UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In re:
Chapter 11 Case

JTG Acquisition Corporation,
BKY Case No. 3-89-4139

Debtor.

MEMORANDUM ORDER

This matter came before the Court on September 30, 1991 on JTG Acquisition Corporation's (JTG) motion for summary judgment that the claims of the City of Minneapolis (City) and the Minneapolis Community Development Agency (MCDA) be disallowed. Michael A. Nekich appeared for JTG. James A. Rubenstein and Timothy J. Nolan appeared for the City and MCDA. This is a core proceeding under 28 U.S.C. Sections 1334 and 157(a) and Local Rule 201. The Court has jurisdiction to determine this matter under 28 U.S.C. Section 157(b)(2)(B). Based upon all of the files and records in this case, being fully advised in the premises, the Court now makes the following order pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.
FACTS

JTG was formed in 1987 as a successor entity to the Jefferson Company (Jefferson). JTG is the parent company for the transportation related businesses: Jefferson Transportation Group, Inc. (Transportation); Jefferson Lines, Inc.; and Jefferson Tours and Travel Services, Inc. Prior to the formation of JTG, Jefferson controlled various corporate entities operating in transportation-related and real estate development businesses.

In 1984, Jefferson guaranteed the obligations of one of its real estate subsidiaries, Upton Association Limited Partnership (Upton), in connection with financing and development of St. Anthony Main. On December 1, 1984, Jefferson and MCDA entered into a Guaranty Agreement which bound Jefferson as guarantor for \$1,140,000 under a 1984 lease agreement between Upton and MCDA. On December 7, 1984, Jefferson and the City entered into a Guaranty Agreement which obligated Jefferson to guarantee payments of \$900,000 under a Combination Development and Loan Agreement between Upton and the City. Jefferson pledged 60 shares of Transportation stock (Jefferson's only valuable asset) as collateral for its guarantees to the City and MCDA.

Due to general decline in commercial real estate business, Jefferson's real estate subsidiaries suffered financial difficulties which created a financial strain upon the entire family of Jefferson entities. This strain increased as the transportation group was forced to help finance the debt-ridden operations of the real estate group. In January 1986, Jefferson restructured its subsidiaries into two distinct groups under two entirely separate subsidiary holding companies. Transportation controlled the transportation businesses of Jefferson. The Jefferson Real Estate Group (Real Estate) controlled Jefferson's real estate businesses. Both Transportation and Real Estate were under the control of Jefferson.

Norwest Banks (Norwest) issued a substantial amount of credit to Jefferson and to Jefferson subsidiaries. According to the Stock Purchase Agreement of September 24, 1987 between JTG and Norwest, Jefferson's outstanding indebtedness to Norwest for loans and guarantees totalled $4,351,169.80. In connection with its borrowing, Jefferson granted Norwest a first secured position in all of the inventory, accounts receivable, general intangibles, motor coaches, real estate of Transportation and its subsidiaries, and all shares of Transportation stock (60 shares). In late 1986, Jefferson looked for new credit facilities to continue its operation, and on October 28, 1986, the board of directors of Transportation adopted a letter of credit for the purpose of financing continued operations for $1,000,000 from Central Trust Company of Cleveland, Ohio (Central). The letter of credit was adopted in favor of Norwest to secure a loan of $975,000 from Norwest to Transportation. On December 4, 1986, Central also authorized, based upon the personal guarantee of Louis Nippert,(1) a $5,500,000 letter of credit to Transportation, for the purpose of debt restructuring. However, this letter of credit was never adopted by Transportation.

Footnote 1
Louis Nippert is related to the Zelle Family, the major shareholders of Jefferson and JTG. Nippert made his guarantee of the $5,500,000 letter of credit subject to the condition that it only be made available to, and that it provide for, the restructuring of the transportation companies.
End Footnote

By early 1987, Jefferson's debts to Norwest were in default and Norwest prepared to exercise its option to foreclose on the 60 shares of Transportation stock. In connection with the foreclosure, Transportation retained Dain Bosworth, Inc. (Dain), on May 16, 1987, to value 100% of the Transportation stock as a going concern. At this time, JTG was formed by a number of Jefferson shareholders for the express purpose of purchasing the 60 shares of Transportation stock from Norwest after the foreclosure. On June 22, 1987, JTG's board of directors adopted the issuance of the $5,500,000 letter of credit from Central (initially made available to Transportation) to JTG in order to assist JTG in its proposed purchase of the Transportation shares when foreclosed. On September 3, 1987, Norwest sent JTG a letter outlining the terms by which JTG could purchase the foreclosed Transportation stock from Norwest. On September 16, 1987, Dain valued the Transportation stock between $200,000 and $400,000.

