UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Southern Division

In re:	)	Bankr. No. 97-40115
VIKING GLASS, INC. tax I.D. no. 46-0306138	)	Chapter 7
Debtor.	)	
JOHN S. LOVALD, TRUSTEE	)	Adv. No. 98-4011
Plaintiff,	)	
-vs-	)	MEMORANDUM OF DECISION
NEIL F. SCHMID, JR.,	)	
Defendant.	)	

The matter before the Court is the Plaintiff-Trustee's amended complaint seeking avoidance of a fraudulent transfer or damages from Debtor's principal for breach of his fiduciary duty to Debtor. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Memorandum of Decision, accompanying Order, and subsequent judgment shall constitute the Court's findings and conclusions under F.R.Bankr.P. 7052. As set forth below, the Court concludes that judgment must be entered for Plaintiff-Trustee for $38,418.65.

I.

Viking Glass, Inc., operated several glass stores throughout the area. Neil F. Schmid, Jr., held all the common stock and was the sole officer of Viking Glass.

VG Air, Inc., was a wholly owned subsidiary of Viking Glass. Schmid was the sole officer of VG Air. VG Air's primary asset was a 1973 Beech Bonanza airplane.

86

Viking Air Limited Partnership was organized in 1993. Its purpose was to provide airplanes for the partners' business and personal use while recouping much of the maintenance and operating costs by also leasing the planes to Daedalus, Inc. VG Air became a 33% limited partner in Viking Air Limited Partnership by contributing its airplane, cash of $6,000, and liabilities of $70,000. Viking Air, Inc., headed by President Dale E. Froehlich, was the general partner; Duane Sather was the other limited partner.

In December 1995, Schmid and Sather met with Dr. Timothy M. Zoellner to discuss Zoellner's possible investment in the limited partnership. Their asking price for a one quarter interest in the company was $75,000. Schmid and Sather also advised Froehlich that this would be a good time for the limited partnership to convert to a limited liability company.

During negotiations with Schmid and Sather, Zoellner was told that the resale value of the limited partnership's three airplanes was over $400,000. The planes were "Part 135 ready," which means they were maintained at the high level necessary for the planes to be used for charter service and thus had a 5 to 10% higher value than planes that are not Part 135 ready.

In a letter dated January 30, 1996, Zoellner made a counteroffer to Viking Air Limited Partnership for a one quarter interest for $60,000. He based his offer on valuations by John K. Melcher and Brian Brost, who were both in the general aviation business, some of the planes' low engine hours, and the present

value of the company of $156,000. He also included $21,000 for going concern value. In a responsive letter dated February 6, 1995 [but intended to be 1996], Schmid highlighted for Zoellner that because the planes were all Part 135 ready, 5 to 10% may need to be added to Melcher's appraisal of the planes. He also told Zoellner that he was really only paying $8,000 for going concern, not the $21,000 Zoellner had calculated, because each of the existing three shares was worth $52,000.

Negotiations culminated in February 1996 when Zoellner invested $65,000 in the limited partnership's successor, Viking Aircraft Owners, L.L.C., in exchange for a 25% equity interest with the same rights and privileges as the three other members. As indicated by Schmid's February 6, 1996 letter, the capital contribution Zoellner made for his interest reflected about $52,000 for the book value of an existing share in the business and an additional $13,000 for going concern.

The limited liability company used the $65,000 to reduce debt and it credited Zoellner's capital account with that sum. Zoellner also became a guarantor of the limited liability company's debt. None of the $65,000 went directly to the partners from the predecessor limited partnership.

About the time Schmid and Sather were negotiating with Zoellner, Schmid purchased VG Air from Viking Glass. Schmid, as the sole officer and director of Viking Glass, did not solicit any other purchase offers for the VG Air stock or obtain a formal appraisal. He had the permission of Viking Glass's primary lender,

the First National Bank (Bank), to buy VG Air to help reduce Viking Glass's debt, which Schmid and his wife had personally guaranteed. The sale was part of a deal between the Bank and the Schmids. Under the deal, the Schmids agreed to liquidate assets of Viking Glass to reduce debt and the Bank agreed to release the Schmids from all but $50,000.00 of their personal guarantee if they maximized the recovery from the asset sales.

