UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re:
Immedia Duplication Services, Inc. BKY No. 3-93-1044
Debtor.

Randy Sullivan, as Trustee of ADV No. 3-94-223
Immedia Duplication Services, Inc.,
Plaintiff,
v.
David Russ and Immedia, Inc., ORDER
Defendants.

This adversary proceeding came on for trial August 17 and 18, 1995. Appearances were noted on the record. The Court, having received and considered the evidence presented at trial; having heard arguments of counsel; and, otherwise being fully advised on the matter; now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.
OVERVIEW.

This adversary proceeding is the aftermath of a struggle between two groups for the acquisition and control of Immedia Duplication Services, Inc. (IDSI), a bankrupt company. It is, essentially, a grudge action, brought by a principal of the party that lost the struggle before the filing of the bankruptcy case, against the party that won the struggle - but lost the company.

The Trustee seeks to avoid a prepetition transfer of the Debtor's assets to David Russ, an insider of the Debtor, and his company, Immedia, Inc. Mr. Russ repossessed the assets of IDSI pursuant to a security agreement. The security agreement secured the payment of a company note that he had purchased from IDSI's lender. The transfer was made while Kevin Lamson and his group, the Warren Utz Partnership, were seeking takeover of IDSI through the acquisition of stock and a company note held by the company's major stockholder.
An involuntary petition was filed under 11 U.S.C. Chapter 7 against IDSI on March 7 against IDSI on March 5, 1993, after the transfer.

This action, brought by the Trustee at the direction of the Lamson group, seeks to avoid the repossession as: a fraudulent transfer under federal and state law, 11 U.S.C. Section 548 and M.S.A. Section 513.41 et seq.; and, as a preferential transfer under 11 U.S.C. Section 547. Alternatively, the Trustee seeks judgment against the Defendants for conversion.

IDSI received equivalent value for the assets transferred. Russ did not receive more than he would have received had the case been a case under Chapter 7 when the transfer was made. The Trustee did not prove conversion by the Defendants. Accordingly, none of the causes of action prevails; and, judgment is ordered for the Defendants.

II.
FACTS.

History of Financial distress.

IDSI began business operations in 1986. The company duplicated computer software discs from master discs, primarily for video games, to be distributed and sold by others. IDSI

suffered financial losses for several years prior to its involuntary bankruptcy filing. IDSI's balance sheets reveal accumulated net deficits of $316,180 in 1990, and $304,675 in 1991. The first six months of 1992, resulted in net operating losses of $116,000; for July 1992, net operating losses of $21,835; and, for August 1992, net operating losses of $21,315. Operation during the first 11 days of September 1992, alone, resulted in net losses of $21,915.

Resource Bank and Trust (Resource), held a line of credit available for the Debtor, from 1989 through September 1992. Resource secured the credit line with all of IDSI's assets. During their financial relationship, IDSI paid down the line through a lockbox arrangement. As incoming receivables were collected, each payment was made directly to the lockbox, and the line of credit was reduced accordingly.

During 1991, Resource became increasingly nervous about the financial stability of the Debtor. Jewell Mohn, a representative of Resource in charge of the account, testified that IDSI's loan had been classified as substandard by the bank's examiners. In 1992, Resource began pressuring IDSI to increase efforts to collect its accounts receivables. IDSI's line of credit exceeded $200,000. By that summer, Resource had decided to end the relationship.

The Lamson Connection.

IDSI also suffered financial distress defending itself in litigation commenced by the Warren Utz Partnership.(FN1) The litigation centered around a note held by the Partnership, commonly referred to as the "Gearman Note". In January, 1987, Arvin Gearman, then IDSI's major shareholder, loaned the company $350,000. IDSI executed a note, and a duly recorded security agreement, for the loan. Gearman received a security interest in all of the Debtor's collateral. On August 19, 1988, when IDSI received its line of credit form Resource Bank, Gearman released his interest in the Debtor's collateral.

