IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In Re THE DON LUSCOMBE AVIATION HISTORY FOUNDATION, INC., Debtor. _____ LOUIE A. MUKAI, AS TRUSTEE OF THE DON LUSCOMBE AVIATION HISTORY FOUNDATION, INC., Plaintiff, v. P. DOUGLAS COMBS, and LAURI A. EDER, Husband and Wife, Defendants.	Chapter 7 Case No. 02-18352-SSC Adv. No. 03-333 MEMORANDUM DECISION (Opinion to Post)

I. Introduction

This matter comes before the Court on the Plaintiff's December 15, 2004 Motion for Summary Judgment on Count 2 and Cross-Motion for Summary Judgment on Count 3 in the above captioned adversary.[1] After the Court extended the deadline to file a response, the Defendants, P. Douglas Combs ("Combs") and Lauri A. Eder ("Eder"), filed a Response on March 23, 2005. A Reply to the Response was filed on March 31, 2005. On April 5, 2005, the Court held oral argument on the motions. At the conclusion of the hearing, the Court took the

1. The Caption in this Adversary was amended by Order dated December 27, 2004, Docket Entry No. 65.

matter under advisement.

Subsequently, Combs filed his own voluntary petition under Chapter 11 of the Bankruptcy Code on April 18, 2005, which was assigned Case No. 05-6498. The Court determined to set an Order to Show Cause Hearing on whether the Court could issue its Memorandum Decision in this Adversary irrespective of Combs' filing of a bankruptcy petition. In the Order to Show Cause, the Court cited the parties to the In re Miller Decision, 397 F.3d 726 (9th Cir. 2005) as authority for the Court's issuing a decision in this matter, although the automatic stay in the Combs case normally prevented creditors and interested parties from taking any action. Renaissance Aircraft LLC filed a motion to transfer the Combs bankruptcy proceeding, then pending before the Honorable Charles G. Case II, to this judge. A hearing on the Motion to Transfer was also set for hearing at the same time as the Order to Show Cause. On June 8, 2005, this Court concluded, on the Motion to Transfer, that the Combs case should be transferred to this judge, and as to the Order to Show Cause, the Court determined that the automatic stay did not preclude this Court from issuing its Memorandum Decision in this adversary.[2]

In this Memorandum Decision, the Court has now set forth its findings of fact and conclusions of law pursuant to Rule 7052 of the Rules of Bankruptcy Procedure. The issues addressed herein constitute a core proceeding over which this Court has jurisdiction. 28 U.S.C. §§ 1334(b) and 157(b) (West 2005).

II. Factual Background

The Don Luscombe Aviation History Foundation, Inc. ("Foundation") is an Arizona non-profit corporation. Combs is the former President and Director of the Foundation.[3] Eder is Combs' wife and served as a Director of the Foundation. In November of 2001, an arbitrator entered an award against the Foundation in the amount of $2.2 million. The

---

2. *See* Docket Entries No. 481 and 482; Minute Entry dated June 8, 2005.

3. *See* the administrative docket of this case, the December 23, 2002 Statement of Financial Affairs, Docket Entry No. 24.

Foundation filed its voluntary petition under Chapter 11 approximately one year later on November 14, 2002.

On March 11, 2003, Combs filed five Proofs of Claim based on an alleged security interest in all assets of the Foundation created through the filing of a Uniform Commercial Code ("UCC") Financing Statement with the Arizona Secretary of State on March 15, 2002, [4] and a separate filing of a lien on aircraft with the Federal Aviation Administration ("FAA"). The Defendants maintain that the Foundation issued certain promissory notes ("Notes") between 1996 and 2002 in their favor in return for advances of money or property to assist the Foundation in its operations. At all relevant times between 1996 and 2002, Combs and Eder were husband and wife, Combs was President and a member of the Board of Directors of the Foundation, Ms. Eder was a member of the Board, and Ms. Eder's father was on the Foundation's Board. The Defendants conceded at oral argument that the obtainment of a lien on the Foundation's assets, in most cases, occurred years after the original advances were made by one or both Defendants.

