IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF NEBRASKA

In the Matter of THURSTON CORPORATION, Bankrupt. MARK L. LAUGHLIN, Trustee, Appellee, vs HOCKENBERGER & CHAMBERS CO., IRENE TELLER, S. S. LEVINE, W. M. FERGUSON and ARDIS SPERBER, Appellants.	CIVIL NO. 79-0-33 BK 77-0-356 MEMORANDUM

APPEARANCES: For Appellee - Steven Turner, Omaha, Nebraska

For Appellants - James Gessford, Lincoln, Nebraska

DENNEY, District Judge

This matter comes before the Court on appeal from the Memorandum and Order [Filings #54 and #55], and Supplemental Memorandum and Revised Order [Filings #28 and #59] entered by the Bankruptcy Court on December 27, 1978, and January 4, 1979, respectively.

On March 29, 1977, Thurston Corporation filed a voluntary petition in bankruptcy in the United States District Court for the District of Nebraska. Subsequent to the filing, Mark L. Laughlin was appointed Trustee.

Thereafter, on March 20, 1978, the Trustee filed Objections to the Claims of W. M. Ferguson, Irene Teller, S. S. Levine, Ardis Sperber and Hockenberger & Chambers Company, the appellants herein. The Trustee objected on the grounds that the infusion of money by the claimants into the corporation was, in reality, contributions to capital rather than debt and, therefore, the corporation was not indebted to the claimants.

On July 21, 1978, the Bankruptcy Court held an evidentiary hearing, from which the Court made the following findings of fact:

Thurston Corporation was organized as a Nebraska corporation on April 28, 1958. Stock was issued by the corporation to the shareholders as follows:

I. E. Levine	19.875 shares
Fern Bank Company, Trustee for S.S. Levine	19.875
Irene Teller	30.000
W.M. Ferguson	42.250
Hockenberger & Chambers Co.	24.000
Elmer Bradley	20.000
W. A. Curry, Trustee	24.000
TOTAL	180.000 Shares

The stock had a $100 per share par value, and was fully paid. Stock originally issued to I. E. Levine now belongs to Mr. Levine's daughter, Ardis Sperber.

The main business of Thurston Corporation was the ownership and rental of real estate. The corporation owned the J. C. Penney and Williams Brothers buildings in Columbus, Nebraska. The site on which the two buildings were constructed was purchased by the corporation for $90,000.00. On the site, an older building was torn down and in 1960 the two buildings referred to above were built with a common wall for a total cost, including land, of $430,000.00.

The land acquisition and construction funds were provided by a first mortgage on the lot on which the J. C. Penney building is located, to Becher, Hockenberger & Chambers Company, later assigned to Community Housing, in the sum of $250,000.00 and a first mortgage on the Williams Building to Columbus Savings Bank, later assigned to Equitable Savings and Loan Association in the original amount of $35,000.00. The remaining funds were supplied by an $18,000.00 capital stock contribution and a "second mortgage loan" on the Penney building in the sum of $126,000.00.

The second mortgage was necessary because the building cost more than anticipated and because the corporation did not have enough financing available to build the building. This "second mortgage" was given by Thurston Corporation to Becher, Hockenberger & Chambers Company, acting as trustees for the stockholders of Thurston Corporation, who held certificates in the trust in the same proportion as their capital stock interest in the corporation.[1]

[1] The "second mortgage note" to Becher, Hockenberger & Chambers Company, Trustee, is the basis of the stockholders' claims in the bankruptcy proceeding. This is the note to which the trustee objects.

Prior to bankruptcy, there was a six per cent (6%) payment of principal to each stockholder paid in January of 1966, a ten per cent (10%) payment of principal in March of 1967, a twelve (12%) payment of principal in December of 1968, a fifteen per cent (15%) payment of principal in May of 1971, a ten per cent (10%) payment of principal in February of 1973, an eight per cent (8%) payment of principal in February of 1974, and a twelve per cent (12%) payment of principal in February of 1975. None of the financial records of the company indicate any liability to any stockholders or to the trustee for the benefit of the stockholders for interest. The only payments made on the mortgage were principal payments, and no interest payments were ever made. None of the stockholders even expected any interest to be paid.

Although a document in the form of a mortgage was given to Becher, Hockenberger & Chambers Company as trustee for the benefit of the stockholders on the $126,000.00 "mortgage loan," the mortgage was not recorded at the time of the transaction and apparently the parties never intended that it be recorded. The mortgage was eventually recorded in 1975, yet there apparently is a dispute as to whether it should have been recorded. The repayment of capital to the stockholders was made only when the corporation had available to it profits from which payments could be made and the corporation disregarded the terms of the note with respect to payment of interest, payment of principal and with regard to the stated due date of December 30, 1970, in making payments.

In its Memorandum Opinion of December 27, 1978, the Bankruptcy Court, applying the indicia set forth in J. S. Biritz Constr. Co. v. Commissioner, 387 F.2d 451 (8th Cir. 1967), and noting that the subjective determinations of the parties were not controlling, see In re Uneco, Inc., 532 F.2d 1204, 1208-09 (8th Cir. 1976), specifically found:

1. That the corporation was grossly undercapitalized;

2. That the "mortgage loan" was made in proportion to equity holdings;

3. That repayment of the "loan" was predicated on the corporation's success;

4. That the fixed date for payment of the note was disregarded;

5. That, although the note by its terms was not subordinated to other corporate debts, the parties considered it subordinated in that they received payments only when money was available after other corporate debts were paid;

6. That a third party would not have made a similar loan in that the note, as treated by the parties, became one which

bore no interest and was repayable only if the corporation made profits;

7. That while the loan was secured by a mortgage, it was not filed of record and it appeared questionable whether the parties ever intended that it be recorded;

8. That there was no sinking fund established to retire the loan;

9. That most of the stockholders were directors of the corporation and the corporation was operating with the concurrence of all the claimant stockholders in the financial dealings between the corporation and the stockholder claimants;

10. That the corporation had a large proportion of debt to equity in that if the $126,000.00 mortgage note was validly a debt of the corporation, the debt to equity ratio was 23 to 1, and leaving aside the $126,000.00 mortgage note, the debt to equity ratio was approximately 16 to 1.