On May 15, 1992, Peter Shapps, a general partner in the Utz Partnership, purchased the "Gearman Note" at a Washington County sheriff's sale for $600. The sale was part of an execution of a judgment against Gearman. Shapp's interest in the "Gearman Note" was later assigned to the Warren Utz Partnership. The Partnership attempted to foreclose what it claimed was a subordinated junior security interest in IDSI, through an action commenced in Hennepin County District Court. However, the Honorable Lucy Weiland, Hennepin County District Court, ultimately held that the Warren Utz Partnership was an unsecured creditor, and had no lien to foreclose. (FN2)

The Warren Utz Partnership also purchased Gearman's shares in IDSI at the sheriff's sale. The Partnership now held 65% of the shares in IDSI. After purchasing the shares, the Partnership called a meeting of shareholders, and elected Kevin Lamson and Robert Olson officers in the corporation. The Debtor's new board then turned-out IDSI's management; specifically terminating Phillip Buckstein and Thomas Hau, both officers and directors of IDSI.

Hau and Buckstein commenced an action in Anoka County District Court, to enjoin the new board from any activity involving the management of IDSI. They were awarded injunctive relief; the original management was returned; and, Hau and Buckstein were reinstated in their previous positions.

The David Russ, Immedia, Inc. Connection.

Buckstein was introduced to David Russ in the fall of 1991. Russ was a principal of Premier Management, Inc., a company that provided marketing and sales advice to businesses. Russ became

actively involved in IDSI in the summer of 1992. According to Buckstein, his role was limited to consulting with IDSI in efforts to increase sales, and to improve customer relations and personnel decisions. Buckstein testified that he accepted Russ' advice, because he believed Russ was interested in investing in the company. In fact, Russ intended takeover of the company, and positioned himself to run the business in the meantime.

In September of 1992, after negotiations with Resource, Russ stepped in to guaranty the Resource note, pledging as additional collateral, a $70,000 personal savings account. On September 9, Russ formed Immedia, Inc., with Hau and Buckstein. Russ owned 40%, and Hau and Buckstein each owned 30%.

Then, on September 11, 1992, Russ purchased the Resource note, and all rights and interests under the security agreement. He paid the original $70,000 pledged personal savings on deposit, and he gave his own note for $160,000, to acquire the Resource note. The Russ note became secured by all of the assets of IDSI; the same assets that secured the Resource note.

On September 16, 1992, Russ served a notice of default on IDSI regarding the Resource note that he held. The notice declared that the note was in default; it acknowledged Russ' lawful recovery of his security interest; and, it stated that it was served in accordance with M.S.A. Section 336.9-503. Russ took control of the assets of IDSI, including the accounts receivable, notes and contract rights; and, he accepted them in satisfaction of the Resource note. The note had a balance of $211,000 at foreclosure.

That same day, Hau and Buckstein executed a Consent of Immedia Duplication Services, Inc., to Russ' foreclosure of his security interest. The Consent renounced the rights of IDSI under the Uniform Commercial Code, and acknowledged the company's voluntary surrender of the assets. From September 16, 1992, to November 11, 1992, IDSI collected $112,000 in accounts receivable, which reduced the $160,000 Russ Note, through the lockbox arrangement that was continued with Resource.

On November 11, 1992, Russ sold the assets of IDSI to Immedia, Inc., for $237,409. The business continued to do poorly, however. The Warren Utz Partnership continued its pursuit of the assets through various litigation strategies. IDSI finally ceased business in February of 1993, after the Lamson group succeeded in levying on a company account, taking approximately $30,000. Russ sold the hard assets in April 1993. He advertised the sale, and received $35,000 for them.

The Financial Statements.

The business had always performed poorly. Every reported period disclosed substantial operating losses, except for 1991. That year produced a net income of $11,505. All of IDSI's financial documents, balance sheets, and income statements were prepared internally. Phillip Buckstein was employed as IDSI's accountant and Vice-President of Finance. He was responsible for preparing the monthly balance sheets and related financial documents.(FN3) Following, is how the company's balance sheet appeared as of August 1992, the last full month prior to the repossession by Russ:

Current Assets,

Cash In Bank	-22,250
Trade Receivables	264,852
Other Cur. Assets	12,552
Inventory	131,127

