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U.S. Bankruptcy Court
Greensboro, NC
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UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

IN RE: Bonds Distributing Company, Inc., Debtor.	Case No. 97-52130C-7W
Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc., Plaintiff, v. Donald R. Bonds and Bonds, Inc., Defendants.	Adversary No. 98-6044
Donald R. Bonds, Third-Party Plaintiff, v. William L. Mills, III, Attorney at Law, d/b/a "The Mills Law Firm", Third-Party Defendant.	

MEMORANDUM OPINION

This adversary proceeding came before the court on October 5, 1999, for hearing upon motions for summary judgment filed on behalf of the plaintiff, the defendants and the third-party defendant. Thomas W. Waldrep, Jr., and Daniel C. Bruton appeared on behalf of the plaintiff, Richard S. Gordon appeared on behalf of the defendants and G. Gray Wilson appeared on behalf of the third-party defendant.

BACKGROUND

Bonds Distributing Company, Inc. ("the Debtor") was incorporated under the laws of the State of North Carolina in 1976. From the date of incorporation through November 7, 1995, Donald R. Bonds ("Bonds") was the president, sole director and sole shareholder of the Debtor. The primary business of the Debtor involved the operation of a wholesale outlet for small engine parts for outdoor power equipment such as chain saws, lawnmowers, edgers, etc. Up until November of 1995, Bonds managed the business operations of the Debtor.

In the summer of 1995, Bonds had discussions with Stephen H. Young ("Young") concerning the sale of the Debtor to Young. On November 7, 1995, Bonds, Young and the Debtor entered into a stock purchase agreement evidencing their agreement to a transaction in which, among other things, 4,000 shares of Bonds' stock in the Debtor were sold to Young for the purchase price of $161,121.10;

approximately 90% of Bonds' shares of stock in the Debtor (35,999 shares) were redeemed by the Debtor in exchange for a $1,451,000.00 promissory note payable to Bonds; the Debtor granted to Bonds a security interest in all of the assets of the Debtor to secure the payment of the promissory note; Young granted to Bonds a security interest in the 4,000 shares which he acquired from Bonds; and Bonds retained one share of stock in the Debtor and continued as a director of the Debtor.

Following the closing of the transaction, Young became president of the Debtor, assumed control of the Debtor and managed the business operations of the Debtor. In approximately July of 1997, the Debtor defaulted on its payments to Bonds under the $1,451,000.00 promissory note. Bonds initiated collection efforts against the Debtor, which included a foreclosure sale which was held on August 21, 1997, at the Cabarrus County Courthouse. The foreclosure sale was conducted by one of the attorneys who represented Bonds. The only bid was one made by the attorney in the amount of $1,484,391.11

Following the foreclosure sale, Bonds, Inc., a new corporation formed by Bonds shortly before the sale, assumed control of Debtor's assets, including the inventory which Debtor owned at the time of the foreclosure sale. Bonds, Inc., under the management of Bonds, thereafter conducted a business similar to that which had been conducted by the Debtor prior to the foreclosure sale.

On October 30, 1997, approximately two months after the foreclosure sale, an involuntary petition under Chapter 7 of the Bankruptcy Code was filed against the Debtor. An order for relief under Chapter 7 of the Bankruptcy Code was entered in the bankruptcy court on December 16, 1997, and Bruce Magers (the "Trustee") was named as Trustee in the case.

On August 14, 1998, the Trustee filed the adversary proceeding which is now before the court asserting that Bonds never acquired a perfected security interest in the Debtor's assets and attacking the validity of the foreclosure sale conducted by Bonds in August of 1997. Bonds and Bonds, Inc., answered, denying any liability to the Trustee and raising various affirmative defenses. Additionally, Bonds asserted a professional malpractice claim against the third-party defendant alleging that the third-party defendant acted as his attorney with regard to the transaction with Young and was negligent with respect to the legal representation provided to Bonds.

MOTIONS FOR SUMMARY JUDGMENT

In his motion for partial summary judgment the Trustee seeks summary judgment as to the Second, Third, Seventh, Ninth and Tenth claims for relief. In their motion for summary judgment the defendants seek summary judgment as to all of the claims asserted by the Trustee. In his motion for summary judgment the third-party defendant seeks summary judgment as to the professional malpractice claim asserted by Bonds as third-party plaintiff.

DISCUSSION

A. Summary Judgment Standard.

Under Rule 56 of the Federal Rules of Civil Procedure, which is incorporated into Rule 7056 of the Federal Rules of Bankruptcy Procedure, summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to judgment as a matter of law. "Where the moving party has carried its burden of showing that the pleadings, depositions, answers to interrogatories, admissions and affidavits in the record construed favorably to the nonmoving party, do not raise a genuine issue of material fact for trial, entry of summary judgment is appropriate." Gutierrez v. Lynch, 826 F.2d 1534, 1536 (6th Cir. 1987)(citing Celotex Corp. v. Catrett, 477 U.S. 317, 106 S. Ct. 2548, 91 L.Ed.2d 265 (1986)); In re Specialty Concepts, Inc., 108 B.R. 104 (W.D.N.C. 1989); In re Caucus Distribs., Inc., 83 B.R. 921 (Bankr. E.D. Va. 1988).

In order to carry this burden, a plaintiff who is moving for summary judgment must show through affidavits, depositions or admissions all facts required to support each element of the claim and that none of those facts are disputed. See Moore's Federal Practice, § 56.13. p. 56-134 (3d ed. 1998)(movant must make a prima facie case for summary judgment by establishing (1) the apparent absence of any genuine dispute of material fact and (2) movant's entitlement to judgment as a matter of law on the basis of the undisputed facts). In determining whether the evidence is sufficient to establish the claim, the court must apply the substantive evidentiary standard that would be applicable at trial. See Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1968).

The evidence must be viewed in the light most favorable to the nonmoving party, and inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. See In re Graham, 94 B.R. 386 (Bankr. E.D. Pa. 1988); In re Trauger, 101 B.R. 378 (Bankr. S.D. Fla. 1989). However, the existence of a factual dispute is material and precludes summary judgment only if the disputed fact is determinative of the outcome under applicable law. Anderson v.

Liberty Lobby, Inc., 477 U.S. 242, 248, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). The party seeking summary judgment bears the initial responsibility of informing the court of the basis of its motion, and also must identify those portions of the record that it believes demonstrates the absence of a genuine issue of material fact. Only after the movant has sustained the initial burden of production does the burden shift to the nonmovant to show the court that there is a genuine issue for trial. However, once this is done, the opposing party must set forth the specific facts showing there is a genuine issue for trial. Only when the entire record taken as a whole could not lead a rational trier of fact to find for the nonmoving party, can the court find there is no genuine issue for trial. See In re Trauger, 101 B.R. at 380, citing Matsushita Elec. Indus. Co. v. Zenith Radio Corp., 475 U.S. 574, 587, 106 S.Ct. 1348, 2513, 89 L.Ed.2d 538 (1986).

B. Application of Standard to Claims.

Since at least one of the parties has moved for summary judgment as to each of the claims alleged by the parties, the court will discuss each of the claims in chronological order, resolving whether either of the parties is entitled to summary judgment with respect to each claim.

1. First Claim - Plaintiff's Preference Claim.

In the First Claim, the Trustee seeks the recovery of $122,168.24 in transfers paid by the Debtor to Bonds during the year immediately preceding the bankruptcy filing, which the Trustee maintains are preferential under § 547 of the Bankruptcy Code. While the general "look-back" period under § 547 is 90 days, § 547(b)(4)(B) allows the recovery of preferential payments made within one year of the petition date when the transferee is an "insider." The defendants contend that they are entitled to summary judgment on the Trustee's preference claim because Bonds was not an insider when the payments were made. Because the Trustee has produced evidence showing that Bonds was a director of the Debtor during the one-year period, the court concludes that Bonds was an insider under § 547 and therefore is not entitled to summary judgment as to the preference claim.