On September 24, 1987, Norwest commenced foreclosure proceedings for the Transportation stock under the Security Agreement between Norwest and Jefferson. Jefferson's sole equity for its guarantee of the its real estate obligations to the City and MCDA was the same 60 shares of Transportation stock being foreclosed. Therefore, the foreclosure left Jefferson insolvent and unable to fulfill its guarantee obligations to the City and MCDA. Ultimately, Jefferson was dissolved.

After the foreclosure against the Transportation shares, JTG immediately entered a Stock Purchase Agreement with Norwest in the amount of $1,700,000 for the shares. At the closing, JTG paid $500,000 cash and gave Norwest a promissory note for $1,200,000. JTG received a $4,750,000 loan from Western and Southern Insurance Company (Western), based on the $5,500,000 letter of credit ultimately issued to JTG by Central. JTG used the proceeds of Western's loan to satisfy the conditions of closing the Stock Purchase Agreement. According to the conditions in the agreement, JTG transferred $3,473,767.21 to Norwest.(2) Norwest released $1,056,402.59 of Jefferson's $4,531,169.80 total indebtedness as part of the transaction.

Footnote 2
In addition to the $500,000 cash payment, Norwest required the following payments as conditions of closing: Full payment of principal and interest on three promissory notes due to Norwest with original principal amounts of $1,700,000; $300,000; and $975,000. Additionally, Norwest required payment of Norwest's attorney's fee (which were not to exceed $20,000) and overdrafts on all accounts of Jefferson subsidiaries.
End Footnote

Two years later, JTG, Transportation, Jefferson Lines, and Jefferson Tours & Travel Services each filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code on October 27, 1989. The City and MCDA seek allowance of their claims as unsecured in the JTG bankruptcy case, based on the obligations guaranteed by Jefferson.

The City and MCDA argue that the purchase of the Transportation shares by JTG was a fraudulent transfer by Jefferson, JTG, and their subsidiaries in an attempt to hinder, delay, and defraud creditors. Additionally, the City and MCDA claim the officers and directors of JTG, Jefferson, and Transportation owed and breached a fiduciary duty to creditors. The City and MCDA also argue that JTG is liable for Jefferson's obligations based on a theory of successor corporate liability. Finally, the City and MCDA argue that the conduct of Jefferson and JTG shareholders was so inequitable as to warrant a remedy of equitable subordination of the JTG shareholder interest to their claims.(3)

Footnote 3
These theories are not being argued as separate causes of action asserted by the City and MCDA, but rather as providing an equitable basis for recognition of their claims against JTG as opposed to Jefferson.
End Footnote

JTG objects to the claims and filed this motion for summary judgment against their allowance. It argues that: no fraudulent transfer occurred; JTG is neither an officer nor a director of Jefferson and no fiduciary duty was owed to creditors of Jefferson; JTG cannot be responsible for the debts of Jefferson under a theory of successor corporate liability; and, that JTG engaged in no inequitable conduct which would require a remedy of equitable subordination.

## II.
## ISSUES

1. Did JTG acquire the 60 shares of Transportation in a foreclosure sale from Norwest by means of a fraudulent transfer?

2. Did JTG violate a fiduciary duty it owed to the City and MCDA by purchasing the 60 shares of Transportation?

3. Can the City and MCDA base their claims against JTG on a theory of successor liability?

4. Did JTG shareholders engage in conduct so inequitable that the City and MCDA's claims should be recognized through equitable subordination?

## III.
## DISCUSSION

### 1. Were the shares purchased by JTG acquired by means of a fraudulent transfer?

JTG's motion for summary judgment may be granted if JTG shows that there is no genuine issue as to any material fact and that [JTG] is entitled to a judgment as a matter of law. See: Bankr. R. 3007, 9014, 7056; Loc. Bankr. R. 505; and, Fed.R.Civ.P. 56(c). JTG argues that there could be no fraudulent transfer because Norwest, not Jefferson was the transferor. However, a fraudulent transfer can result from an involuntary transfer, such as a foreclosure, and can be recoverable from a subsequent transferee. See: Minn.Stat.Section 513.48(b)(2); and, 11 U.S.C. Section 550. Furthermore, where a debtor enables a scheme that would result in a fraudulent transfer if accomplished by the debtor directly, the transfer is no less fraudulent because it is accomplished indirectly through the actions of another. Here, the difficulty with the City's and MCDA's argument is not with the theory, but with the facts. In this case, there is no evidence from which a finding of fraud could be made regarding the transaction.