Notes Receivable	276,430
Total Cur. Assets	$662,771
Fixed Assets	
Due From stkhldrs	5,024
Furniture & Fixtures	9,518
Machinery & Equipment	737,092
Leasehold Impr.	68,082
less acc. depr.	-713,358
Net Fixed Assets	$106,358
Total Assets	$769,129
Current Liabilities	
Line of Credit	210,000
Accounts Pay. Trd.	367,390
Accrued Expense	222,145
Total Current Liab.	799,585
Noncurrent Liab.	
Sub. Nt. Pay. Rel. Pty.	186,031
Total Liabilities	$985,616
Stockholder's Eq.	
Common Stock	12,307
Add Pd. in Cap.	242,219
Retained Ernngs. Pr.	-304,770
Cur. Year's Ernngs.	166,243
Total Sthldr. Equity	-$216,487
Tl. Lia. & Sthldr. Eq.	$769,129

An Immedia, Inc., balance sheet, dated November 24, 1992, for the period ending October 31, 1992, "booked" the value of the assets at $679,154.(FN4) The asset values were completely fanciful. The hard assets were sold within six months for $35,000. Russ eventually wrote off, as uncollectible, the note receivable of $276,438; and, he was able to collect only $66,000 of the $264,852 trade accounts receivable stated on the IDSI August balance sheet.(FN5) Jewell Mohn, the officer at Resource Bank, who had been in charge of the loan for the Bank, testified that in 1992, he believed that the value of the Bank's collateral marginally covered the loan. He was right.

The Filing.

IDSI was filed as an involuntary case under chapter 7 on March 5, 1993. Randy Sullivan was later elected Interim Trustee on February 23, 1994, sponsored by the Lamson group. This adversary proceeding was commenced by the Trustee on October 28, 1994.

III.
ANALYSIS.

Fraudulent Transfer.

11 U.S.C. Section 548 provides, in pertinent part:

> (a) The Trustee may avoid any transfer of an interest of the debtor in property, or any obligation incurred by the debtor, that was made or incurred on or within one year before the date of the filing of the petition, if the debtor voluntarily or involuntarily--
>
> (1) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or
>
> (2)(A) received less than a reasonably equivalent value in exchange for such transfer or obligation; and
>
> (B)(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;...

A. Fraudulent Transfer per 11 U.S.C. Section 548(a)(2) and M.S.A. Section 513.45

The Trustee seeks to avoid the transfer of IDSI's assets to Russ, through the foreclosure on the Resource note, as a violation of 11 U.S.C. Section 548 (a)(2) and M.S.A. Section 513.45.(FN6) There are four elements to a fraudulent transfer under the statutes. They are: (1) that a transfer was made; (2) on or within one year before the date of the filing of the petition; (3) where the debtor received less than a reasonably equivalent value in exchange for the transfer; and, (4) where the debtor was insolvent on the date that the transfer was made, or became insolvent as a result of the transfer. The burden of proving each of these four elements is on the Trustee. In re Minnesota Utility Contracting, Inc., 110 B.R. 414 (Bkrtcy. D. Minn. 1990).

The parties do not dispute that a transfer occurred on September 16, 1992, through the foreclosure by Russ on the Resource note. The first issue here, then, is whether IDSI received less than the reasonably equivalent value of what was transferred to Russ in the transaction. The second issue, if it be determined that IDSI received less than reasonably equivalent value, is whether IDSI was , or was rendered, insolvent.

Value is determined as of the transfer. In re Morris Communications NC, Inc., 914 F.2d 458 (4th Cir. 1990). The Trustee argues that both IDSI's own August balance sheet, valuing its assets at $769,129, only one month prior to the transfer; and, Immedia Inc.'s October balance sheet, booking the assets at $679,154, only one month after the transfer; are conclusive evidence that IDSI received far less than it transferred in the transaction. According to the Trustee, IDSI was shortchanged by at least $558,129, which is the difference between what it parted with ($769,129 in assets) and what it received ($211,000 debt cancellation).(FN7)

Reasonable equivalence of value is a fact question. In re Minnesota Utility Contracting, Inc., 110 B.R. 414 (Bkrtcy. D. Minn. 1990). In determining whether a debtor has received reasonable equivalent value for a transfer, courts consider the purpose of the

requirement, which is to conserve the debtor's estate for the benefit of the creditors. Minnesota Utility, at 420. In considering the factors bearing on the transfer or sale of the debtor's assets, the issue is whether the debtor received a fair market value for the property. In re Ozark Restaurant Equipment Co., Inc., 850 F 2d. 342 (8th Cir. 1988). The consideration offered in exchange for the transfer may provide either a direct or indirect benefit to the debtor. An indirect benefit, however, must be fairly concrete. Id.