Section 101(31) of the Bankruptcy Code defines an "insider" as follows:

> (B) if the debtor is a corporation -
> (i) director of the debtor;
> (ii) officer of the debtor;
> (iii) person in control of the debtor;
> (iv) partnership in which the debtor is a general partner;
> (v) general partner of the debtor; or
> (vi) relative of a general partner, director, officer, or person in control of the debtor;

While acknowledging that Bonds was a director of the Debtor at the time of the transfers, the defendants argue that since Bonds did not "act" like a director, the plain language of § 101(31)(B) should not apply in this case. None of the cases cited by the defendants support the conclusion that this court should interpret the meaning of "insider" as not including a director of a corporate debtor.

The defendants quote the following language from the Fourth Circuit opinion of In re Broumas, 1998 WL 77842, at *7 (4th Cir. 1998):

> an insider may be any person or entity whose relationship with the debtor is sufficiently close so as to subject the relationship to careful scrutiny. . . . Accordingly, insider status is determined by a factual inquiry into the debtor's relationship with the alleged insider.

Defendant's Memorandum, pp. 16-17. What the defendants have overlooked is that immediately preceding this passage, the Broumas court quoted the applicable portion of § 101(31) and stated that the list of insiders in that section is "non-exhaustive." Id. Accordingly, the court wrote the above-quoted passage in order to convey that, in addition to the list of insiders found in § 101(31), courts can also look to the facts and circumstances of a case to determine if someone who does not meet the criteria of § 101(31) is nonetheless an "insider." Additionally, in Broumas the debtor was an individual, not a corporation. There is no discussion whatever in Broumas as to whether a director of a corporation should or should not be considered an insider as is suggested by the defendants.

The defendants also cite In re Babcock Dairy Co. of Ohio, Inc., 70 B.R. 657 (Bankr. N.D. Ohio 1986), in support of their contention that, although a director, Bonds was not an "insider." Like Broumas, Babcock Dairy is inapposite to the facts of this case. Although Babcock Dairy does involve a debtor corporation, the court specifically found that the defendant was not a director of the debtor corporation at the time that the preferential transfers were paid. See id. at 661. Accordingly, the court shifted its focus from § 101(25)(B)(i)[9] of the Code -- where the Code defines an insider as a director -- to § 101(25)(B)(iii)[10] -- where the Code defines an insider as a "person in control of the debtor."

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[9]Currently § 101(31)(B)(i).

[10]Currently § 101(31)(B)(iii).

Thus, the quoted language in the Defendants' Memorandum[11] has no bearing on whether a director is an insider under § 101(31)(B)(i), but, instead, addresses whether a non-director can be "a person in control of the debtor" under § 101(31)(B)(iii). Therefore, as in Broumas, there is no discussion in Babcock Dairy concerning whether a person who is a director of a debtor corporation ought not to be considered an insider of the corporation despite the plain language of § 101(31)(B)(i). Rather, the Babcock Dairy court specifically recognized that "any person that is a director of a corporate debtor . . . is automatically considered to be an insider." Id. at 660.

Also cited by the defendants is In re Boston Publishing Co., 209 B.R. 157 (Bankr. D. Mass. 1997). Like Babcock Dairy, Boston Publishing involves a defendant who was a former director of a

[11]The following language from Babcock Dairy is quoted in the Defendants' Memorandum:

> "It does not appear that a standard has been established for determining the degree to which a person must control a debtor before he is considered to be an insider. However, it does appear that . . . the person must exercise sufficient authority over the debtor so as to unqualifiedly dictate corporate policy and the disposition of corporate assets. . . . It is insufficient that the alleged insider had only a superior bargaining position in a contractual relationship with the Debtor.

Babcock Dairy, 70 B.R. at 661."

debtor corporation. Accordingly the court did not look to § 101(31)(B)(i) in examining the defendant's insider status. Rather, the court focused on the point that the list set forth in § 101(31)(B) is not exclusive, and that an insider may be any person whose relationship with the debtor is sufficiently close so as to subject the relationship to careful scrutiny. See id. at 169.

"The plain meaning of legislation should be conclusive, except in 'rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.'" Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 868 (4th Cir. 1994)(quoting United States v. Ron Pair Enters., Inc., 489 U.S. 235, 242, 109 S.Ct. 1031, 103 L.Ed.2d 290 (1989). When interpreting statutes, a court should "look first to the plain language of a statute and interpret it by its ordinary, common sense meaning. . . . If the statutory terms are unambiguous, our review generally ends and the statute is construed according to the plain meaning of its words.'" Elliott Assocs., L.P. v. Banco De La Nacion, 194 F.3d 363, 371 (2d Cir. 1999)(citations omitted). In accord In re Fegeley, 118 F.3d 979, 983 (3d Cir. 1997); In re JKJ Chevrolet, Inc., 26 F.3d 481, 483 (4th Cir. 1994). The definition of "insider" contained in § 101(31) of the Bankruptcy Code clearly and unambiguously includes a director of a corporate debtor. Giving this statutory provision its plain meaning does not produce a result demonstrably at odds with the intentions of Congress in adopting this provision. Pursuant to the foregoing tenets of statutory interpretation, Bonds, as a director of the Debtor, must be regarded as an insider.

2-3. Second and Third Claims - Failure to Perfect Security Interest.

In these claims the Trustee alleges that no security interest was perfected because of the inadequacy of the description of collateral and because the financing statement filed with the Secretary of State contains no address for Bonds. The court first will address issue of whether the financing statements contain an adequate description of the collateral, including whether the description of collateral includes after-acquired property.

(a) Description of Collateral.

The requirement that there be a description of the collateral applies to both the security agreement and the financing statements. Under G.S. § 25-9-203, one of the requirements for a security interest to attach is that the debtor have signed "a security agreement which contains a description of the collateral." Under G.S. § 25-9-402(1), one of the formal requisites of a financing statement is that it contain "a statement indicating the types, or describing the items, of collateral."

The present case does not involve a complete omission of any description of collateral, since both the security agreement and the financing statements purport to describe collateral. The stock purchase agreement provides for the issuance of a promissory note evidencing the amount to be paid for the redemption of 39,999 shares of stock owned by Bonds. The agreement provides that the note is to be secured "by a Security Agreement and Financing Statement executed by Corporation covering the assets identified in subparagraph (a) through (f) above." The assets which are described in these subparagraphs are the Debtor's inventory, all "hard or 'fixed' assets", all motor vehicles and all accounts receivable and cash balances in the corporate bank accounts at the close of business on October 31, 1995. Although these subparagraphs state that the assets are to be identified on written schedules or exhibits, no such schedules or exhibits are attached to the stock purchase agreement.

The parties signed a security agreement on the same date as the stock purchase agreement. In the security agreement, the collateral is described as follows:

> [A]ll of the personal property, including, but

> not limited to, the assets identified in Paragraph 2 of the Stock Purchase Agreement dated November 7, 1995, and the various Schedules referenced therein which shall be attached hereto as well as all additional equipment, furniture and fixtures, supplies, inventory, instruments, accounts receivable, wherever located and including, substitutions, additions, replacements, proceeds, and proceeds of proceeds, of any nature and kind, used and unused by the Debtor in the business.

No schedules or exhibits are attached to the security agreement.

Financing statements also were signed on the date of the closing, which subsequently were recorded in the Office of the Register of Deeds of Cabarrus County and in the Office of the North Carolina Secretary of State. The description of the collateral contained in the financing statements reads as follows:

> All of the personal property, including, but not limited to the assets identified in paragraph 2 of the Stock Purchase Agreement dated November 7, 1995, and as shown on the schedules attached to that agreement, which schedules which shall be attached hereto; as well as all additional equipment, furniture, fixtures, supplies, inventory, instruments, accounts receivable, where ever located and including substitutions, additions, accounts receivables, replacements, proceeds, and proceeds of proceeds of any kind or nature, used and unused by Debtor."

Although this description refers to "schedules which shall be attached hereto", no schedules were attached to either of the financing statements as recorded.

The issue thus presented is whether the foregoing descriptions of collateral are sufficient to satisfy the requirements of G.S. §§ 25-9-203 and 25-9-402(1). In arguing that the description is insufficient, the Trustee points out that the description contains three clauses consisting of (1) the reference to "all personal property"; (2) the reference to attached schedules; and (3) the reference to all other equipment, furniture and fixtures, etc. The Trustee argues that neither of these clauses constitutes a sufficient description and that the financing statements therefore do not contain a sufficient description of the collateral. This argument is not accepted because the description in the financing statements must be read as a whole, rather than being dissected into separate parts, with each part then being read as if the other parts did not exist. When the description is read as a whole, and each portion thereof is given effect, the description is sufficient to identify the collateral as being all of the equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable of Bonds Distributing Company, Inc.