Schmid paid $3,973.59 for the VG Air stock. On February 25, 1996, when the sale was closed, VG Air's assets were cash deposits of $13,534.74 and its 25% interest in Viking Air Limited Partnership or the successor limited liability company. In the limited liability company, VG Air's capital account was in the red about $18,306.

Schmid applied VG Air's cash deposits and the $3,973.59 in sale proceeds on Viking Glass's debt to the Bank. Consistent with their earlier deal, the Bank eventually released the Schmids from their personal guarantees of Viking Glass's large deficiency debt.

An involuntary Chapter 7 bankruptcy proceeding was commenced against Viking Glass on February 12, 1997. An order for relief was entered on March 12, 1997.

On February 13, 1998, Chapter 7 Trustee John S. Lovald filed an adversary complaint seeking to avoid Debtor Viking Glass's sale of VG Air to Schmid as a fraudulent transfer to an insider under 11 U.S.C. § 548 and seeking damages from Schmid for violation of his fiduciary duty to Debtor Viking Glass. Schmid admitted he was an insider and there was no dispute about the date that Debtor sold

VG Air to Schmid. The Trustee filed a motion for summary judgment and Schmid filed a motion to dismiss. The Court granted the Trustee's motion for summary judgment on the issue of Debtor's insolvency at the time of Debtor's transfer of VG Air to Schmid, but ordered a trial on the issue of whether the transfer was for a reasonably equivalent value. Schmid's motion to dismiss was denied because the pleading problems raised therein had been addressed by the Trustee.

A trial was held February 10, 1999. Both parties presented expert testimony on the value of VG Air and related tax ramifications.

Melcher reviewed the "blue book" valuations he had made of the limited partnership's airplanes in late 1995. He said he had not personally viewed the airplanes. He said the values did not reflect Part 135 readiness.

Froehlich also reviewed Melcher's 1995 "blue book" valuations. He explained that the "retail" value from the blue book was what a willing seller would pay a willing buyer in an arm's-length transaction and that the "marketable" value from the blue book was slightly lower because it reflected a sale of a plane to a dealer or wholesaler. Froehlich explained that neither value included discounts for the cost of sale. He said this brokerage cost is typically 7% on smaller planes and includes advertising and other related costs except the pre-buy inspection.

The Trustee's tax expert, Timothy J. Bergstrom, a CPA, valued VG Air at $67,236 by using as a base the $65,000 in capital that Zoellner contributed for his interest in the L.L.C. Bergstrom then added the $13,354 in cash that VG Air had and he deducted taxes of $11,117 that he calculated Schmid would have to pay when he dissolved VG Air.

Michael Billion, Schmid's tax expert and an attorney, offered three different values of VG Air, all based on VG Air's interest in the L.L.C. The first was that the value of VG Air's interest in the L.L.C. was zero because VG Air had a negative capital account. His second opinion was that VG Air was worth $5,263 based on the liquidation value of the L.L.C. The third opinion was the VG Air was worth $10,082.00. It too was a liquidation value of the L.L.C., except that Billion deducted a 7% brokerage fee from the value of the airplanes and he distributed the liquidation proceeds equally, rather than based on his interpretation of S.D.C.L. § 47-34A-806.

Schmid testified that he calculated the $3,973.59 he paid Debtor Viking Glass for the VG Air stock by valuing VG Air's interest in the limited liability company using the monthly "book value" and dividing by four to represent the number of members and then adding $2,000 to reflect one-quarter of the value of its going concern. He thought it was a fair price since he would have an unknown tax liability to pay later because of VG Air's negative capital account in the L.L.C.

