Y.1985); See also, *In re Imperial Corp. of America*, 1992 WL 427752 (S.D. Cal. 1992) (agreeing with *EECO*).

In the *Matter of Krehl*, 86 F.3d 737, 741 (7^{th} Cir. 1996), Mr. Krehl was, prior to his resignation, the corporate president, owner of stock and a director. He was an insider. *Krehl*, at 742-43. Mr. Krehl argued that his resignation cleared him of insider status. The Court held that, "We do not believe that in the circumstances of this case Krehl could eviscerate his historically close relationship with [the debtor] simply by resigning as an officer and director . . . " *Id.*

Likewise, Defendants could not clear the label of being an insider simply by resignation. They continued to bear the fruit of their transactions with the Debtors after their resignation and from a point at which they were insiders.

C. DEFENDANTS WERE PAID WITHIN ONE YEAR OF FILING.

In the year prior to filing, Wikner received the sum of $102,095.00 and Iverson received the sum of $14,400.00. These payments were made to each as an unsecured creditor in furtherance of an antecedent debt. Further, each received more than he would have received in this Chapter 7 proceeding.

CONCLUSION

Iverson and Wikner are solely to blame for the claims asserted against them. They could have constructed a transaction which allowed them to receive a fair price for their stock and which made MSI whole. Instead, they, together with MIAC, wrongfully utilized the assets of MSI to pay the purchase price for their personal stock. It appears to the Trustee that Wikner and Iverson just stood back and allowed their attorney and MIAC to drive the transaction. As discussed herein, this was a breach of the fiduciary duty owed to the corporation and its creditors and caused fraudulent transfers to occur. Wikner and Iverson gave the transaction little to no thought.

Defendants deprived MSI of the ability to assert it rights against them for payment of $2,221,463.91 for Iverson and $1,362,736.23 for Wikner. The Trustee desires to have each Defendant repay these amounts for the benefit of the creditors of this estate.

LEONARD, O'BRIEN
SPENCER, GALE & SAYRE, LTD.

Dated: March 22, 2004

/e/ Matthew R. Burton
By______________________________

Matthew R. Burton, #210018
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UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: Chapter 7 Case

SRC Holding Corporation,
f/k/a Miller & Schroeder Financial, Inc,
and its subsidiaries,

Debtor.

BKY Case Nos. 02-40284 to 02-40286

Jointly Administered

Brian F. Leonard, Trustee,

Plaintiff,

vs.

Roger J. Wikner,

Defendant.

ADV Case No. 03-4153

UNSWORN CERTIFICATE OF SERVICE

I, Stephanie Wood, declare under penalty of perjury that on the 22nd day of March, 2004, I mailed a copy of the annexed ***Notice of Hearing and Motion for Summary Judgment, Memorandum in Support of Motion for Summary Judgment, Affidavit of J. Patrick McDavitt, Affidavit of Daniel S. Kleinberger, Order (proposed) and CD Rom (containing the exhibits to the Notice served herewith)*** on:

Larry B. Ricke, Esq.
Leonard Street & Deinard
150 South Fifth Street
Suite 2300
Minneapolis, MN 55402

by hand delivering to all parties copies thereof, enclosed in an envelope, directed to said party at the last known addresses of said parties.

Dated: March 22, 2004

Stephanie Wood

Stephanie Wood
100 South Fifth Street, Suite 1200
Minneapolis, MN 55402
(612) 332-1030

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UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA

In re: Chapter 7 Case

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Debtor.

BKY Case Nos. 02-40284-02-40286

Jointly Administered

Brian F. Leonard, Trustee,

Plaintiff.

vs.

Roger J. Wikner,

Defendant.

ADV Case No. 03-4153

FINDINGS OF FACT, CONCLUSIONS OF LAW AND ORDER FOR JUDGMENT

This adversary proceeding came on before the Court on May 5, 2004, for hearing on the Plaintiff's motion for summary judgment against Defendant Roger Wikner ("**Defendant**").

Appearances were as noted on the record.

The Court having been fully advised upon all of the files, pleadings and proceedings herein, issues the following Findings of Fact and Conclusions of Law pursuant to Bankruptcy Rule 7052.

FINDINGS OF FACT

1. Plaintiff, Brian F. Leonard ("**Trustee**"), is the duly qualified and acting Trustee in the above-captioned bankruptcy cases.

2. These bankruptcy cases were voluntarily filed by the Debtors under Chapter 7 of the Bankruptcy Code on January 22, 2002.

3. The Trustee requested an order granting summary judgment against each Defendant James E. Iverson ("**Iverson**") in Adv. No. 03-4155 and Defendant Roger Wikner ("**Wikner**") in Adv. No. 03-4153 (Iverson and Wikner are sometimes collectively referred to herein as "**Defendants**").