In determining whether the Defendants have a perfected security interest on all of the assets of the Foundation, it is helpful to analyze each Note, the property which served as collateral for the Note, and when the alleged perfected security interest was obtained.

Note 1 is in the original principal amount of $53,910.90, executed on February 10, 1996, by the Foundation through Combs, as its President, and Donna Warner, the Foundation Secretary. This Note is referred to in the UCC Financing Statement filed in March 2002.

Note 2, in the original principal amount of $180,000, was executed on October 25, 2000, by Combs and Warner, as President and Secretary, respectively, and was referred to in the aforesaid UCC Financing Statement. A separate Aircraft Security Agreement ("Agreement"), executed only by Warner, was filed with the FAA referring to this Note as well. The date entered at the top of the Agreement is "November 9, 2001," and a date of "December

---

4. For the purposes of the Summary Judgment Motion, the Trustee took the position that all the Notes in question were listed on the March 15, 2002 UCC Statement. Trustee's MSJ p. 5, ll.7-10. Although the Court has questions as to whether the Notes were properly referenced in the UCC filing, the Court will accept March 15, 2002 as the filing date.

26, 2001," as the date received, is stamped at the bottom of the Agreement.

Note 3, in the original principal amount of $128,500.00, was executed on November 2, 2000, by Combs and Warner, as President and Secretary, respectively, and this Note was also referred to in the UCC Financing Statement and the Agreement filed with the FAA.

Note 4, in the original principal amount of $84,100, was executed on November 9, 2001, by Combs and Warner, as President and Secretary, respectively, and was referred to in the UCC Financing Statement and the Agreement filed with the FAA.

Finally, as to Note 5, in the original amount of $35,000, it was executed on March 5, 2002, and was referred to only in the UCC Financing Statement.

The Trustee, the Plaintiff herein, argues that the Board of Directors of the Foundation never approved any of the aforesaid transactions. The Trustee has submitted the depositions of several members of the Board at the time of the alleged transactions. None of these individuals remembers approving any of the transactions. They simply have no memory of any of the transactions ever having been submitted to the Board for approval. The Defendants' evidence of approval is a document purportedly showing Board approval. However, Combs conceded that a similar document previously presented to this Court in this case was later admitted by him to be a forgery. Finally, there are no minutes or other documentation from any Foundation Board Meeting that support the transactions that the Defendants rely on in support of their allegation that they have a perfected security interest in the Foundation's assets.

III. Discussion

A. THE STANDARD FOR SUMMARY JUDGMENT

A motion for summary judgment should be granted if the movant has shown that there are no genuine issues of material fact and the movant is entitled to judgment as a matter of law. Fed.R.Bankr.P. 7056(c). Ruling on a motion for summary judgment necessarily implicates that substantive evidentiary standard of proof which would apply at trial. Anderson v. Liberty

Lobby, Inc., 477 U.S. 242 at 252 (1986). A material fact is genuine if the evidence is such that a reasonable jury could return a verdict in favor of the non-moving party. Id. Procedurally, "the proponent of a summary judgment motion bears a heavy burden to show that there are no disputed facts warranting disposition of the case on the law without trial." In re Aquaslide 'N' Dive Corp., 85 B.R. 545, 547 (9th Cir. BAP 1987). Once that burden has been met, "the opponent must affirmatively show that a material issue of fact remains in dispute." Frederick S. Wyle P.C. v. Texaco, Inc., 764 F.2d 604, 608 (9th Cir. 1985). The opponent may not assert the existence of some alleged factual dispute between the parties. Liberty Lobby, 477 U.S. 242 at 252, 106 S.Ct. 2505 at 2512, 91 L.Ed.2d 202 Instead, to demonstrate that a genuine factual issue exists, the objector must produce affidavits which are based on personal knowledge, and the facts set forth therein must be admissible in evidence. Aquaslide, at 547. In addition, summary judgment must be used with care and restraint, Hutchinson v. United States, 677 F.2d 1322, 1325 (9th Cir. 1982), and is reviewed in the light most favorable to the non-moving party. Hifai v. Shell Oil Co., 704 F.2d 1425, 1428 (9th Cir. 1983).