II.
FRAUDULENT TRANSFER

The remaining issue under 11 U.S.C. § 548(a)(1)(B)(i)[1] is whether Schmid paid Debtor Viking Glass "less than a reasonably equivalent value" for VG Air. A "reasonably equivalent value" for a transfer is the "value that is substantially comparable to the worth of the transferred property[.]" *BFP v. Resolution Trust*, 114 S.Ct. 1757, 1767 (1994). Outside the foreclosure sale context, that value is ordinarily the fair market value,[2] *id.* at 1766-67, or it is at least the starting point when all circumstances are considered. *Hirsch v. Steinberg (In re Colonial Realty Co.)*, 226 B.R. 513, 523 (Bankr. D. Conn. 1998). The valuation is made at the time of the transfer. *Id.*

The Court concludes that Debtor Viking Glass received less than a reasonably equivalent value for VG Air when it was sold to Schmid. While Schmid paid Debtor $3,973.59, from the evidence presented the Court calculates that the reasonably equivalent or fair market value of VG Air was $55,746.24.

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[1] Section 548(a) was amended in 1998. The June 19, 1998 enactment was made applicable to all pending cases. Though applicable, the amendments were not substantive in this case. The amendments were primarily to add a new subsection regarding charitable gifts not at issue here.

[2] Fair market value is what a willing buyer will pay a willing seller where both parties are informed of all relevant circumstances. *Campbell v. C.I.R.*, 943 F.2d 815, 823 (8th Cir. 1991).

The fair market value, less brokerage costs, of the limited liability company's airplanes in February 1996 was $456,069.96. This figure is based on Melcher's "retail" blue book valuation in late 1995 of $456,184 since the retail value represents, as explained by Froehlich, the planes' fair market value. Melcher's statement did not include any value attributable to the planes' Part 135 readiness, so 7.5% (the mid-point between the 5-10% often referenced in the record) was added to the $456,184 for a final value of the airplanes at $490,397.80.

Based on Froehlich's testimony regarding the method and costs of properly marketing an airplane, the Court deducted from the fair market value of the planes 7% or $34,327.85 for the expected brokerage fee. With that deduction, the final liquidated value of the L.L.C's airplanes was $456,069.95.

The limited liability company's other assets were cash on hand and receivables totaling $43,778. This figure was provided by the limited partnership's January 31, 1996 audited year-end statement and is consistent with Zoellner's accountant's calculations as set forth in Zoellner's letter of January 30, 1996. When added to the airplanes' value, the limited liability company's total assets were worth $499,847.95.

Debt of $289,279 was then deducted from total assets. That figure came from the limited liability company's January 31, 1996 year-end statement of debt of $354,279 less Zoellner's capital contribution earlier in February 1996 of $65,000.

To the net value of the limited liability company's assets,

the Court added $24,000 for going concern value. The Court concluded that some going concern value existed because Froehlich stated it had some, Schmid purchased the VG Air stock with the understanding and intention that the limited liability company would continue in business, and the business was cash flowing. The only evidence presented on the amount of one-quarter of the limited liability company's going concern value was Schmid's two assessments of $2,000 when he bought VG Air and $8,000 when he and Sather made a counteroffer to Zoellner and the approximate $13,000 that Zoellner actually paid. In the absence of other evidence, the Court concluded $6,000 was a reasonable value for going concern. When multiplied by four for each existing member's interest, the final $24,000 in going concern value was reached. Billion's conclusion that the limited liability company had no going concern value because it was a "flying club" and was not operated for profit had no supporting evidence.

When the $24,000 in going concern value was added to the limited liability company's total net assets, the fair market value of the L.L.C. was $234,568.95. The Court allocated the first $65,000 in value to Zoellner based on S.D.C.L. § 47-34-32's[3] requirement that upon dissolution a member is third in line, behind non member creditors and the payment of profits to members, to receive back his capital contributions. VG Air's one-quarter share

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[3] Section 47-34A-806, though it appears to produce the same result, was not applied because there was no evidence that the limited liability company adopted the Uniform Limited Liability Company Act after its enactment in 1998. *See* 1998 S.D.LAWS § 1205.

of the remainder was $42,392.24. This distribution method is consistent with Froehlich's understanding of what would take place at liquidation.