The pre-transfer financial history of IDSI, and the August balance sheet itself, indicates that there was no correlation between the "book" and "market" values of the assets. Most of the stated value on the balance sheet represented current assets. The machinery and equipment had been depreciated from $737,092 by $713,358. The equipment consisted of old assets in a rapidly changing technology industry. Throughout 1992, Resource was increasingly nervous about IDSI's financial situation, and was especially concerned about the value of its security interest. Russ was the only prospective investor that approached IDSI or Resource. IDSI's consistent and substantial losses; the inability to right itself, for nearly three years; and, lack of investor interest; suggested inflated asset values on its balance sheet.

While value is determined as of the transfer, events subsequent to the transfer can be relevant in consideration and determination of value at transfer. Such is the case here. For example, the note receivable of $276,490 was never collected, and ultimately written off. Only $66,000 of the approximately $254,000 in trade receivables, was collected. The stated values of the current assets on the August 1992, IDSI balance sheet, were fictional.(FN8)

The hard assets were overstated as well. They were sold six months after the acquisition for $35,000. Given: the financial history of IDSI; the state of the balance sheet itself; and, the post-transfer history of the business through liquidation; asset values significantly in excess of the amount owing on the Resource note, are simply not credible.

The value of what IDSI received in the transfer, satisfaction of the Resource debt in the amount of $211,000, was substantially equal to the value of the assets transferred in the foreclosure. The insolvency issue is not reached. The transfer was not fraudulent under 11 U.S.C. Section 548(a)(2)(A) or M.S.A. Section 513.45.

B. Transfer to Hinder, Delay or Defraud per 11 U.S.C. Section 548 (A)(1)

The Trustee also seeks to avoid the transfer pursuant to 11 U.S.C. Section 548 (A)(1), alleging that Russ, Hau and Buckstein schemed, with actual and inferable intent, to defraud IDSI's creditors. Fraudulent intent can be shown by direct evidence, or by "badges of fraud" from which actual fraud may be inferred. Max Sugarman Funeral Home, Inc. v. A.D.B. Investors, 926 F.2d. 1248 (1st Cir. 1991). A number of factors may infer fraud, such as: (1) actual or threatened litigation against a debtor; (2) purported transfer of all or nearly all of a debtor's property; (3) insolvency or other unmanageable debt of the transferor; (4) a special relationship between the transferor and transferee; and, after transfer; or, (5) retention of possession of property by the transferor. Id. at 1254. The presence of a single badge of fraud may spur mere suspicion, but the confluence of several can constitute conducive evidence of an actual intent to defraud, absent "significantly clear" evidence of a legitimate supervening

purpose. Id. at 1254-1255. However, the presence of one or more badges is not determinative of the question.

The Trustee points to numerous facts and circumstances that he claims present evidence of actual fraud, and clear badges of fraud, on the part of the Defendants. They involve actions taken by Russ from inside IDSI, while the Warren Utz Partnership was attempting to assert its rights from the outside. The simple fact is, however, the actions by Russ were competing with the actions by Lamson, through the Warren Utz Partnership. Both were after the same prize, such as it was. That is takeover of IDSI. Lamson pursued a strategy from the outside, through acquisition of stock, and what he believed was secured debt. Russ pursued a strategy from the inside, through acquisition of secured debt and its foreclosure. Russ prevailed. But, in winning the contest, and the dubious prize, he did not defraud or hinder creditors in general, or the Lamson group in particular. Russ took no undue advantage of anyone; he took no more from IDSI than he gave it. A corporate takeover is not necessarily a fraud on creditors, simply because it occurs. Fraud has not been shown under 11 U.S.C. Section 548 (A)(1).

Preferential Transfer Under 11 U.S.C. Section 547.