According to the City and MCDA, Jefferson accomplished a transfer of the shares of Transportation in order to hinder, delay or defraud the City and MCDA in violation of Minn.Stat. Section 513.44(a)(1). Because Jefferson had given Norwest a first secured interest in all of Jefferson's assets, including the 60 shares of Transportation, and because the security foreclosed upon was far less in value than the amount of the underlying debt owed Norwest, there was no value to the City's and MCDA's security interest in the transferred shares.(4) No apparent realizable value to, or exercisable right by, the City and MCDA was denied them by the transaction; and neither has identified any.

Footnote 4
If the City and MCDA believed otherwise, they could have exercised their junior lien rights during the Norwest foreclosure. As junior perfected lienholders, the City and MCDA were entitled to written notice by Norwest of the foreclosure sale, assuming that they notified Norwest of their interest, and they could have purchased or redeemed the stock at the sale. See: Minn.Stat. Sections 336.9-504 and 336.9-506. Presumably, neither the City nor MCDA interfered with the foreclosure because they recognized that their interests represented no reasonably realizable value.
End Footnote

The City and MCDA also claim that Jefferson transferred the shares without receiving reasonably equivalent value for them in violation of Minn.Stat. Section 513.44(a)(2). The value

Jefferson received through the foreclosure of the shares of Transportation included the satisfaction of several notes it had guaranteed and the release of Jefferson from other obligations it owed Norwest. Even viewing the foreclosure and purchase as an entire transaction, Norwest forgave over $1 million in debt owed to it by Jefferson and its subsidiaries for which the shares served as collateral. This is far above Dain's estimated value of the shares transferred.

There is no alleged material fact of record that, if true, could support a claim of fraudulent transfer in the foreclosure and purchase of the Transportation shares complained of. The City and MCDA would not be entitled to any of the remedies allowable under Minn.Stat. Section 513.47. Furthermore, JTG would not be subject to a judgment under Minn.Stat.Section 513.48(b)(2) or 11 U.S.C. Section 550 as a subsequent transferee of the assets. Accordingly, the theory of fraudulent transfer cannot serve as an equitable basis for the allowance of a claim of the City and MCDA in the JTG bankruptcy case.

2. Did JTG owe a fiduciary duty to the City and MCDA?

According to the Minnesota Supreme Court in Snyder Electric Co. v. Fleming, "When a corporation is insolvent, or on the verge of insolvency, its directors and officers become fiduciaries of the corporate assets for the benefit of the creditors." 305 N.W.2d 863, 869 (Minn.App. 1981); see also: Honn v. Coin & Stamp Gallery, 407 N.W.2d 419,422-423 (Minn.App. 1987). Because of this fiduciary relationship, directors or officers cannot prefer themselves to the detriment of the other creditors.

However, this fiduciary duty is limited. When a corporation is insolvent or near insolvency, "officers and directors are fiduciaries with respect to creditors under Minnesota law, only to the limited extent that they are prohibited from securing for themselves, as creditors, a preference over other creditors." In re Metropolitan Cosmetic & Reconstructive Surgical Clinic, 115 B.R. 185, 187 (Bankr.D.Minn. 1990)(emphasis added). The officers and directors of Jefferson were under a fiduciary duty to the creditors of Jefferson, only to the extent that the officers and directors were also creditors of Jefferson; and then, only to the limited extent that they not prefer their own creditor claims over the similar claims of non-insider creditors. Mere insider status does not give rise to general fiduciary duties to creditors. Officers and directors owe general fiduciary duties to shareholders, not to creditors, of the company. Assigning general fiduciary duties to both could obviously guaranty the breach to one, since shareholders and creditors have inherently conflicting interests.

Certain officers, directors, and shareholder insiders of Jefferson participated in the formation of JTG and the purchase of the Transportation shares, but no breach of fiduciary duty has been shown. No officer, director, or other insider of Jefferson recovered his debt due to the foreclosure and acquisition of the Transportation shares. Additionally, Louis Zelle and Louis Nippert each either paid or pledged personal assets to enable JTG to acquire the shares.(5)

Footnote 5
As a condition to closing the Stock Purchase Agreement between JTG and Norwest, Louis Zelle was required to pay $125,000 to Norwest due to a
guarantee he gave for a prior Jefferson obligation. Louis Nippert gave

a
personal guarantee which allowed JTG to get the $5,500,000 letter of credit issued from Central.
End Footnote

Therefore, since neither creditor status nor preference has been shown, no fiduciary duty owed to the City and MCDA was violated. Accordingly, no fiduciary relationship or its breach can provide an equitable basis for the allowance of a claim of the City and MCDA in the JTG bankruptcy case.