B. REQUIREMENTS UNDER STATE LAW

At all relevant times described herein, Combs was the President and a member of the Board of Directors. Ms. Eder was a member of the Board. Combs and Eder are husband and wife, and were married when these transactions occurred. Ms. Eder's father was also a member of the Board. A review of the various Notes, the UCC Financing Statement, and the Agreement reflect that the purpose of the documentation was to grant the Defendants a perfected security interest in the Foundation's assets, in most cases, years after the funds were advanced by the Defendants or the services were performed. Whether this Court reviews the initial Notes or the subsequent perfection of the security interest, it is clear that the Defendants were attempting to obtain a beneficial financial interest in their favor as to the Foundation's assets. Under Arizona law, a director of a corporation may not participate in such beneficial transactions unless a number of steps are taken.

One such step is for the director to disclose fully to the Board, and then allow the

Board to consider the transaction with the interested director to be disqualified from voting on the transaction. Then at least a majority of the remaining directors, of which at least two disinterested directors must vote, must approve the transaction.[5] A.R.S. §10-862. The Defendants have presented no credible documentation to this Court which supports this step having been taken by the Foundation's Board. Although Combs did attach a document to his pleadings as to this Motion for Summary Judgment, Combs previously submitted a similar document that he later admitted was a forgery.[6] Moreover, the depositions of the disinterested Board Members at the time of the transactions do not recall any of the transactions or any Board approval ever having been obtained. Finally, there are no Minutes or other documentation from the Foundation's Board Meetings supporting the approval of the transactions.

Arizona law also provides a second step to approve such financial transactions between a director and his/her corporation. A.R.S. §§10-860 and 861 allow a director that has engaged in a "conflicting interest" transaction to have the transaction approved. First, a transaction is deemed to be "conflicting," if a director is a party to the transaction or has a beneficial financial interest in the transaction. A.R.S. §10-860(1)(a)(i) and (ii). The Defendants clearly qualify as parties to the transactions described herein and the perfection of a security interest on all of the Foundation's assets, elevating their unsecured advances or services from 1996 to 2002 to secured transactions a few months prior to the Foundation filing its bankruptcy petition, would be deemed to be a beneficial interest in the transactions.

Next, the Court must consider whether the transactions should not be set aside, although representing conflicting interests by the Defendants with the Foundation, if the Defendants have complied with A.R.S. §10-861B. There are a number of subsections

---

5. Under Arizona law, Combs and Eder, as recipients of a beneficial financial interest, would be disqualified from voting on whether the Foundation should grant one or both of them, or their marital community a perfected security interest in all of the Foundation's assets. Ms. Eder's father would also be disqualified from voting. *See* A.R.S. § 10-862.

6. *See* Exhibit 65, 65A; January 21, 2004 Minute Entry (Administrative Docket in Case No. 02-18352, Docket Entry No. 282.)

thereunder. Many do not apply to these Defendants.[7] As to one of the subsections, the Court has already determined that the Defendants did not comply with Section 10-862. That subsection cannot authorize the transactions. However, another subsection, Section 10-861B(3) should be further analyzed by the Court. A conflicting transaction may still be approved by a Court, if "the transaction, judged according to the circumstances at the time of the commitment, is established to have been fair to the corporation." In this matter, the Notes were executed by Combs and Warner over a number of years, yet the filing of the UCC Financing Statement and the filing of the Agreement with the FAA did not occur until just prior to the Foundation filing its bankruptcy petition. Since the Foundation derived no benefit under such an objective test, and the Defendants have shown no such benefit, the Court concludes that the granting and perfection of a security interest to the Defendants was not fair to the Foundation. Hence, the test under Arizona law has not been met, and the granting and perfection of a security interest on all assets of the Foundation in favor of the Defendants must be set aside as in violation of Arizona law. The Trustee should be entitled to judgment as a matter of fact and law as to Counts 2 and 3 in the Complaint.