If the description referred only to "all personal property" there are cases which would support a finding of insufficiency.[12]

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[12]See In re Ashkenazy Enters., Inc., 94 B.R. 645, 647 (Bankr. C.D. Calif. 1986). Compare Womack v. Newman Fixture Co., 11 UCC

The same would be true if the description consisted only of a reference to an unattached schedule which was not a part of the public record.[13] However, the description in the present case is not so limited. It begins by referring to "all" of the personal property of the Debtor "including" the assets shown in the schedules, as well as "all additional" equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable. Even without knowing what equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable are listed on the schedules, it is apparent from this description, read as a whole, that it encompasses all of Debtor's equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable.

The applicable test of the sufficiency of a description of collateral is contained in G.S. § 25-9-110.[14] Under this provision, a description is sufficient if it "reasonably identifies" what is

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Rep. Serv. 2d 285 (Ark. App. 1989); In re John Oliver Co., 91 B.R. 643 (Bankr. D.N.H. 1988).

[13]See In re H.L. Bennett Co., 588 F.2d 389, 391 (3rd Cir. 1978); In re Waldick Aero-Space Devices, Inc., 49 B.R. 192 (Bankr. D.N.J. 1985).

[14]G.S. § 25-9-110 provides: "For the purposes of this article any description of personal property or real estate is sufficient whether or not it is specific if it reasonably identifies what is described."

described. As reflected in the Amended Official Comment, the only requirement under G.S. § 25-9-110 is that "the description do the job assigned to it -- that it make possible the identification of the thing described." The description in the present case makes it possible to identify all of Debtor's equipment, furniture, fixtures, supplies, inventory, instruments and accounts receivable as being the collateral described in the financing statement. The description therefore "reasonably identifies" those assets as collateral covered by the security interest granted to Bonds and thereby satisfies the requirements of G.S. § 25-9-402 that the financing include a description of the collateral. Accordingly, the Trustee is not entitled to avoid the security interest asserted by Bonds on the ground that the description of collateral is insufficient.

(b) After-Acquired Property.

G.S. § 25-9-204 permits a creditor to obtain a security interest in property which is acquired by the debtor after the execution of the security agreement. The statutory language making this possible provides that "a security agreement may provide that any or all obligations covered by the security agreement are to be secured by after-acquired collateral." The effect of this language is explained in the Amended Official Comment as follows:

"Subsection 1 makes clear that a security interest arising by virtue of an after-acquired property clause has equal status with a security interest in collateral in which the debtor has rights at the time value is given under the security agreement."

The requirement under G.S. § 25-9-204 is that the security agreement contain the language which provides that the collateral includes after-acquired property. The Amended Official Comment points out that this "should not be confused with the use of financing statements in notice filing." Since the reference to after-acquired property clauses in G.S. § 25-9-204 is limited to the security agreement, "[t]here is no need to refer to after-acquired property or future advances in the financing statement." Therefore, in the present case, whether Bonds acquired a security interest in after-acquired property depends upon the language contained in the security agreement. See Dowell v. D.R. Kincaid Chair Co., 125 N.C. App. 557, 561, 481 S.E.2d 670, 673 (1997)("it is the security agreement, and not the financing statement, which defines the extent of the security interest involved").

The fact that the security agreement in the present case does not use the exact term "after-acquired property" does not mean that no security interest was granted with respect to after-acquired property. There are no magic words which must be used in order to obtain a security interest in after-required property. All that is required under G.S. § 25-9-204 is that the security agreement contain language reflecting an intention to create a security interest in after-acquired collateral. <u>See</u> <u>In re Carter</u>, 203 B.R. 697, 704 (Bankr. W.D. Mo. 1996); <u>Central Production Credit Assn. v. Hopkins</u>, 810 S.W.2d 108, 111 (Mo. Ct. App. 1991); <u>Kubota Tractor Corp. v. Citizens & Southern Nat'l Bank</u>, 403 S.E.2d 218, 222 (Ga. Ct. App. 1991).

In the present case, the description of collateral in the security agreement involves incorporation by reference of a description of property contained in the stock purchase agreement, as well as a separate description of collateral contained in the security agreement:

> The collateral of this Security Agreement is all of the personal property, including, but not limited to, the assets identified in Paragraph 2 of the Stock Purchase Agreement dated November 7, 1995, and the various schedules referenced therein which shall be attached hereto as well as all additional equipment, furniture and fixtures, supplies, inventory, instruments, accounts receivable, wherever located and including, <u>substitutions</u>, <u>additions</u>, <u>replacements</u>, proceeds, and proceeds of proceeds, of any nature and kind, used and unused by Debtor in the business. (Emphasis supplied).

In arguing that the reference to substitutions, additions and replacements should be read narrowly, the Trustee relies upon the presence of a semi-colon which appears in the description of collateral contained in the financing statements. However, the controlling description is the one contained in the security agreement, which does not contain the offending semi-colon. The use of the words "substitutions", "additions" and "replacements" is sufficient to encompass and include in the description property acquired after the execution of the security agreement. Although the description certainly is not a model of legal draftsmanship, the placement of these words is such that they logically and reasonably may be read as applying to all of the types of property referred to earlier in the description. Therefore, the court concludes that the collateral encompassed by the security agreement included all equipment, furniture and fixtures, supplies, inventory, instruments and accounts receivable owned when the agreement was executed and all after-acquired substitutions, additions and replacements for such property.

Even without the reference to substitutions, additions and replacements, the description in the security agreement is sufficient to encompass after-acquired accounts and inventory. As noted above, the described collateral includes all inventory and all accounts receivable of the Debtor.[15] Because of the particular characteristics of accounts receivable and inventory and the fact that they are cyclical and constantly turning over, a majority of courts have concluded that a security agreement referring to all inventory and all accounts receivable creates a security interest in after-acquired inventory and accounts.[16] Recognizing that accounts and inventory change or turnover constantly in the ordinary course of business without affecting the identity of the res itself, these cases treat accounts and inventory as a "floating

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[15]Paragraph 2(a) of the stock purchase agreement refers to "inventory", while paragraph 2(d) refers to "all accounts receivable." In addition to the incorporation of these provisions, the security agreement also refers to "all additional" inventory and accounts receivable.

[16]See, e.g., Paulman v. Gateway Venture Partners III (In re Filtercorp, Inc.), 163 F.3d 570, 579 (9th Cir. 1998); American Employers Ins. Co. v. American Sec. Bank, N.A., 747 F.2d 1493, 1500 (D.C. Cir. 1984); National Bank v. West Tex. Wholesale Supply Co. (In re McBee), 714 F.2d 1316, 1330-31 (5th Cir. 1983); Manchester Nat'l Bank v. Roche, 186 F.2d 827, 831 (1st Cir. 1951) (old UCC); In re Fibre Glass Boat Corp., 324 F.Supp. 1054, 1056 (S.D. Fla. 1971); Rosenberg v. Rudnick, 262 F. Supp. 635, 639 (D. Mass. 1967); In re Shenandoah Warehouse Co., 202 B.R. 871, 873 (Bankr. W.D. Va. 1996); Provident Hosp. & Training Ass'n v. GMAC Mortgage Corp. (In re Provident Hosp. & Training Ass'n), 79 B.R. 374, 380 (Bankr. N.D. Ill. 1987); Juemmerle v. United N.M. Bank at Roswell, N.A., 831 P.2d 976, 979-80 (N.M. 1992); Frankel v. Associates Fin. Servs. Co., 377 A.2d 1166, 1168 (Md. Ct. App. 1977). But see In re Middle Atl. Stud Welding Co., 503 F.2d 1133, 1136 (3d Cir. 1974); Covey v. First Nat'l Bank (In re Balcain Equip. Co.), 80 B.R. 461, 462 (Bankr. C.D. Ill. 1987); In re Taylored Prods., Inc., 5 U.C.C. Rep. Serv. (CBC) 286, 289-91 (Bankr. W.D. Mich. 1968).

mass" which must be viewed as a single entity continuously in existence and not consisting of individual components.