4. At all times material herein, and through July 31, 1997, Defendants were significant shareholders of Debtor Miller & Schroeder, Inc. (now known as SRC Holding, Inc.) ("**MSI**") (MSI, as used herein, includes its subsidiaries), each owning approximately 49% of the shares of MSI.[1] Together, Defendants were the controlling shareholders of MSI.

5. At all times material to this motion, Defendants in addition to being shareholders were directors and officers of MSI.

6. The Trustee seeks, in part, to recover assets of MSI which he alleges were inappropriately used to fund the purchase of Defendant's stock or for which MSI expended in furtherance of the stock purchase, and for which it received no value.

7. Defendant Iverson owed the Debtors the sum of $1,190,951.50 as of June 20, 1997. This amount was owed for loans, advances and unearned bonuses. The loans were evidenced by promissory notes. The amounts owed are summarized on Closing Statement Certificate and Receipt dated July 31, 1997.

8. Defendant Wikner owed the Debtor the sum of $795,992.29 as of June 20, 1997. This amount was owed for loans, advances and country club dues. The "loans" were evidenced by promissory notes. Again, the amounts owed are detailed in the Closing Statement Certificate and Receipt.

9. Defendants have admitted that the amounts stated in the Closing Statement Certificate and Receipt were, in fact, due to MSI as of July 31, 1997.

10. On or about February 28, 1997, James F. Dlugosch offered $16,400,000.00 for all the stock of MSI. Mr. Dlugosch's offer letter stated that, "In addition, $1,400,000 of the purchase price will be paid over a seven year period as compensation for consulting services and the execution of a non-compete agreement."

11. Pursuant to a Stock Purchase Agreement signed July 31,1997, dated June 20, 1997 and effective June 1, 1997 ("**Stock Purchase Agreement**"), Defendants sold their personal shares

[1]MSI was the parent of Miller & Schroeder Financial, Inc. and Miller & Schroeder Investments, Inc.

of stock in MSI to MI Acquisition Corporation ("**MIAC**"), for the amount of $7,310,725.55, each. The original purchase price for all of the shares of MSI sold under the Stock Purchase Agreement was $15,000,000.00. (The price was subsequently adjusted downward in December of 1997 by $1,274,874.10, bringing the total purchase price to $13,725,126.00.)

12. Paragraph 5.5 of the Stock Purchase Agreement required Defendants to "at or prior to closing pay the full amount of the principal and interest on his outstanding notes and advances owed to the Company or any Subsidiary." This was also made a condition of closing.

13. Notwithstanding the requirements of the Purchase Agreement, Defendants did not repay their debts to MSI. Instead, Defendants walked away from MSI on July 31, 1997 without ensuring that their debts would be paid. This action directly harmed MSI by the sum of at least $1,986,942.70 (the "**Released Obligations**").

14. MSI received no consideration for the Released Obligations. MSI, in effect, paid $1,986,942.70 of MIAC's purchase price of Wikner and Iverson's shares.

15. After the closing on July 31, 1997, accounting records were created which purport to show MIAC owed MSI and its subsidiaries roughly $2 million dollars as an "advance." There are no real economic transactions underlying these entries. In other words, MIAC did not ever "advance" money or money's worth to MSI or vice versa. Mr. Dlugosch, President of MIAC, testified that the $2 million was "accounting treatment."

16. MIAC could not pay MSI $2 million dollars because all of its funds went to Defendants in furtherance of the Stock Purchase Agreement. MIAC had no other funds.

17. The "Settlement Agreement" dated December 11, 1997 does not support Defendants' defenses of "release."

18. Subsequent to the Stock Purchase Agreement, and immaterial to this motion, MIAC and MSI merged on May 8, 2000, with MSI being the surviving corporation which then took on MSI's name ("**Miller & Schroeder, Inc.**"). Under the Articles of Merger, MIAC received all the assets and liabilities of MSI.

19. MSI was either insolvent or in the zone or vicinity of insolvency on July 31, 1997.

20. Wikner and Iverson allowed the Stock Purchase Agreement to close without ensuring that their liabilities to MSI would, in fact, be satisfied. The only alleged evidence that the debts were "satisfied" are accounting entries of MIAC generated after the closing. There never was cash paid to MSI, there was never a real economic transaction and Defendants rely solely upon "accounting treatment."

21. Prior to closing on July 31, 1997, MSI had promissory notes and detailed accounting entries evidencing its entitlement to payment from two debtors (Defendants) who had, it appears, substantial assets. <u>After the closing, MSI, was left with no means whatsoever to pay its debts</u>. Defendants claim that their debts were supplanted by an accounting entry showing a debt owed by MIAC to MSI. However, MIAC had substantial debt and its only asset was its interest in MSI. Any MSI claim against MIAC would have been futile.