However, even if the Court's analysis on the foregoing is incorrect, there is an additional basis to void the granting and perfection of the Defendants' security interest. A.R.S. §10-1201(A)(2) states, "[o]n the condition and for the consideration determined by the board of

---

7. A.R.S. § 10-861(B) (West 2005) provides in pertinent part:

> A director's conflicting interest transaction shall not be enjoined, be set aside or give rise to an award of damages or other sanctions in a proceeding by a shareholder or by or in the right of the corporation, because the director, or any person with whom or with which the director has a personal, economic or other association, has an interest in the transaction, if either:
>
> 1. Directors' action respecting the transaction was taken at any time in compliance with § 10-862.
>
> 2. Shareholders' action respecting the transaction was taken at any time in compliance with § 10-863.
>
> 3. The transaction, judged according to the circumstances at the time of commitment, is established to have been fair to the corporation.

Combs and Eder acted as Officer/Directors of the Foundation; therefore, Subsection 2, as to the shareholders' action, does not apply.

directors, a corporation may ... [m]ortgage, pledge, dedicate to the repayment of indebtedness ... any or all of its property." This section of Arizona law makes it clear that a corporation may mortgage or pledge its property under certain circumstances. However, the Court should analyze the Foundations' Bylaws to determine whether the Defendants appropriately obtained their security interest in this matter. Article VII, Section 2 of the Foundation's Bylaws sets forth the requirements for creating a note of indebtedness.[8] Under Article VII, Section 2:

> All ... notes or other evidence of indebtedness issued in the name of the [Foundation], shall be signed by such officer or officers, agent or agents of the [Foundation] and in such manner as shall from time to time be determined by resolution of the board of directors. In the absence of such determination by the board of directors, such instruments shall be signed by the Treasurer or an Assistant Treasurer and countersigned by the President of Vice-President of the [Foundation].

It appears that although the Notes were initially executed by Combs and Warner, as President and Secretary, respectively, the Treasurer or Assistant Treasurer of the Foundation did not execute any of the Notes. Under the terms and conditions of the Bylaws, the Notes were not executed by the appropriate parties. Moreover, it appears that the Notes that were filed with the Agreement with the FAA were, for some reason, only executed by Warner. As noted earlier in this Decision, there was no separate Board approval that was obtained for any of the transactions. Based upon the foregoing analysis, the execution of the Notes was not pursuant to the Bylaws of the Foundation and, hence, avoidable by the Trustee under Arizona law. If the Notes were not appropriately authorized, the Defendants improperly obtained a perfected security interest on all of the Foundation's assets, since there is no debt for which the assets serve as security.

C. AVOIDABILITY UNDER §547

Assuming *arguendo* that the transactions are not void under Arizona law, Notes 1 through 4 were secured by the assets of the Foundation through transactions which the Trustee may avoid under 11 U.S.C. §547. Under §547 the Trustee must show: (1) the claimed security

---

8. *See* Exhibit E, Trustee Statement of Facts in Support of Motion for Summary Judgment.

interest constitutes a transfer of an interest of the Foundation in property to or for the benefit of a creditor (11 U.S.C. § 547(b)(1)); (2) the claimed security interest constitutes a transfer of an interest of the debtor in property for or on account of an antecedent debt owed by the debtor before such transfer was made (§ 547(b)(2)); (3) the claimed security interest constitutes a transfer of an interest of the debtor in property made while the debtor was insolvent (§ 547(b)(3)); (4) the claimed security interest constitutes a transfer of an interest of the debtor in property made within the statutory 'reachback' period (§ 547(b)(4)); and (5) the claimed security interest constitutes a transfer of an interest of the debtor in property that enables the defendants to receive more than they would receive if the case were under Chapter 7, the transfer had not been made, and the defendants received payment of the debt to the extent provided by the provisions of Chapter 11 (§ 547(b)(5)). Here the Trustee satisfies all five requirements.

As to requirement 1, there is no dispute that the property in question was transferred from the Foundation to the Defendants, who by filing proofs of claim with this Court are alleging that they are creditors of this estate. The Defendants allegedly obtained a perfected security interest in the assets of the Foundation. This is a transfer subject to §547. *See* 11 U.S.C. §101(54).