The Trustee also claims that Russ received a preferential transfer. He seeks to avoid the transfer under 11 U.S.C. Section 547(b), subparagraphs (4) and (5).

11 U.S.C. Section 547 provides, in pertinent part:

> (b) Except as provided in subsection (c) this section, the trustee may avoid any transfer of an interest of the debtor in property--
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made---
>
> (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if--
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. Section 101(31) defines an "insider" as:

(31) insider' includes--

(B) if the debtor is a corporation--

(I) director of the debtor;
(ii) officer of the debtor;
(iii) person in control of the debtor;..."

Russ was an insider. He clearly controlled IDSI at the time of the transfer, which was made within one year prior to filing of the petition. But, he did not receive more than he would have received: if the case were a case under Chapter 7 at the time of the transfer; and, if the transfer had not been made. Russ held a security interest in the assets transferred. The assets were worth no more than the value of the security interest. If IDSI had been in Chapter 7 at the time of the transfer, Russ would have been entitled to relief from stay to foreclose, and he would have received the same value.

Conversion.

Finally, the Trustee contends that the transfer constituted the tort of conversion. He argues that, when a transfer arises out of a wrongful foreclosure or repossession of collateral by a secured creditor, the transfer is a conversion. The Trustee contends the foreclosure, commenced by the default notice, was irregular; and, that the subsequent voluntary turnover was wrongful.

The Trustee failed to show that Russ wrongfully served the notice of default upon IDSI on September 16, 1992. Surrender of the assets by the company was voluntary, and there was no breach of the peace. Russ exercised his interest as the first secured creditor, and IDSI turned over its collateral as required under the Uniform Commercial Code. There was no objection to this notice of default, and Russ was not obligated to seek further judicial relief to obtain possession of the assets. The Trustee's claim that the transfer constituted conversion is not credible.

IV.

DISPOSITION

Based on the foregoing, it is hereby ORDERED: that repossession of assets of Immedia Duplication Services, Inc., on September 16, 1992, by David Russ, as secured creditor, was not a fraudulent or preferential transfer; and, the transfer did not constitute conversion.
LET JUDGEMENT BE ENTERED FOR THE DEFENDANTS, ACCORDINGLY.

Dated: November 13, 1995. By the Court:

Dennis D. O'Brien
Chief U.S. Bankruptcy Judge

(FN1) The Warren Utz Partnershiiiip was an entity formed by Kevin Lamson and others associated with his company, Marrit Acquisition.

(FN2) Warren Utz Partners, a Minnesota Limited Partnership v. David Russ, an individual, Immedia, Inc., a Minnesota Corporation, Henn.Cty. Cistrict Court

CT 92-23105 (December 3, 1993).

(FN3) The IDSI corporate tax returns were prepared by an independent accounting firm, which relied upon the financial records and information provided by Buckstein.

(FN4) However, Immedia, Inc. did not acquire the assets until November 11, 1992.

(FN5) According to Plaintiff's Exhibit 14, $248,390.36 in trade receivables existed as of September 11, 1992. The exhibit shows those accounts receivable through Februrary 21, 1995, remaining in the amount of $158,111. The difference, $90,279.92, would ordinarily represent the amount actually collected on the accounts. However, a number of post-acquistion accounts receivable appear to have been mixed in with the payment calculations, the largest being an account receivable of Artist Graphics in the amount of $24,360.85. Backing that transaction out of the calculation results in $65,918.35, as the amount actually collected.

(FN6) The state statute is virtually the same as the federal statute. While the discussion refers only to 11 U.S.C. Section 548, it equally applies to M.S.A. Section 513.45.

(FN7) The Trustee offered evidence through his expert, Harold Baker, that IDSIhad an additional "going concern" value of $117,000. None of Mr. Baker's testimony regarding value was persuasive. He simply accepted the value of the assets as they were booked, and tacked on a going concern value. Mr. Baker considered nothing else, and had no special knowledge of the assets, their condition, or of the industry.

(FN8) To book assets at substantially more than they are worth is to play a dangerous game; but, "booked" value does not establish market value. The inflated book balues on November 24, 1992, Immedia statement are no more persuasive of market value than the values on the IDSI statement.