22. Defendants treated the money paid to them by MIAC as a capital gain. Neither reported forgiveness of debt despite the fact that their debts were never satisfied. This allowed each to achieve a better tax rate on the sale transaction (i.e., capital gain vs. ordinary income).

23. The Trustee seeks summary judgment on the issue of the Defendants' liability to Plaintiff in the amount of $1,190,451.50 (Iverson) and $795,992.29 (Wikner), which represents the damages suffered by the Debtors for the waste of corporate assets and the *ultra vires* acts committed by Defendants against the interests of MSI as described herein. The Trustee submits that each should be accountable for the whole loss to MSI - $1,986,942.70.

24. There is no corporate resolution approving the transaction at bar nor ratifying the same on the part of MSI. Additionally, there are no corporate records authorizing, nor other records substantiations, the "advances" upon which Defendants rely for their defense.

25. <u>Prior</u> to the Stock Purchase Agreement, each Defendant had an employment contract with MSI. Each Employment Contract protected against use of proprietary information after employment (§ 3.1) and restricted employment for one year (§ 3.2).

26. At the closing of the Stock Purchase Agreement, Defendants each executed new noncompetition agreements with MSI. Whereas their preexisting noncompetition agreements did not provide for compensation, the new agreements provided that Wikner would receive four years of monthly payments of $14,585.00 ($700,080.00) and Iverson would receive seven years of monthly payments of $1,200.00 ($100,800.00). Wikner received all of his payments ($700,080.00). Iverson received his payments through the bankruptcy filing on January 22, 2001 ($50,400.00). These noncompetition agreements were entered into between MSI and Defendants at the behest of MIAC. There is no evidence that MSI, independently, was unsatisfied with its preexisting arrangement.

27. MIAC's attorneys' records which show that the MIAC and Defendants initially were negotiating "consulting agreements" and that those morphed into noncompetition agreements.

28. Each of the Debtors were insolvent in the year prior to filing. These cases have, in aggregate, in excess of $50 million in claims filed and the assets in these cases are, at present, approximately $500,000.00.

29. The payments to Defendants in the years prior to filing allowed them to receive more than they otherwise would receive as creditors of these estates pursuant to 11 U.S.C. § 547(b)(5).

30. The demand is calculated as follows:

Wikner forgiveness	$795,992.29
Wikner noncompete payments	$700,080.00
Iverson forgiveness	$1,190,951.50
Iverson noncompete payments	$50,400.00
TOTAL:	$2,737,423.70

CONCLUSIONS OF LAW

1. Pursuant to Rule 7056 of the Federal Rules of Bankruptcy Procedure and Rule 56 of the Federal Rules of Civil Procedure, Plaintiff is entitled to summary judgment.

2. By virtue of causing their personal obligations to MSI to be released, Defendants Iverson and Wikner committed the most egregious acts which a fiduciary can commit, a waste of a substantial corporate asset. They walked away from closing on July 31, 1997 without ensuring that MSI would be made whole. MSI and its creditors lost a valuable asset.

3. MSI was either insolvent or within the zone or vicinity of insolvency on July 31, 1997.

4. The noncompetition agreements were nothing more than a sham vehicle to have MSI pay part of MIAC's purchase price. The fact that the agreements started out as consulting agreements and switched to noncompete agreements, together with the fact that Defendants already had in place a noncompete agreement with MSI, evidences the lack of sincerity in those agreements. Further, all witnesses have testified that the new noncompetition agreements were of the behest of MIAC - not MSI.

5. In any event, MSI received no consideration for the new noncompetition agreements.

6. Defendant breached his fiduciary duties owed to MSI.

7. The release of debt, together with the newly created noncompetition agreements, constitute fraudulent transfers as MSI was insolvent and did not receive reasonably equivalent value.

8. The Trustee has established that Defendants converted MSI's assets to the extent of $2,737,423.70.

9. Iverson and Wikner were unjustly enriched by the forgiveness of their debt and the payments that they received under the noncompetition agreements.

10. The payments that each Defendant Iverson and Wikner received in the year prior to filing of this case constituted preferential transfers.

11. Plaintiff may recover from Defendant Wikner the following pursuant to 11 U.S.C. §550:

Wikner forgiveness	$795,992.29
Wikner noncompete payments	$700,080.00
Iverson forgiveness	$1,190,951.50
Iverson noncompete payments	$50,400.00
TOTAL:	$2,737,423.70

ORDER

IT IS, THEREFORE, ORDERED AND ADJUDGED:

That Judgment be entered:

a. Awarding Plaintiff a judgment against Defendant Wikner, in the amount of $2,737,423.70 together with prejudgment interest thereon;

b. Award Plaintiff his costs and disbursements incurred herein.

LET JUDGMENT BE ENTERED ACCORDINGLY

Dated: ____________________, 2004

____
Nancy C. Dreher
US Bankruptcy Judge

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