The $65,000 that Zoellner contributed as capital for his one-quarter interest in the L.L.C. as a going concern validates the $42,392.24 value of VG Air's interest in the L.L.C. that the Court calculated based on the record before it. The difference between the two values accommodates any discount to VG Air's interest in the limited liability company due to VG Air's negative capital account and the potential tax consequences down the road, a figure that could not be calculated due to the numerous variables identified by Bergstrom. The difference between the two values also reflects the fact that Zoellner may have paid more for going concern since he had not had to incur the start up costs or risks that VG Air and the other original partners had.

Two possible tax implications raised at the hearing were not considered. Zoellner's opportunity to make a 754 election under the federal tax code was not considered in comparing the value of his interest in the L.L.C. to VG Air's interest because neither party quantified it and because Zoellner attributed no long-term value to the election. Also, no deduction in the value of VG Air's assets was made for a tax cost upon liquidation of the limited liability company. No liquidation was made nor intended when Debtor Viking Glass sold VG Air to Schmid.

When valuing VG Air's interest in the L.L.C., the Court also made no deduction because it is closely held or because VG Air held

only a minority interest. Zoellner's capital contribution reflected both of these considerations and was still higher than the value of VG Air's interest that the Court calculated from the evidence. Billion's proposition that a 50% discount to the *cash* remaining after a hypothetical *liquidation* of the limited liability because the company was closely held and because VG Air had only a minority interest was without merit.

To the $42,392.24 value of VG Air's interest in the limited liability company, the Court added VG Air's cash on hand of $13,354 for total assets of $55,746.24. While Schmid says he did not purchase the cash, it was an asset of VG Air when he purchased it. Further, after purchasing the VG Air stock, Schmid subsequently closed VG Air's account and he used the cash to his, his wife's, and Debtor Viking Glass' benefit.

No adjustment was made for tax costs if the purchaser later dissolved VG Air as a corporation. That change was not a necessary element of a fair market sale. Also, while Debtor Viking Glass would have had to pay some taxes on the proceeds from the sale of its VG Air stock to Schmid, that amount was not clearly set forth in the record and there was little testimony on how it would impact VG Air's fair market value.[4]

What Debtor Viking Glass did receive from Schmid was $3,973.59

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[4] Bergstrom testified about the tax that Schmid would have to pay when he dissolved VG Air. Billion testified about some taxes that would have to be paid if both the limited liability company and VG Air were liquidated but it was not clear that either tax was Debtor Viking Glass' obligation.

plus VG Air's cash account of $13,543. Since that sum, $17,516.59, is not the reasonable equivalent of VG Air's fair market value of $55,746.24, Debtor's pre-petition sale of VG Air to Schmid is deemed to be a constructively fraudulent transfer under § 548(a)(1)(B)(1998).

Returning the VG Air stock to Debtor is no longer feasible since Schmid dissolved VG Air. *See Colonial Realty*, 226 B.R. at 525-27. The appropriate remedy under § 550(a)(1), as discussed earlier in this adversary proceeding, is for Schmid to reimburse the bankruptcy estate $51,772.65 for the difference between the $3,973.59 that he paid and VG Air's value of $55,746.24. A credit of $13,354 will be given since Schmid used VG Air's cash to pay down Debtor Viking Glass's debt. That leaves a balance of $38,418.65 for Schmid to pay the bankruptcy estate.

III.
BREACH OF FIDUCIARY DUTY

Corporate officers and directors are fiduciaries to the corporation and its members. *Case v. Murdock*, 488 N.W.2d 885, 890 (S.D. 1992). They must exercise the utmost good faith in all transactions that touch the director's duties. *Id.* They are also charged with the knowledge of any matter that it is their duty to know. S.D.C.L. § 47-30-11; and *Case*, 489 N.W.2d at 890.

When it comes to dealings between the corporation and a director or officer, the transaction must be "open, fair, and free from all suspicion;" it is subject to rigid scrutiny. *Knudsen v.*

Burdett, 287 N.W. 673, 674 (S.D. 1939). The burden is always on the director to show that the transaction was above board. *Id.* Everything that the director knows about the value of the subject property must be disclosed. *Id.* at 675.