Whether a security agreement creates a security interest in particular assets is a question which is determined by controlling state law,[17] which in the present case is North Carolina law. The North Carolina courts apparently have not decided the issue of whether a reference in a security agreement to all inventory and all accounts receivable encompasses accounts receivable and inventory acquired after the execution of the security agreement. In the absence of controlling state law on this issue, the function of this court is to predict or anticipate how the Supreme Court of North Carolina would decide the issue. See McNair v. Lend Lease Trucks, Inc., 93 F.3d 325, 328 (4th Cir. 1996); In re Bower, 234 B.R. 109, 111 (Bankr. D. Nev. 1999); In re Johnson, 120 B.R. 461, 474-75 (Bankr. N.D. Ind. 1990). Having concluded that the North Carolina Supreme Court likely would adopt the rule followed by the cases cited earlier, this court concludes that the reference to all inventory and all accounts receivable encompasses accounts receivable and inventory acquired by the Debtor subsequent to the

[17]See Butner v. United States, 440 U.S. 48, 55, 99 S.Ct. 914, 918, 59 L.Ed.2d 136 (1978); In re Carter, 203 B.R. 697, 703 (Bankr. W.D. Mo. 1996); In re Shenandoah Warehouse Co., 202 B.R. 871, 873 (Bankr. W.D. Va. 1996).

execution of the security agreement.

(c) Failure to include Secured Party's Address in Financing Statement.

It is undisputed that the financing statement filed with the Secretary of State contains no address for Bonds, who is identified in the financing statement as the secured party. The issue presented is whether this omission is fatal to the perfection of a security interest by Bonds. This is a legal issue which is appropriate for determination by summary judgment.

G.S. § 25-9-302(1) requires that a financing statement be filed in order to perfect a security interest in inventory, equipment and accounts. The formal requisites for a financing statement are contained in G.S. § 25-9-402(1). Under this statute, a financing statement is sufficient if it "gives the names of the debtor and the secured party, is signed by the debtor, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral." As stated in the Amended Official Comment to G.S. § 25-9-402, "[s]ubsection (1) sets out the simple formal requisites of a financing statement under this Article. These requirements are (1) signature of debtor; (2) addresses of both parties; (3) a description of the collateral by type of item."

In an attempt to avoid overly technical requirements, G.S. § 25-9-402(8) directs that "[a] financing statement substantially complying with the requirements of this section is effective even though it contains minor errors which are not seriously misleading." The North Carolina Supreme Court has recognized that G.S. § 25-9-402 "adopts a system of notice filing," and that the rule of substantial compliance in subsection (8) of the statute reflects the notice function of the filing. See Evans v. Everett, 279 N.C. 352, 183 S.E.2d 109 (1971). See also In re Southern Supply Co. of Greenville, N.C., Inc., 405 F. Supp. 20, 22 (E.D.N.C. 1975)("One of the policies of [Article 9] is to simplify formal requisites and filing requirements and is designed to discourage the fanatical and impossibly refined reading of statutory requirements in which courts have occasionally indulged themselves.").

As reflected in the language of G.S. § 25-9-402(1), the purpose of the address requirement for the secured party in a financing statement is to enable other creditors to contact the secured party for the purpose of obtaining information concerning the security interest. See Mid-American Dairymen, Inc. v. Newman Grove Coop. Creamery Co., 214 N.W.2d 18, 23 (Neb. 1974). Some cases recognize that if a financing statement lists a partial address which is sufficient to enable creditors to locate the secured party, then the financing statement, although deficient, substantially complies with the requirement of G.S. § 25-9-402(1). For example, in E-B Grain Co. v. Denton, 73 N.C. App. 14, 325 S.E. 2d 522 (1985), the court determined that the debtor's address, listed as "Whitakers, N.C. 27891", was not seriously misleading and satisfied the requirement of G.S. § 25-9-402(1).

However, the situation presented in the present case is different because the financing statement at issue provided no information regarding the address of the secured party. Despite the general rule of liberality found in G.S. § 25-9-402(8) and the recognition that a partial address may pass muster under the rule of substantial compliance, many courts have reached a different conclusion when there is no attempt whatsoever to comply with the address requirement of G.S. § 25-9-402(1), and the address of the secured party or the debtor is totally omitted from the financing statement. Such an omission involves substantial noncompliance with the terms of the statute and has been treated as preventing the perfection of the creditor's security interest. See In re Keefer, 25 B.R. 597 (Bankr. D. Idaho 1983); In re Smith, 205 F. Supp. 27, 28-29 (E.D. Pa. 1962)(omission of debtor's address from financing statement, as a matter of law, prevents such a statement from perfecting a security interest); In re Permian Anchor Servs., Inc., 649 F.2d 763, 766 (10th Cir. 1981)("There are no degrees of invalidity. A financing statement is invalid because of a lack of debtor's signature as it is for lack of the debtor's address."); Whitworth v. Kreuger, 558 P.2d 1026, 1035 (Idaho 1976)("The address requirement is strictly construed because the potential creditor must be able to know where to go to get further information. . . . A financing statement is insufficient when it does not contain the address of the creditor."); In re L & K Transp. Co., Inc., 8 B.R. 921, 922 (Bankr. D. Mass. 1981)(complete absence of debtor's address is not the type of minor error contemplated by § 402(8) unless the debtor is so well known that there could be no question as to its identity and address); Cushman Sales and Service of Neb., Inc. v. Muirhead, 268 N.W.2d 440, 444 (Neb. 1978)(financing statement fatally defective where address of secured creditor omitted); Strevell-Paterson Fin. Co. v. May, 422 P.2d 366, 369 (N.M. 1967)("If the secured party's address does not appear it would be an undue burden on the person seeking such information to find him. The filing system will perform its intended function only if the secured party substantially complies with the requirements of § 9-402(1)."); In re HGS Technical Assoc., Inc., 14 UCC Rep. Serv. 237 (Bankr. E.D. Tenn. 1972)(lack of address of debtor caused financing statement to be ineffective – "[T]he courts in the guise of interpretation should not ignore express requirements of the Code as to the content of the financing statement. Nor should the Code requirements be scuttled on a plea that they are loose and relaxed."). Cf. In re Environmental Aspecs, Inc., 235 B.R. 378, 388-89 (E.D.N.C. 1999)(the court outlined the "relationship between the notice-filing policy behind the statute's requirement that a creditor file a financing statement, and the discrete requirement that a sufficient financing statement contain certain enumerated elements," and determined that the omission of the debtor's signature from a financing statement caused the creditor's security interest to be unperfected). But see Rooney v. Mason, 394 F.2d 250 (10th Cir. 1968); In re French, 317 F. Supp. 1226 (E.D. Tenn. 1970); Riley v. Miller, 549 S.W.2d 314 (Ky. Ct. App. 1977).

Defendants argue that the financing statement in the present case should be upheld under G.S. § 25-9-402(8) because the financing statement substantially complied with G.S. § 25-9-402(1) and was not seriously misleading. This argument is rejected. In order for the rescue provisions of G.S. § 25-9-402(8) to be operative, the financing statement must be one which "substantially" complies with the requirements of G.S. § 25-9-402(1). As a majority of the cases have recognized, a financing statement which completely omits the address of the secured creditor does not substantially comply with that statute. By its terms, G.S. § 25-9-402(8) is applicable where there are "minor errors" which are not seriously misleading. The complete omission of the secured creditor's address from a financing statement involves a failure to comply with one of the statutory requirements under G.S. § 25-9-204(1), which may not be passed off as a minor error. Perhaps, from the standpoint of semantics, it is debatable whether the total absence of information "mis" leads; however, this is immaterial where, as in the present case, the omitted information is specifically required by the statute and its absence from the financing statement prevents the financing statement from serving one of the purposes expressly stated in the statute, i.e., giving the location of the source from which "information concerning the security interest may be obtained." This court concludes, therefore, that the North Carolina Supreme Court would, as most other courts have, decide that although the requirements of the U.C.C. have been liberalized somewhat under § 9-402(8), the complete omission of one of the basic elements of an effective financing statement constitutes noncompliance with G.S. § 25-9-

402(1), not substantial compliance, and renders a secured creditor's security interest unperfected. As recognized by the court in In re Softalk Publishing Co., 64 B.R. 523, 525 (9th Cir. BAP 1986), aff'd, 856 F.2d 1328 (9th Cir. 1988), "[s]ince the U.C.C. has reduced the formal requisites of a financing statement to a minimum, there can be no acceptable excuse for failure to comply with its provisions." Because the financing statement filed with the Secretary of State provided no information regarding the Bonds' address, it did not comply with G.S. § 25-9-402 and was insufficient to enable Bonds to perfect a security interest in the assets of the Debtor. Accordingly, Bonds never acquired a perfected security interest in the Debtor's assets.