The determination of whether an antecedent debt exists is a bit more complex. An antecedent debt is, "[a] debtor's prepetition obligation that existed before a debtor's interest in property." Blacks Law Dictionary (Bryan A. Garner ed., 8th ed., West 2004). A transfer occurs at the time of the transfer, if the perfection occurs within 10 days of the transfer, or at the time of perfection, if the transfer is perfected more than 10 days after the transfer. *See* §547(e)(2)(A),(B).

As to the inventory, accounts receivable, and other assets of the Foundation, excluding the aircraft, the Trustee argues that the Defendants obtained a perfected security interest on said assets at the time that the UCC Financing Statement was filed with the Arizona Secretary of State; that is, March 15th 2002. The Trustee also argues that the Defendants did not obtain a perfected security interest in the Foundation's aircraft until the Agreement was filed with the FAA. The Trustee relies on the date of "December 26, 2001," stamped on the

Agreement as the date that the FAA received the Agreement and, hence, the date of perfection. The Defendants do not dispute the date of the filing of the Financing Statement and conceded at oral argument that Notes 1 through 4, if valid, were executed well before the UCC Financing Statement was filed with the Secretary of State. Only Note 5 was executed within the 10-day perfection period, since the Financing Statement was filed with the Arizona Secretary of State on March 15, 2002.

Under federal law perfection occurs for aircraft and certain aircraft parts upon the filing of the security agreement with the FAA. 49 U.S.C. §44107. The Supreme Court has stated, "[a]lthough state law determines priorities, all interests [in aircraft] must be federally recorded before they can obtain whatever priority they are entitled to under state law." Philko Aviation v. Shacket, 103 S.Ct. 2476, 2480 (1983). As noted in this Decision, only Notes 2, 3, and 4 were referred to in the Agreement filed with the FAA. Hence, only the indebtedness reflected by said Notes would arguably be perfected by an interest in the aircraft.

However, there is a dispute as to what date the Agreement was filed with the FAA. The Defendants allege that the Agreement was filed with the FAA on November 9, 2001. The Trustee claims that the Agreement was not filed until December 26, 2001. The Defendants, in supporting their claim of a November filing, point to the date entered by the Foundation on the FAA Agreement. The Trustee, in supporting his claim of a December filing, points to the December date on the bottom of the FAA Agreement stamped by the FAA. Under Federal Regulations, '[a] conveyance is filed for recordation upon the date and the time it is received by the FAA Aircraft Registry." 14 C.F.R §49.19 (2004). Each conveyance must be accompanied by a $5.00 fee to be accepted by the FAA. 14 C.F.R. §49.15(2004). The $5.00 fee is instrumental to the Court's analysis of the facts. A careful inspection of the date on the bottom of the FAA Agreement reflects the sum of "$5.00" to the left of the noted "12/26/2001" date. This indicates to the Court that the FAA Agreement was received on December 26, 2001. Accordingly Notes 3, 4, and 5 were perfected by an interest in the aircraft and certain aircraft parts as of December 26, 2001.

Setting the dates of possible perfection at December 26, 2001 and March 15,

2002, the Court concludes that Notes 1 through 4 were antecedent debts. Note 1 was based on debts as of February 10, 1996; it was perfected on March 15, 2002 at the earliest. Note 1 is an antecedent debt. Note 2 was based on debts as of October 25, 2000; it was perfected as to an interest in aircraft as of December 26, 2001, and as to the remaining Foundation assets as of March 15, 2002. Note 2 is an antecedent debt. Note 3 was based on debts as of November 2, 2000; it was perfected as to the aircraft on December 26, 2001, and as to the remaining assets on March 15, 2002. Note 3 is an antecedent debt. Note 4 was based on debts as of November 9, 2001; it was perfected as to the aircraft on December 26, 2001, and as to the remaining assets on March 15, 2002. Note 4 is an antecedent debt. Note 5 is based on debts as of March 5, 2002. Note 5 is only secured by the UCC Financing Statement filed on March 15, 2002. This falls within the 10-day window for perfection under §547(e)(2)(A). However, the Agreement filed with the FAA does not refer to Note 5. Accordingly, the only possible Note that is not based on an antecedent debt is Note 5.