The Bankruptcy Court then concluded that the claimants "were infusing risked capital in the nature of an additional stock contribution and were not creating a debt which can be proved in a bankruptcy proceeding."

Apparently, the parties agree on the law to be applied in this case. Clearly, in cases involving the question of whether a claim is a bona fide loan or a contribution to capital, the determination depends upon the particular facts of the case. In re Uneco, Inc., supra, 532 F.2d at 1207. With respect to factual questions, the Bankruptcy Court's "findings are to be accepted unless clearly erroneous." Shainman v. Shear's of Affton, Inc., 387 F.2d 33, 37 (8th Cir. 1967); see also In re Uneco, Inc., supra, 532 F.2d at 1210; Bankr. Rule 810. Thus, the sole issue before this Court is whether the Bankruptcy Court's findings are clearly erroneous.

As the Bankruptcy Court correctly noted, our circuit in the cases of J. S. Biritz Constr. Co. v. Commissioner, supra, and In re Uneco, Inc., supra, has outlined various criteria to be applied in determining whether a claim is a bona fide debt or a capital contribution. The criteria, as set forth in Uneco, are as follows:

> (1) Whether the corporation was so grossly undercapitalized that the loans were in fact needed for capital purposes and were actually intended to be risked capital rather than a loan.
>
> (2) Whether the purported loans were made in proportion to equity holdings.
>
> (3) Whether the repayment of the loan was predicated on the success of the venture.

(4) Whether there was a fixed date for payment of the note and a reasonable expectation of payment by that date.

(5) Whether the note was subordinated to other corporate debts.

(6) Whether third parties would have made the loan under the same conditions.

(7) Whether the claimed loan was secured by a mortgage or otherwise.

(8) Whether a provision was made for a sinking fund to retire the loan.

(9) Whether the person making the purported loan participated in the management of the corporation.

(10) Whether the corporation had a large proportion of debt to equity.

In re Uneco, Inc., supra, 532 F.2d at 1208. In addition, as the Bankruptcy Court indicated, it is now clear that the subjective intent of the parties as to the nature of the claim is not controlling. In re Uneco, Inc., supra, 532 F.2d at 1209.

The Court is of the opinion that the Bankruptcy Court's decision should be affirmed. A review of the evidence thoroughly indicates that the Bankruptcy Court's findings were not clearly erroneous and further that the Bankruptcy Court correctly applied the factors delineated in Biritz and Uneco.

While it is unnecessary to reiterate the findings of the Bankruptcy Court, the Court believes that a brief examination of the evidence, tested against the objective criteria enumerated earlier, will clearly demonstrate the validity of the Bankruptcy Court's decision. The corporation was grossly undercapitalized; the total "borrowed capital" was $411,000.00 and the total "equity capital" was $18,000.00, producing a debt-equity ratio of 23 to 1. The loan was made in direct proportion to the stockholder interests in the corporation, each stockholder owning the same proportionate share of the $126,000.00 loan that the stockholders held of the $18,000.00 total equity capitalization.[2] Repayment of the loan was clearly predicated on the success of the corporation in that payment was made only if and when cash was available, no fixed structure for payment pursuant to the terms and conditions of the note was ever created, no interest was ever accrued or intended to be accrued on the mortgage note, and the mortgage note was never filed. The due date of the loan was completely disregarded and no attempt was made to enforce the note on the date fixed for payment. Apparently, none of the

[2] Although the original "note and mortgage" was directed to Becher, Hockenberger & Chambers Company, it was done so with Becher, Hockenberger & Chambers Company acting as trustee for the other stockholders.

stockholders anticipated repayment by the due date. The parties treated the note as subordinated to all other corporate debts. In fact, the parties, during the seventeen years of the operation of the corporation, received payment only after all other corporate debts were paid and only after money was available. Since the loan was necessary due to a lack of financing and, since the note as treated by the parties became one which bore no interest and was repayable only if the corporation made profits, it is doubtful that third parties would have made a similar loan.

No sinking fund was established to retire the loan. Many of the stockholders were directors of the corporation. Finally, there was a large proportion of debt to equity. As the Court noted earlier, if the $126,000.00 mortgage note was a valid debt of the corporation, the debt-equity ratio would be 23 to 1. Even excluding the $126,000.00 mortgage note which reduces the debt from $411,000.00 to $285,000.00, this leaves a debt-equity ration of 16 to 1, still a large proportion of debt to equity.

In sum, the record in this case, tested against the Uneco and Biritz guidelines with proper consideration given to the parties' intent, fails to demonstrate that the advances were bona fide loans rather than capital contributions. The conclusions of the Bankruptcy Court are supported by the evidence and are not clearly erroneous.

An order shall issue contemporaneously with this Memorandum Opinion.

Dated this 15th day of June, 1979.