The fact that the financing statement recorded in Cabarrus County includes Bonds' address does not cure the defect in the financing statement filed with the Secretary of State. Under G.S. § 25-9-401(c), "in order to perfect a security interest" in the assets of a debtor with a single place of business in North Carolina, two financing statements must be recorded, one with the Secretary of State and the other in the county in which the debtor has its place of business. Courts in dual filing states do not allow defective financing statements to ride on the coattails of proper filings. Rather, most courts require that all financing statements, whether filed locally or with the secretary of state, stand on their own. <u>See</u>, <u>e.g.</u>, <u>In re B. Hollis Knight Co.</u>, 605 F.2d 397 (8th Cir. 1979)(filing with secretary of state was proper but local filing failed to list one of two debtors, so security interest was unperfected); <u>In re Multi-Photo, Inc.</u>, 62 B.R. 159 (Bankr. E. D. Mo. 1986)(debtor signed local filing but failed to sign filing with secretary of state, so security interest of creditor was unperfected); <u>In re Sportswear Shoppe, Ltd.</u>, 15 B.R. 970 (Bankr. W.D. Mo. 1981)(court implied that what a search of the local filing would reveal was irrelevant since the filing with the secretary of state was deficient, and therefore the security interest was unperfected); <u>First Nat'l Bank of St. Charles v. Chemical Prods., Inc.</u>, 637 S.W.2d 373 (Missouri Ct. App. 1982)(local filing was proper but central filing was defective, so court did not look to local filing under general notice policy of the Code, but instead required central filing to stand on its own). This court concludes that under the rule which would be adopted in North Carolina, the failure to file properly with the Secretary of State resulted in the non-perfection of Bonds' security interest notwithstanding the filing which was made in Cabarrus County.

Since Bonds did not have a perfected security interest in Debtor's assets, the Trustee is entitled to avoid the transfer of

Debtor's assets which occurred when Bonds repossessed and sold the assets on August 21, 1997. Such transfer from an obviously insolvent debtor enabled Bonds to receive more than he would receive as an unsecured creditor in a Chapter 7 case. See In re Colacci's of Am., Inc., 490 F.2d 1118, 1120 (10th Cir. 1974)(repossession of equipment within 90 days of bankruptcy constituted a preferential transfer where repossessor did not have a perfected security interest); Glessner v. Massey-Ferguson, Inc., 353 F.2d 986, 992 (9th Cir. 1966)("It follows then that repossession by the appellee of the property subject to the conditional sale agreements, under the circumstances here and within four-months period next preceding filing the petition in bankruptcy, must be held to be a preference"). Section 550(a) provides that "[e]xcept as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b) of 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property." As reflected in this language, the successful plaintiff in an avoidance action is entitled to recover the specific property transferred or, with court approval, the value of such property from the initial transferee or the immediate or mediate transferee of the initial transferee. See generally, 5 Collier on Bankruptcy ¶ 550.02 (15th ed. 1999).

The Code provides no guidelines regarding when to permit recovery of the value of the property rather than the property itself. However, the cases recognize that one situation in which the Trustee is entitled to recover the value of the property is when the debtor's property has been disposed of by the transferee and cannot be recovered. See In re Willaert, 944 F.2d 463, 464-65 (8th Cir. 1991); In re Da-Sota Elevator Company, 939 F.2d 654, 656 (8th Cir. 1991); In re McLaughlin, 183 B.R. 171, 177 (Bankr. W.D. Wis. 1995); In re Classic Drywall, Inc., 127 B.R. 874, 877 (D. Kan. 1991). The value of the transferred property is assessed as of the date of the transfer and, generally, the value which may be recovered is the fair market value of the property. See In re Vann, 26 B.R. 148 (Bankr. S.D. Ohio 1982); In re Hudson Printing & Lithographing Co., 28 B.R. 876 (Bankr. E.D. Tenn. 1983); In re Nevada Implement Co., 22 B.R. 105 (Bankr. W.D. Mo. 1982); In re McLaughlin, 183 B.R. at 177; In re Shape, Inc., 176 B.R. 1, 3 (Bankr. D. Me. 1994); In re Chambers, 125 B.R. 778, 792 (Bankr. W.D. Mo. 1991); In re Brown, 118 B.R. 57, 60 (Bankr. N.D. Tex. 1990).

The record in the present case reflects that Bonds, Inc., has been selling inventory and collecting accounts receivable since August of 1997. It thus appears impractical, if not impossible, to order the recovery of the property itself. Therefore, the court concludes that the Trustee is entitled to recover the value of the property which was owned by the Debtor at the time of the foreclosure sale on August 21, 1997.

The Trustee argues that the $1,484,391.11 bid at the foreclosure sale establishes the fair market value of the property at that figure and that the Trustee therefore is entitled to a summary judgment in the amount of $1,484,391.11. This argument is not accepted. There is evidence from which it could be inferred that the bid at the foreclosure sale was intended as a credit bid based upon the amount of the indebtedness owed by the Debtor, rather than the value of the property. Also, there is evidence in the record tending to show that an inventory was done shortly after the sale which showed an aggregate value of only $863,571.88. Thus, the evidence regarding the value of the property is in dispute, and value therefore may not be determined by summary judgment. The result is that the Trustee is entitled to a summary judgment adjudging that he is entitled to recover from the defendants the value of the property that was owned by the Debtor at the time of the foreclosure sale on August 21, 1997, but the amount of the judgment is a matter to be determined by the jury. The Trustee also is entitled to interest on any recovery at the federal rate from the date of the filing of the complaint in this adversary proceeding. See Precision Walls, Inc. v. Crampton, 196 B.R. 299, 305 (Bankr. E.D.N.C. 1996); In re Shape, Inc., 176 B.R. 1, 3 (Bankr. D. Me. 1994).

4. Fourth Claim - Fraudulent Conveyance.

In the Fourth Claim the Trustee alleges that the issuance of the Redemption Note and the Security Agreement by the Debtor constituted a fraudulent conveyance under G.S. 39-15, et. seq., which is avoidable under § 544(b) of the Bankruptcy Code. In support of this claim the Trustee contends that issuance of the promissory note and security agreement was not supported by sufficient consideration because the Debtor received no value for the issuance of these instruments. According to the Trustee, the transfer represented by the issuance of the promissory note and security agreement occurred while the Debtor was insolvent or rendered the Debtor insolvent.

Under North Carolina law one of the "badges of fraud" which may constitute evidence of a fraudulent conveyance is a transaction in which the conveyance is voluntary and the grantor does not retain property fully sufficient and available to pay its existing debts. See Edwards v. Northwestern Bank, 39 N.C. App. 261, 250 S.E.2d 651 (1979); Aman v. Walker, 165 N.C. 224, 81 S.E. 162 (1914). There is substantial authority that such a situation may arise in the context of a leveraged buyout. See Moody v. Security Pac. Bus. Credit, Inc., 971 F.2d 1056, 1064 (3d Cir. 1992); United States v. Tabor Court Realty Corp., 803 F.2d 1288, 1297 (3d Cir. 1986), cert. denied, 483 U.S. 1005, 107 S. Ct. 3229, 97 L.Ed.2d 735 (1987); Zahn v. Yucaipa Capital Funds, 218 B.R. 656 (D.R.I. 1998); In re Healthco Int'l, Inc., 195 B.R. 871 (D. Mass. 1996); Crowthers McCall Pattern, Inc. v. Lewis, 129 B.R. 992 (S.D.N.Y. 1991); In re Structurelite Plastics Corp., 224 B.R. 27 (6th Cir. B.A.P. 1998); In re Chawley's, Inc., 188 B.R. 832 (Bankr. D. Minn. 1995); In re Oxford Homes, 180 B.R. 1 (Bankr. D. Maine 1995); In re Aluminum Mills Corp., 132 B.R. 869, 885 (Bankr. N.D. Ill. 1991); In re Morse Tool, Inc., 108 B.R. 389 (Bankr. D. Mass. 1989); In re Vadnais Lumber Supply, Inc., 100 B.R. 127, 134-35 (Bankr. D. Mass. 1989). Under these cases, the exchange of equity for debt in a leveraged buyout situation was regarded as not amounting to fair consideration.