The Court concludes that Schmid breached his fiduciary duty to Debtor. Schmid, as the director of Debtor Viking Glass, needed to insure that his purchase of VG Air from Debtor was "open, fair, and free from all suspicion." *Knudsen*, 287 N.W. at 674. Because Schmid did not obtain an independent appraisal or seek other offers for VG Air to insure that a fair price was received, the sale failed to meet the required standard. Again, the appropriate remedy is for Schmid to reimburse the bankruptcy estate $38,418.65.

IV.
INTEREST.

Section § 550(a) does not specifically state whether interest must be paid to the bankruptcy estate on an avoided transfer. *Gray v. Travelers Ins. Co. (In re Neponset River Paper Co.)*, 219 B.R. 918, 919 (Bankr D. Mass. 1998), *aff'd*, ___ B.R. ___, 1999 WL 219526 (1st Cir. B.A.P. March 12, 1999). Such awards are discretionary, not mandatory. *Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1281 (8th Cir. 1988); *Meeks v. Greenville Casino Partners, L.P. (In re Armstrong)*, 217 B.R. 569, 580 (Bankr. E.D. Ark. 1998).

In preference and fraudulent transfer actions, some courts award interest only from the date of the trustee's first demand for

payment or the date of the complaint. *See, e.g., Turner v. Davis, Gillenwater & Lynch (In re Investment Bankers, Inc.)*, 4 F.3d 1556, 1566 (10th Cir. 1993)(cites therein), and *Colonial Realty, 226 B.R. at 526*. Especially in fraudulent transfer cases, the better approach adopted by other courts, however, is to award interest from the date of the transfer to insure that the bankruptcy estate is made hold. *Stevenson v. J.C. Bradford & Co. (In re Cannon)*, 230 B.R. 546, 600-01 (Bankr. W.D. Tenn. 1999). The interest should be an ingredient of full compensation that corrects the judgment for the time value of money. *Hirsch v. Union Trust Co. (In re Colonial Realty Co.)*, 229 B.R. 567, 577 (Bankr D. Conn. 1999) amended by ____ B.R. ____, 1999 WL 235559 (April 14, 1999). The amount awarded should be compensatory, not punitive. *Neponset River Paper Co.*, 219 B.R. at 919.

Prejudgment interest on a judgment awarded under federal law is calculated under 28 U.S.C. § 1961(a) using Treasury Bill prices; on a federal court judgment based on state law, prejudgment interest is calculated based on state law. *Cannon*, 230 B.R. at 601. When remedies overlap, pre-judgment interest should be awarded under the law that will provide the greater recovery to the estate. *Id.* (citing *Grogan v. Garner*, 806 F.2d 829, 838-39 (8th Cir. 1986)).

The Court concludes that in this adversary proceeding prejudgment interest[5] from the date of the transfer of VG Air to Schmid is appropriate. Adding interest is the only means of insuring that the bankruptcy estate is made whole. *Cannon*, 230 B.R. at 601; *Colonial Realty*, 226 B.R. at 525.

Since the judgment in this adversary proceeding is a product of state and federal law, counsel for Plaintiff-Trustee shall calculate pre-judgment interest on the interest bearing sum of $38,418.65 from February 25, 1996 under both 28 U.S.C. § 1961(a) and S.D.C.L. § 21-1-13.1. The higher amount shall be awarded as directed by *Grogan*, 806 F.2d at 838-39.

An order will be entered directing entry of a judgment for Plaintiff-Trustee Lovald. Counsel for Plaintiff-Trustee shall prepare the judgment after calculating the pre-judgment interest.

Dated this 7 day of May, 1999.

BY THE COURT:

Irvin N. Hoyt
Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk
By _____
Deputy Clerk
(SEAL)

UNITED STATES BANKRUPTCY COURT ★ SEAL

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered
MAY 07 1999
Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

I hereby certify that a copy of this document was mailed, hand delivered, or faxed this date to the parties on the attached service list.
MAY 07 1999
Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court, District of South Dakota
By _____

[5] Post judgment interest is a product of statute and does not require the Court's discretion. It is awarded under either 28 U.S.C. § 1961(a) or S.D.C.L. § 54-3-5., whichever provides the greater recovery for the bankruptcy estate.

Case: 98-04011 Form id: 122 Ntc Date: 05/07/1999 Off: 4 Page : 1
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