The Trustee may show that the Foundation was insolvent within the one-year time frame that would be applicable to the Defendants, since they are insiders. 11 U.S.C. § 547(b)(4)(B); *See* also 11 U.S.C. §101(31). The Defendants assert that the Foundation had a book value of more than $23 million in assets when it filed its petition. Hence, given the debts that were listed on the Schedules by the Foundation, the Defendants argue that the Foundation was solvent during the one-year period. However, a review of the Foundation's Annual Reports and tax returns reflect assets that only had a value of approximately $900,000, and yearly income of approximately $475,000 during the relevant time period. Moreover, at the time of filing, the Foundation did list a debt due and owing to Renaissance Aircraft in excess of $2.2 million as a result of an arbitration award which was determined prepetition. During the one-year period prior to filing, the Foundation's obligation to Renaissance Aircraft under the Licensing Agreement would have been a contingent obligation that was subsequently liquidated. Under such an analysis, the Foundation was clearly insolvent during the one-year time period.

Combs, as the President of the Foundation, and one of the Defendants herein, was responsible for the information contained on both the Schedules at the time of filing and as

to the information provided in the Annual Reports and tax returns. Under Ninth Circuit law, when a party presents conflicting information to the Court in attempting to defeat a motion for summary judgment, the Court may force the party to present more documentation or facts in support of its position before the Court will conclude that a genuine issue of fact has been raised. California Architectural Bldg. Prods., Inc., v. Franciscan Ceramics, Inc., 818 F.2d 1466, 1468 (9th Cir. 1987) (citing Matsushita Elec. Indus. v. Zenith Radio Corp., 475 U.S. 574, 106 S. Ct. 1348, 1356 (1986)). In this case, the Trustee has set forth a sufficient offer of proof that the Foundation was insolvent. In turn, the Defendants are required to submit more cogent admissible evidence to create a genuine issue of material fact. In this case, the Defendants have been unable to present such evidence. Finally, when this Court did conduct an auction sale of the Foundation's assets, which sale is now final, the Trustee sold the assets for less than $600,000 in cash and subordination of certain debt. The market value of the Foundation's assets was far less than the $2.2 million November 2001 arbitration award rendered in favor of Renaissance Aircraft. Given the difference in the value of the assets and the amount of the liabilities at the time of the auction sale, the Court may conclude that the Foundation was clearly insolvent during the relevant time period.

For the Trustee to avoid a transfer to an insider, the transfer must be made by the Foundation to or for the benefit of an insider within one year prior to the filing of the debtor's petition. 11 U.S.C. §547(b)(4)(B). Here the Court returns to the discussion *supra* concerning perfection. The Defendants attempted to obtain a perfected security interest in the Foundation's assets as to Notes 1 through 4 within the one-year period prior to the Foundation's filing of its bankruptcy petition. The Trustee has met this prong of the test as to Notes 1 through 4.

Finally, the Trustee must show that the Defendants would have received more than they would have received if the transfer had not been made and the Defendants simply had received a distribution under Chapter 7. 11 U.S.C. §547(b)(5). Here, the Defendants concede the matter. In their Response, the Defendants state that had they not obtained an alleged perfected security interest in all of the Foundation's assets, they would not be entitled to receive

any distribution in a Chapter 7 proceeding.[9]

Based upon the foregoing, the Court concludes that the Trustee has shown that the Defendants received an avoidable preference, since they obtained a perfected security interest in the Foundation's assets to secure Notes 1, 2, 3, and 4. The Court is unable to enter a judgment in the Trustee's favor as to Note 5 concerning the issue of a preference.

However, the Court has previously found that Note 5 is void under Arizona State law, so the Court will enter judgment in the Trustee's favor on Counts 2 and 3 in the Complaint.

IV. Conclusion

Based upon the foregoing, the Court concludes that the Plaintiff's Motion for Summary Judgment on Count 2 and Cross Motion for Summary Judgment on Count 3 is GRANTED. The Court will execute a separate order incorporating this Memorandum Decision.

DATED this 12th day of July, 2005.

Honorable Sarah Sharer Curley
U. S. Bankruptcy Judge

BNC TO NOTICE

9. *See* Response to Motion for Summary Judgment, p. 4 ll. 12-13.