Unfortunately, there apparently are no North Carolina cases involving the issue of whether and under what circumstances a leveraged buyout may involve a fraudulent conveyance. However, under North Carolina law, a conveyance "is deemed to be [without consideration] when the purchaser does not pay a reasonably fair price such as would indicate unfair dealing and be suggestive of fraud." See North Carolina Nat'l Bank v. Evans, 296 N.C. 374, 378, 250 S.E.2d 231, 234 (1979). The record in the present case includes conflicting affidavits and other materials which create disputed issues of fact as to the value of the Debtor's assets and the amount of its liabilities at the time of the transaction with Young and the financial condition of the Debtor immediately before and immediately after the transaction. These issues of fact are material in that they have a significant bearing on the extent to which there was consideration for the promissory note and security agreement which Bonds received from the Debtor and whether the Debtor was insolvent at the time of the transaction or was rendered insolvent by the transaction. Since there are material issues of fact regarding the fraudulent conveyance claim, defendants' motion for summary judgment as to the fraudulent conveyance claim may not be granted.

5. Fifth Claim - Avoidance of Promissory Note and Security Agreement as an Unauthorized Distribution Under G.S. § 55-6-40(c).

Under G.S. § 55-6-40(c) no distribution may be made to the shareholders of a corporation if, after giving it effect, the corporation would not be able to pay its debts as they become due in the usual course of business or the corporation's total assets would be less than the sum of its total liabilities. In the Fifth Claim the Trustee alleges that the promissory note and security agreement which Bonds received from the Debtor are avoidable under G.S. § 55-6-40(c) because, after giving effect to the promissory note and security agreement, the Debtor was not able to pay its debts as they became due in the usual course of business and the Debtor's total assets were less than the sum of its total liabilities. The Defendants seek summary judgment on this claim on the grounds that the G.S. § 55-6-40(c) is not applicable because the issuance of the promissory note and security agreement did not constitute a "distribution" for purposes of the statute and, alternatively, on the ground that the Debtor was not insolvent after the note and security agreement were issued.

In arguing that G.S. § 55-6-40(c) is inapplicable, the Defendants rely heavily on In re C-T of Virginia, Inc., 958 F.2d 606 (4^{th} Cir. 1992), a case in which the Fourth Circuit Court of Appeals held that a similar Virginia statute was not applicable to a transaction involving a merger in which the shareholders of the debtor corporation were paid for their shares with proceeds from a loan which was secured by a lien on the assets of the debtor corporation. The court reasoned that a corporate acquisition, structured as a merger, "is simply a different animal from a distribution", noting that the payments to shareholders were not made by the debtor corporation and the encumbering of the assets occurred after the change in ownership and was not approved by the directors of the debtor corporation. There are factual differences in the present case which make the C-T of Virginia case inapposite. In the present case, the issuance of the promissory note and deed of trust went directly from the Debtor to Bonds, the transaction was approved by Bonds as the sole director of the Debtor and Bonds continued to be a shareholder of the Debtor following the transfer. As pointed out in the Official Comment to G.S. § 55-6-40, the definition of a "distribution" under North Carolina law is very broad: "Section 1.40 defines 'distribution' to include virtually all transfers of money, indebtedness of the corporation or other property to a shareholder in respect of the corporation's shares. It thus includes cash or property dividends, payments by a corporation to purchase its own shares, distributions of promissory notes or indebtedness, and distributions in partial or complete liquidation or voluntary dissolution." (Emphasis supplied). While this definition may not encompass a merger of the type involved in the C-T of Virginia case, it is broad enough to encompass the transaction involved in the present case.

The remaining argument regarding this claim has to do with whether the Debtor was insolvent following the transaction. This involves a disputed factual matter which obviously is material to the merits of the claim. It follows, therefore, that the Defendants are not entitled to summary judgment with respect to the Fifth Claim.

6. Sixth Claim - Liability of Directors under G.S. § 55-8-33(a) for Distributions which Violate G.S. § 55-6-40(c).

The Sixth Claim is based upon G.S. § 55-8-33(a), which provides that a director who votes for or assents to a distribution made in violation of G.S. § 55-6-40 is personally liable for the amount of the distribution that exceeds what could have been distributed without violating G.S. § 55-6-40 if it is established that he did not perform his duties in compliance with G.S. § 55-8-30. Since this claim turns upon whether there has been a violation of G.S. § 55-6-40, the Defendants are not entitled to summary judgment for the same reasons stated in foregoing discussion of the Fifth Claim, and because the record now before the court does not reflect as a matter of law that Bonds performed his duties as a director in compliance with G.S. § 55-8-30.

7. Seventh Claim - Whether Sale Was Commercially Reasonable.

Under G.S. § 25-9-504 a secured creditor has a right to dispose of collateral after default by the debtor. G.S. § 25-9-504(3) provides that the disposition of the collateral "may be by public or private proceedings and may be made by way of one or more contracts." However, G.S. § 25-9-504(3) specifically requires that "every aspect of the disposition including the method, manner, time and terms must be commercially reasonable." G.S. §§ 25-9-601 through 25-9-607 set forth procedures for conducting public sales of collateral. These provisions deal with the content of notices of sale, posting and mailing notices of sale, etc., but are not mandatory. However, G.S. § 25-9-601 provides that if a secured party disposes of the collateral by means of a public sale which "substantially" complies with these procedures, the disposition is conclusively deemed to be commercially reasonable in all respects.

In the present case, Bonds elected to dispose of the collateral by means of a public sale which was held on August 21, 1997, at the courthouse in Cabarrus County. The Trustee alleges that the foreclosure sale was not commercially reasonable as required by G.S. § 25-9-504(3) because: (1) the notice of sale stated that the sale would be held on August 21, 1996, rather than on August 21, 1997; (2) notwithstanding having notified the Debtor that the sale would be postponed until August 29, 1997, the sale was held on August 21, 1997, as originally scheduled; (3) Bonds failed to comply with the terms of the sale which called for payment in full in cash upon completion of the foreclosure sale; and (4) the sale was held after a state court receiver had been appointed for the Debtor. Because of the alleged failure to conduct the sale in a commercially reasonable manner, the Trustee alleges that he is entitled to recover the sum of $1,484,391.11, representing the fair market value of the Debtor's assets at the time of the foreclosure sale. For the reasons hereinafter stated, the court has concluded that neither party is entitled to summary judgment on this issue.

G.S. § 25-9-602 requires that a notice of sale must: (a) refer to the security agreement pursuant to which the sale is held; (b) designate the date, hour and place of sale; (c) describe the personal property to be sold; (d) state the terms of sale; and (e) include any other provisions required by the security agreement. Under G.S. § 25-9-603, the notice of sale must be posted on the notice bulletin board of the courthouse in which the sale is to be conducted for at least five days immediately preceding the sale and must be mailed to each debtor at its actual address if known by the secured party, the address provided by the debtor, or the debtor's last known address.

In the absence of allegations and evidence that the notice failed to comply with G.S. § 25-9-602 or the notice was not posted and mailed in accordance with G.S. § 25-9-603 or the public sale was not held as advertised, it is a question of law for the court whether the secured party has substantially complied with the procedures provided in G.S. § 25-9-601, etc. On the other hand, if there is competent evidence that the secured party did not substantially comply with the statutory procedures, then a jury issue is raised. If it is established that the secured party did not substantially comply with G.S. § 25-9-601, etc., the secured party then has the burden of proving by the greater weight of the evidence that the sale was commercially reasonable under G.S. § 25-9-504. <u>See</u> <u>Wachovia Bank & Trust Co. v. Murphy</u>, 36 N.C. App. 760, 245 S.E.2d 101, appeal dismissed, 295 N.C. 557, 248 S.E.2d 734 (1978); <u>Parks Chevrolet, Inc. v. Watkins</u>, 74 N.C. App. 719, 329 S.E.2d 728 (1985).