3. Did JTG incur any liability for Jefferson's obligations based on successor liability?

The Minnesota standard regarding successor liability is:

[W]here one corporation sells or otherwise transfers all of its assets to another corporation, the latter is not liable for the debts and liabilities of the transferor, except:

(1) where the purchaser expressly or impliedly agrees to assume such debts;

(2) where the transaction amounts to a consolidation or merger of the corporation;

(3) where the purchasing corporation is merely a continuation of the selling corporation; and

(4) where the transaction is entered into fraudulently in order to escape liability for such debts.

J.F. Anderson Lumber Co. v. Myers, 296 Minn. 33, 37-38, 206 N.W.2d 365, 368-369 (1973); Niccum v. Hydra Tool Corp., 438 N.W.2d 96, 98 (Minn. 1990). An additional exception has been suggested, although this exception is sometimes included as part of the prior four exceptions:

(5) where there is inadequate consideration for the sale or transfer of assets.

Carstedt v. Grindeland, 406 N.W.2d 39, 41 (Minn.App. 1987).

There has been no showing of any express or implied agreement between Jefferson and JTG that JTG would assume all Jefferson's debts. Within the Stock Purchase Agreement, JTG was required to pay portions of outstanding Jefferson debts to Norwest. These were conditions to a purchase and not an implied assumption of debts. Furthermore, Norwest forgave over $1 million of Jefferson's debts. JTG was not merged with or merely a continuation of Jefferson. The fact that JTG dealt only with transportation businesses instead of both real estate and transportation businesses leads away from the traditional approach to "mere continuation" where continuity of business is an element of showing continuation. Niccum, 438 N.W.2d at 99. Additionally, there has been no showing of fraudulent transfer in this case. If the fifth exception is considered, JTG paid Norwest over $3.5 million for 60 shares of stock valued between $200,000 and $400,000. JTG paid more than adequate consideration for the shares of Transportation.

Because the facts fail to fulfill any of the exceptions to the non-liability rule, JTG cannot be held liable for the debts of Jefferson. Accordingly, the doctrine of successor liability cannot serve as an equitable basis for the allowance of a claim of the City and MCDA in the JTG bankruptcy case. 4. Were JTG shareholder actions so inequitable that equitable subordination should be required?

In Pepper v. Litton, 308 U.S. 295 (1939), the power of equitable subordination was granted to the bankruptcy court. This power was later codified in Section 510(c) which grants the court authority to " (1).

. . subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest; or (2) order that any lien securing such a subordinated claim be transferred to the estate." 11 U.S.C. Section 510(c).(6)

Footnote 6
Interestingly, neither 11 U.S.C. Section 510(c) nor case law references subordination of shareholder interests to claims. Such interests are by definition junior to claims, and need not be subordinated by application of any equitable doctrine. Whether, in theory, the concept of equitable subordination can be applied against shareholder interests to justify the allowance of an unsecured claim against an insolvent debtor company where none would otherwise exist, is questionable. Allowance would apparently prejudice other claims of the same and lower priority as much, or more, than equity interests. The question is not addressed here, however, because a case has not been made for equitable subordination even if the remedy is theoretically available
End Footnote

Although this grant of power to subordinate came without guidelines, courts have created a three-part test to determine, generally, whether equitable subordination is appropriate. These elements must be present to justify equitable subordination:

(i) The claimant must have engaged in some type of inequitable conduct.

(ii) The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant.

(iii) Equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy [Code].

In re Bellanca, 850 F.2d 1275, 1282 (8th Cir. 1988) (Emphasis in original).

There has been no showing of inequitable conduct or that any unfair advantage taken by, or bestowed upon, JTG shareholders because of this restructuring. In fact, certain insiders worsened their financial position in order to accomplish the purchase. Furthermore, no injury has been suffered by the City and MCDA. All of Jefferson's collateral available to repay its obligations to the City and MCDA was subject to the undersecured claim of a prior secured creditor (Norwest). Therefore, the guarantee by Jefferson to the City and MCDA represented a right without any value or reasonable expectation of realization. There cannot be inequity to the City and MCDA in a restructuring that left them out of the loop when the guarantee, that would otherwise have held them in, was supported by no value.

Accordingly, the doctrine of equitable subordination cannot serve as an equitable basis for the allowance of a claim by the City and MCDA in the JTG bankruptcy case.

## IV.
## DISPOSITION

Because the City and MCDA have failed to show material facts that give rise to a genuine issue, the motion for summary