The evidence relied upon by the Trustee is sufficient to raise a jury issue as to whether Bonds substantially complied with the requirements of G.S. § 25-9-601 in noticing and conducting the purported sale which was held on August 21, 1997, but does not show as a matter of law that Bonds did not substantially comply or as a matter of law that the sale was not commercially reasonable. The evidence submitted by the Trustee in support of his motion shows that the notice of sale which was prepared on behalf of Bonds used an improper date for the sale when it referred to August 21, 1996, instead of August 21, 1997. The evidence also showed that after the original notice was issued, a notice of postponement was sent to the Debtor purporting to postpone the sale to August 29, 1997. Then, shortly before the sale, and after receiving conflicting verbal information as to whether the sale would be postponed, the Debtor was notified by representatives of Bonds that the sale would be held as originally scheduled. The evidence also would support a finding that the bid at the sale was made on behalf of Bonds, Inc., rather than Bonds, raising an issue as to whether a credit bid was permissible, rather than Bonds, Inc., being obligated to pay cash as called for under the terms stated in the notice of sale. Substantial compliance means "a compliance which substantially, essentially, in the main, or for the most part, satisfies the procedures." North Carolina Nat'l Bank v. Burnette, 297 N.C. 524, 532, 256 S.E.2d 388, 393 (1979). Considering all of the foregoing circumstances surrounding the sale, the court concludes that reasonable minds could differ as to whether the sale substantially complied with the applicable statutory provisions. The foregoing circumstances, plus the fact that the receiver was in place at the time of the sale, lead to the same conclusion regarding the issue of whether all aspects of the sale were commercially reasonable. The issue of commercial reasonableness "does not readily lend itself to summary judgment, as reasonable minds may differ over what is commercially reasonable." NationsBank of N.C., N.A. v. American Doubloon Corp., 125 N.C. App. 494, 499, 481 S.E.2d 387, 390, cert. denied, 346 N.C. 882, 487 S.E.2d 551 (1997). It follows therefore that neither party is entitled to summary judgment with respect to the Seventh Claim.

8. Eighth Claim - Whether Bonds, Inc. was alter Ego or Mere Instrumentality of Bonds.

Defendants presented no arguments in support of their motion for summary judgment as to this claim, and it does not appear from the record that they are entitled to summary judgment as to this claim. Accordingly, Defendants' motion for summary judgment will be denied as to the Trustee's Eighth Claim.

9. Ninth Claim - Breach of Fiduciary Duties.

G.S. § 55-8-30 requires that a director discharge the duties of a director in good faith, with the care an ordinarily prudent person in a like position would exercise under similar circumstances and in a manner the director reasonably believes to be in the best interest of the corporation. Although the word "fiduciary" is not used in this provision, the North Carolina Commentary to § 55-8-30 points out that "there is no intent to change North Carolina law in this area. The decision not to bring forward the language stating that a director shall 'be deemed to stand in a fiduciary relation to the corporation' in former G.S. 55-35 is not intended to modify in any way the duty of directors recognized under the former law." The earlier cases which discuss and delineate the duties of directors thus continue to be effective. Under these cases directors act in a fiduciary capacity in the sense of owing the corporation the duties of good faith, loyalty and due care. See Hill v. Erwin Mills, Inc., 239 N.C. 437, 80 S.E.2d 358 (1954); Loy v. Lorm Corp., 52 N.C. App. 428, 278 S.E.2d 897 (1981). According to Robinson, the primary duty of a director is good faith. Such duty demands that the director always discharge his or her duties honestly, conscientiously, fairly, and with undivided loyalty to the corporation. R. Robinson, North Carolina Corporation Law, § 14-2 (15^{th} ed. 1995). The requirement in G.S. § 55-8-30(a)(3) that a director act in a manner he reasonably believes to be in the best interest of the corporation prohibits a director from using his position for his own personal gain to the detriment of the corporation or its shareholders. See id.

The evidence in the record now before the court reflects that Bonds was a director of the Debtor at the time of the transaction with Young and that Bonds continued as a director of the Debtor following the transaction. In alleging that Bonds breached the fiduciary duties which he owed to the Debtor, the Trustee relies primarily upon the fact that Bonds approved the transaction with Young in his capacity as a director. The Trustee points out that Bonds had a personal interest in the transaction arising from the fact that the corporation was acquiring 35,999 shares of his stock in the transaction. The Trustee argues that in approving the transaction, "Bonds breached his fiduciary duties of fidelity and due care to the Debtor and is responsible for the financial distress caused to the Debtor as a result of his actions in that regard." A claim for breach of fiduciary duty may arise from directors approving and/or participating in a leveraged buyout transaction, depending upon the terms and conditions of the transaction and the effect of the transaction upon the corporation. See In re Healthco Int'l, Inc., 208 B.R. 288 (D. Mass. 1996); In re Buckhead Am. Corp., 178 B.R. 956 (Bankr. D. Del. 1994). These cases recognize that a transaction involving a purchase or redemption of stock which renders the corporation insolvent or with unreasonably small capital threatens the very existence of the corporation and may give rise to a claim against the directors who approve the transaction. It is undisputed that Bonds was a director and that he approved the transaction with Young. However, the financial condition and solvency of the Debtor, before and after the transaction, which are material in any such claim, are matters which are in sharp dispute in the present case. Moreover, based upon the circumstances disclosed by the evidence submitted by the parties, matters such as whether Bonds exercised the care of an ordinarily prudent person in a like position, whether he acted in good faith, whether he reasonably believed the transaction to be in the best interest of the corporation and whether the transaction was fair from the standpoint of the Debtor, are matters about which reasonable minds could differ and which, more appropriately, are for a jury to determine. It follows that neither party is entitled to summary judgment on the issue of whether Bonds breached his duty as a director by approving the transaction with Young.

The same is true with respect to the issue of whether Bonds breached his duties to the corporation when he foreclosed on the corporate assets in August of 1997. The foreclosure involved a matter in which Bonds had an interest adverse to that of the

Debtor. Under G.S. § 55-8-31, a conflict of interest transaction in which a director has a direct or indirect interest is not voidable if the material facts of the transaction and the director's interest were disclosed or known to the board of directors or the shareholders and the board of directors or shareholders authorized, approved, or ratified the transaction. In arguing for summary judgment, the Defendants say that Young, the other director of the Debtor, ratified the transaction. However, the language of G.S. § 55-8-31 requires the affirmative vote of the ratifying directors and the record now before the court does not disclose that any formal vote of directors was ever taken with respect to the approval of Bonds exercising his security interest in August of 1997.

10. Tenth Claim - Successor Liability.

The general rule under North Carolina law is that the purchaser of all or substantially all the assets of a corporation is not liable for the debts of the old corporation. See Budd Tire Corp. v. Pierce Tire Co., 90 N.C. App. 684, 370 S.E.2d 267 (1988). However, North Carolina recognizes four exceptions to this general rule: (1) Where there is an express or implied agreement by the purchasing corporation to assume the debt or liability; (2) where the transfer amounts to a de facto merger of the two corporations;

(3) where the transfer of assets was done for the purpose of defrauding creditors; and (4) where the purchasing corporation is a "mere continuation" of the selling corporation in that the purchasing corporation has the same shareholders, directors and officers. See GP Publications, Inc. v. Quebecor Printing - St. Paul, Inc., 125 N.C. App. 424, 432-33, 481 S.E. 674 (1997), rev. denied, 346 N.C. 546, 488 S.E.2d 800 (1997). In the present case, the Trustee relies upon the "mere continuation" exception in alleging that Bonds, Inc., should be held liable for the debts of the Debtor.

In the context of a commercially reasonable sale under G.S. § 25-9-504, North Carolina follows the "traditional rule" regarding "mere continuation" theory of liability. Under the "traditional rule" as applied in North Carolina, a corporate successor is the continuation of its predecessor if only one corporation remains after the transfer of assets and there is identity of stockholders and directors between the two corporations. However, North Carolina recognizes two other factors in addition to the issue of continuity of ownership that may be considered in deciding whether liability should be imposed on the successor corporation: (1) inadequate consideration for the purchase; and (2) lack of some of the elements of a good faith purchaser for value. See GP

Publications, 125 N.C. App. at 434; 481 S.E.2d at 680.

Based upon the record now before the court, the Trustee is not entitled to summary judgment against Bonds, Inc., on the theory that Bonds, Inc., is a mere continuation of the Debtor. Under the traditional rule regarding mere continuation liability the plaintiff is required to show identity of stockholders and directors between the former corporation and the successor corporation. The record does not establish such identity as a matter of law in the present case. The record reflects that prior to November of 1995, Bonds was the sole shareholder and director of the Debtor. However, the situation changed in November of 1995 with the closing of the transaction involving Young. At that time Young acquired 4000 shares of the stock owned by Bonds and 35,999 shares of Bonds' stock were redeemed, leaving Bonds with only one share of stock. Although Bonds remained as a director of the Debtor, the record reflects that there were two directors other than Bonds who were selected by Young. While Bonds did receive a security interest in the stock which was sold to Young as a result of the stock being pledged and placed in escrow, the fact remains that Young was the owner of the stock and exercised the rights incident to ownership of the stock by electing directors, exercising control over the Debtor and operating its business following the closing. This is the situation which existed from November of 1995 until the foreclosure sale in August of 1997. If measured by identity of stockholders and directors, Bonds, Inc., was not a continuation of the Debtor because there was a marked difference between the shareholders and directors of Bonds, Inc., and those of the Debtor. Young, the principal shareholder of the Debtor at the time of the sale, owned no stock in Bonds, Inc., all of which was owned by Bonds. None of the directors of the Debtor became directors of Bonds, Inc., other than Bonds. These facts do not establish as a matter of law that there was an identity of shareholders and directors between the two companies.

The two factors other than continuity of ownership which may be considered in deciding whether to impose liability upon a successor corporation are inadequate consideration for the purchase and lack of some of the elements of a good faith purchaser for value. The record now before the court, at most, raises a jury issue as to whether Bonds, Inc., was a "good faith" purchaser and whether the consideration at the foreclosure sale was inadequate. It is for the trier of fact to determine whether these factors have been established and, if so, to weigh the factors in determining whether Bonds, Inc., was a mere continuation of the Debtor. Hence, these additional factors are not sufficient to support the conclusion that, as a matter of law, Bonds, Inc., was a mere continuation of the Debtor. Instead, jury issues are raised, which mean that neither of the parties are entitled to summary judgment on this claim.

11-14. Twelfth through Fourteenth Claims.

Although the defendants included these claims in their motion for summary judgment, defendants presented no arguments in support of summary judgment as to these claims and it does not appear that defendants are entitled to summary judgment as to these claims. Defendants' motion for summary judgment as to the Twelfth through Fourteenth Claims therefore will be denied.

15. Third-party Defendant's Motion for Summary Judgment.

The third-party defendant ("Mills") argues that he is entitled to summary judgment dismissing the professional malpractice claim asserted by Bonds because: (1) the undisputed evidence shows that his employment and professional duty was limited to reviewing the closing documents and attending the closing on behalf of Bonds, and did not extend to analyzing the financial structure of the transaction; (2) even if Bonds shows that Mills breached a duty owed to him, Bonds failed to prove that such breach was a proximate cause of his damages; (3) Bonds had a duty to mitigate his damages which would have eliminated his damages and his failure to do so subjects his claim against Mills to summary judgment; (4) Bonds' claim is subject to summary judgment because he failed to create a genuine issue of material fact indicating that the financing statements were insufficient to perfect a security interest; and (5) Bonds' failure to exercise his rights as a creditor under the closing documents constitutes contributory negligence as a matter of law.

It is undisputed that Mills was employed to act as attorney for Bonds to some extent with respect to the transaction involving Young. While disputing that his engagement extended to "reviewing the underlying transaction", Mills concedes in his first affidavit that he was employed to review the "paperwork" for the transaction and attend the closing on behalf of Bonds. In accepting such employment, Mills impliedly represented that (1) he possessed the requisite degree of learning, skill and ability necessary to the practice of his profession and which others similarly situated ordinarily possess; (2) he would exert his best judgment in reviewing the closing documents and representing Bonds at the closing; and (3) he would exercise reasonable and ordinary care and diligence in the use of his skill and in the application of his knowledge to reviewing the closing documents and attending the closing on behalf of Bonds. See Hodges v. Carter, 239 N.C. 517, 519, 80 S.E.2d 144, 146 (1954).

The evidence reflects without dispute that the "paperwork" for the transaction included the financing statement that ultimately was recorded with the Secretary of State and that this financing statement therefore was one of the documents which Mills reviewed or should have reviewed. It is, of course, undisputed that the financing statement did not contain the address for Bonds, and it is a fair inference from the evidence submitted by the parties that Mills did not make any suggestion or recommendation that this obvious omission be corrected and the financing statement remained incomplete when it was recorded. As a result of the omission of the secured party's address, the financing statement did not comply with the minimal statutory requirements and was insufficient to perfect Bonds' security interest in the Debtor's assets. Based upon these circumstances, the court is satisfied that even if Mills' employment was limited to reviewing the closing documents and attending the closing, a rational trier of facts could conclude that Mills failed to satisfy the professional duty to Bonds and that such failure was a proximate cause of damage to Bonds. Based upon the record in the present case, a trier of fact could rationally conclude that an attorney who possessed the requisite degree of learning, skill and ability necessary to review closing documents of the type involved in this case and which other attorneys similarly situated ordinarily possess would know or ascertain before the closing that one of the requirements of a financing statement is that it supply the addresses of the parties and that if such attorney exerted his best judgment and exercised reasonable and ordinary care and diligence, he would have observed that one of the financing statements did not include the address of the secured party and would have seen to the correction of such omission before the financing statement was recorded. Since the uncorrected omission resulted in the security interest not being perfected, a rational trier of fact also could conclude that the breach of duty by Mills was a proximate cause of damages to Bonds.

Whether Bonds failed to satisfy a duty to mitigate his damages or was contributorily negligent are not matters which are appropriate for summary judgment. In arguing for summary judgment on these grounds, Mills relies upon the general rule that in a negligence action, a plaintiff has a duty to use due care in minimizing his loss and may not recover damages which could have been prevented through the plaintiff's reasonable efforts. Whether Bonds, a lay person, should have exercised his legal rights at a different time or in a different manner in order to have exercised "due care" or to have made "reasonable efforts" to avoid or minimize his damages, at most, is a question about which reasonable minds could differ and is a matter for jury determination and not summary judgment. Since Mills is not entitled to summary judgment based upon the employment which he admittedly undertook, his motion for summary judgment must be denied without regard to whether his employment extended to other matters and, if so, whether he satisfied his professional duty as to those matters.

CONCLUSION

An order in accordance with the foregoing findings and conclusions will be entered contemporaneously with the filing of this memorandum opinion.

This 31st day of March, 2000.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

ENTERED

APR 0 3 '00

U.S. Bankruptcy Court
Greensboro, NC
CPH

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
WINSTON-SALEM DIVISION

IN RE: Bonds Distributing Company, Inc., Debtor.	Case No. 97-52130C-7W
Bruce Magers, Trustee in Bankruptcy for Bonds Distributing Company, Inc., Plaintiff, v. Donald R. Bonds and Bonds, Inc., Defendants.	Adversary No. 98-6044
Donald R. Bonds, Third-Party Plaintiff, v. William L. Mills, III, Attorney at Law, d/b/a "The Mills Law Firm", Third-Party Defendant.	

ORDER

In accordance with the memorandum opinion filed contemporaneously herewith, it is ORDERED, ADJUDGED AND DECREED as follows:

1. The plaintiff's motion for summary judgment is granted as to the Second Claim for Relief and it is adjudged that Defendant Bonds did not perfect a security interest in the assets of Bonds Distributing Company, Inc., as a result of which the plaintiff is entitled to avoid the transfer of the assets of Bonds Distributing Company, Inc. and to recover from Defendant Bonds the value of such assets as of August 21, 1997;

2. Except as hereinbefore provided, the plaintiff's motion for summary judgment is denied;

3. The defendants' motion for summary judgment is denied; and

4. The third-party defendant's motion for summary judgment is denied.

This 31st day of March, 2000.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge