

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF VIRGINIA
Alexandria Division

In re:)	
)	
THE BENTLEY FUNDING GROUP, L.L.C.)	Case No. 00-13386-SSM
)	Chapter 11
Debtor)	

MEMORANDUM OPINION

An evidentiary hearing was held in open court on December 13, 2001, on the objection filed by Fredric Spain and James A. Jeffery to the \$25,000.00 scheduled claim of T.B.R. Associates. The objecting parties and the creditor were present by counsel. For the reasons stated, the claim will be disallowed, without prejudice to the treatment of \$5,000.00 as a capital contribution by T.B.R.'s owner, Peter Horvat.

Background

The Bentley Funding Group, LLC ("Bentley") is a Virginia limited liability company that was formed in 1998 to develop approximately 173 acres of land in a mixed-use development known as "River Oaks" located in the Woodbridge area of Prince William County, Virginia. Bentley had three classes of members, designated as Class A, B, and C, with each class being represented by its own manager. Class A consists of Peter Denger and Peter Horvat, each of whom owns a 33.5% membership interest. Class B consists of Fernando Gomez, James A. Jeffery, Edgar Reilly and Fredric L. Spain, each of whom owns a 7.0% membership interest. Finally, Class C consists of Kenneth Young, who owns a 5.0% membership interest. Only the Class A members were required to

invest money in the proposed development. The Class B members had identified the project and had brought it to the table, but neither they nor the Class C member were required to invest any of their own money. The Class A manager was and remains Peter Horvat. The Class B manager was originally Fernando Gomez, but in October 1998, Edgar Reilly became the Class B manager. The Class C manager was and remains Kenneth Young. Under the company's operating agreement, most decisions required the assent of only two classes of members; however, any bankruptcy filing would have required unanimous consent.

The purchase of the River Oaks property had been financed by a loan secured by a deed of trust against the property. When the note went into default, it was purchased by SK&R Group, L.L.C. ("SK&R"), which then scheduled a foreclosure sale. At that point, T.B.R. Associates, another entity called Glem Management, and three of Bentley's members (Messrs. Horvat, Denger, and Gomez) filed an involuntary chapter 11 petition against Bentley in this court on August 11, 2000, thereby invoking the automatic stay and stopping the foreclosure. Although the petition was initially contested, the opposition was withdrawn, and an order for relief was entered on September 5, 2000.

SK&R filed a motion for relief from the automatic stay, which was denied. Thereafter, Bentley reached a settlement with SK&R under which all but 22 acres of the River Oaks property was sold to SK&R in full satisfaction of the sums due under the deed of trust. As part of the purchase, SK&R also paid \$300,000 to the debtor and paid or assumed various liabilities connected with the project, including the claims of the general contractor and the bonding company. A plan was then confirmed on May 31, 2001, that contemplated on-going operations by the company to sell and develop the

remaining 22 acres.¹ Under the plan, no payment was to be made on account of unsecured “insider” claims, including the claim of T.B.R. Associates; rather they were essentially treated as equity contributions.

T.B.R. Associates is the remnant of what was once a New Jersey general partnership,² but which for the last several years has simply been a sole proprietorship owned by Mr. Horvat. As noted, both T.B.R. Associates and Mr. Horvat were named as petitioning creditors in this case. T.B.R. Associates did not file a proof of claim, but its claim was listed on the debtor’s schedules in the amount of \$25,000.00 and was not scheduled as disputed, unliquidated, or contingent. Mr. Horvat filed his own proof of claim (which has not been objected to) in the amount of \$15,000.00.

As a sanction for the creditor’s failure to provide timely and complete discovery, the court ruled at the outset of the hearing that the creditor would not be able to rely on the presumption of validity that a properly-filed or properly-scheduled claim otherwise enjoys under the Bankruptcy Rules, but would be required to satisfy both the initial and ultimate burden of showing that its claim was valid. The only evidence presented was the testimony of Mr. Horvat, corroborated by copies of paid checks, that he had written three checks on the T.B.R. Associates checking account totaling \$15,000.00 to attorney Robert Zelnick in March and July 2000 as retainers for legal work to be performed on behalf of

¹ Messrs. Spain, Jeffrey and Reilly have recently filed an adversary proceeding to revoke confirmation of the debtor’s plan. A motion to dismiss the complaint is currently pending.

² The partnership came into existence in 1985 to develop a rental real estate project in New Jersey but was formally dissolved in 1990. Mr. Horvat, however, has continued since then to conduct business under the T.B.R. Associates name. Although Mr. Horvat calls himself the “general partner” of T.B.R. Associates, there are no other partners.

Bentley.³ He testified that the payment was made in response to telephone calls from Mr. Zelnick requesting payment of the retainers before undertaking work for Bentley. Mr. Horvat conceded, however, that only two of the payments – totaling \$5,000.00 – are reflected on billing invoices for Bentley he was provided by Mr. Zelnick. He further testified that he intended the payment of the legal fees to be a loan to Bentley, and that had earlier paid \$15,000.00 to Bentley that he regarded as a capital contribution.

Under the December 19, 1997, Operating Agreement for Bentley, the Class A members were required to fund the River Oaks project by providing capital, personally guaranteeing loans to the company, and “causing” letters of credit to be issued on behalf of the company, with the aggregate of those obligations not to exceed \$4.5 million. Op. Agr. § 7.3. The managers had the power, upon determining that the company did not have “sufficient funds to carry out its purposes,” to issue cash calls to the Class A members. Additionally, the agreement provided that the *managers* “may from time to time, advance additional monies to or for the benefit of the Company, and such advances shall not be treated as Capital Contributions to the Company but shall be considered as loans to be repaid upon demand therefore with interest [at prime plus 4%].” Op. Agr. § 9.1. Such loans, however, were to be “evidenced by a promissory note executed and delivered by the Company to the Managers.” *Id.* At the same time, the managers could not, without the prior written consent of the majority of members

³ The amounts and dates of the checks were as follows: Check No. 1612 dated March 31, 2000, in the amount of \$10,000.00; Check No. 1656, dated July 7, 2000, in the amount of \$3,000.00; and check No. 1659 dated July 11, 2000, in the amount of \$2,000.00

(acting by classes) borrow or lend money, or make, deliver, accept, or execute a promissory note, on behalf of the company. Op. Agr. § 16.5 and 16.4(t).

Discussion

A.

A properly filed proof of claim in a bankruptcy case "is deemed allowed" unless a party in interest objects. § 502(a), Bankruptcy Code. Additionally, in a chapter 11 case, the listing of a claim on the schedules filed by the debtor constitutes prima facie evidence of the validity and amount of such claim, unless the claim is scheduled as disputed, unliquidated or contingent. Fed.R.Bankr.P. 3003(b)(1). Unless a claim has been scheduled as disputed, unliquidated or contingent, or has not been scheduled at all, a creditor in a chapter 11 case is not required to file a proof of claim in order for the claim to be allowed. Fed.R.Bankr.P. 3003(c). Ordinarily, the party objecting to a claim has the initial burden of presenting sufficient probative evidence to overcome the prima facie effect of the filing or scheduling. *See In re C-4 Media Cable South, L.P.*, 150 B.R. 374, 377 (Bankr. E.D. Va. 1992). Once the objecting party has done so, however, the burden of proof then shifts to the creditor to establish the validity and amount of its claim. *Id.* As noted, the court, as a sanction for T.B.R.'s failure to provide timely and complete discovery, ruled in this case that T.B.R. would not be able to rely on presumption of validity and would have both the initial and ultimate burden of proving its claim. The standard of proof on an objection to claim is preponderance of the evidence.

B.

In the present case, the evidence supports at most a claim in the amount of \$15,000.00, and not the \$25,000.00 amount listed on the schedules. The question, however, is whether it should be allowed in even the lesser amount. There are three issues to be resolved: first, whether T.B.R. has carried its burden of proving that full \$15,000.00 to which Mr. Horvat testified was actually paid and was applied to a proper company expense; second, whether Mr. Horvat, acting through T.B.R., was authorized to make a loan, as opposed to a capital contribution, to Bentley; and third, whether the claim should be disallowed because it was fraudulently “concocted” in order to support the filing of the involuntary petition. These issues will each be addressed in turn.

C.

On the evidentiary issue, the court is satisfied that T.B.R. has carried its burden of showing that the 2 checks totaling \$5,000.00 were written to, and negotiated by, Mr. Zelnick, and that they were applied to legal work performed for Bentley by Mr. Zelnick’s firm. The third check, for \$10,000.00, is a closer question. Ordinarily, the court would be inclined to accept evidence of a paid check, together with the testimony of the person who wrote it, as sufficient to carry the burden of proof. However, the notable failure of the attorney’s invoices to reflect that the \$10,000.00 was applied to fees due from Bentley, or was payment for services provided to Bentley, seriously undermines the evidentiary weight to be accorded the paid check, particularly given Mr. Horvat’s notable inability to state what legal services the \$10,000.00 payment related to. On balance, therefore, the court concludes that T.B.R. has failed to carry its evidentiary burden as to that payment.

D.

Even as to the remaining \$5,000.00 in payments, the question arises whether Mr. Horvat, as a Class A member, could properly make a loan, as opposed to a capital contribution, to Bentley. Any restrictions on Mr. Horvat loaning money to the company are not removed simply because the payment was made from T.B.R.'s checking account instead of Mr. Horvat's personal account, since T.B.R. had no separate legal existence and was simply a trade name through which Mr. Horvat conducted business.

There is no provision in the Operating Agreement that would allow Mr. Horvat, in his capacity as a *member*, to advance funds in payment of company expenses that would be treated as loans. Rather, the agreement contemplated that funding shortfalls would be met by additional capital contributions from the Class A members. However, Mr. Horvat, in addition to being a Class A member, was also the Class A *manager*. Under the Operating Agreement, managers could make advances to the Company that would be treated as loans rather than capital contributions. The agreement required, however, that such advances be evidenced by a promissory note. No evidence was presented that a promissory note was ever signed. Whether the failure to comply with that requirement should defeat the claim is a close question. The court is certainly aware that in real life the formalities set forth in the organizing or operating documents of a business entity are often not strictly observed, and are sometimes not observed at all. For that reason, a strict application of such formal requirements will not always be appropriate, particularly where the participants in the business have acquiesced in informal departures from the prescribed procedures. At the same time, the requirement for a promissory note serves an important purpose under Bentley's unusual governing structure, since execution of a such a note would have required the concurrence of two of the three membership

classes. What is debt (and would have to be repaid with interest), and what is capital, is a matter of concern to the entire membership. Accordingly, the court concludes that it is appropriate to apply the provisions of the Operating Agreement as written. For that reason, the court determines that the \$5,000.00 payment to Mr. Zelnick did not give rise to a debt but was in the nature of a capital advance.

E.

Since the court finds that the payments from T.B.R.'s checking account to Mr. Zelnick do not give rise to a claim but instead must be treated as a capital contribution from Mr. Horvat to Bentley, it is not necessary to reach the argument advanced by Messrs. Spain and Jeffery that the claim should also be disallowed because it was "concocted" in order to support a "fraudulent" involuntary petition. Nevertheless, some comment is appropriate. As noted, Bentley's Operating Agreement required the unanimous consent of the members in order to file a bankruptcy petition. At the time the SK&R foreclosure was pending, Messrs. Spain and Jeffrey, for whatever reasons, refused to consent to a filing. Messrs. Horvat, Gomez, and Denger, asserting that they were holders of unpaid claims against Bentley, then filed the involuntary petition. Mr. Horvat caused T.B.R. Associates to join as a petitioning creditor, while Mr. Denger did the same with Glem Management. However, since T.B.R. was not a legal entity separate from Mr. Horvat, its signing of the petition as though it were a separate creditor was a fraud upon the court which, it is argued, is a sufficient independent basis for disallowing the claim.

The court readily concludes that Mr. Horvat and T.B.R. are at most one creditor rather than two. Based on Mr. Horvat's testimony at the evidentiary hearing, it also seems clear that the separate

\$15,000.00 claim filed by Mr. Horvat in his own name (Claim No. 9) was a capital contribution rather than a debt. For the reasons already stated, the court additionally concludes that, even though Mr. Horvat may have intended the payments from T.B.R.'s checking account to be treated as a debt, those payments must nevertheless be characterized as a capital contribution. Whether Mr. Horvat *knew* that T.B.R. was not a separate legal entity and intentionally *misrepresented* it as such in order to satisfy the filing requirements for an involuntary petition is a closer question.⁴ Mr. Horvat claimed not to remember that he had signed a certificate approximately ten years earlier formally dissolving T.B.R. as a partnership. Additionally, his testimony (given at a Rule 2004 examination taken by SK&R early in the case) that T.B.R. was a limited partnership was not only incorrect but evinces a rather cavalier disregard of his obligation to look into the question of T.B.R.'s legal status once the issue was called to his attention. At the same time, it is clear that Mr. Horvat continued to conduct business under the name of T.B.R. Associates for fully a decade after its formal dissolution and that he honestly thought he was entitled to be repaid the sums he had paid Mr. Zelnick. There is no suggestion that the reason the checks were written on T.B.R.'s checking account, rather than on Mr. Horvat's personal account, was in order to disguise the source of payment or to create an artificial claim. Fraud normally must be shown by clear and convincing evidence. Having considered all the evidence, the court is unable to conclude that the T.B.R. claim was fraudulent in the sense that Mr. Horvat did not believe the money

⁴ Where a debtor has 12 or more creditors, an involuntary petition must be filed by 3 or more creditors holding noncontingent unsecured claims that aggregate at least \$10,775 and that are not subject to a bona fide dispute. § 303(b)(1), Bankruptcy Code.

was owed and did not believe that it should be paid to T.B.R. Accordingly, the claim will not be disallowed on the ground that it was fraudulent.⁵

F.

For the reasons stated, a separate order will be entered disallowing the scheduled \$25,000.00 claim of T.B.R. Associates, without prejudice to the treatment of \$5,000.00 of the sums paid to Mr. Zelnick as a capital contribution by Mr. Horvat.

Date: December 14, 2001

Alexandria, Virginia

/s/ Stephen S. Mitchell
Stephen S. Mitchell
United States Bankruptcy Judge

⁵ As noted, the confirmed plan subordinated all the insider claims, including T.B.R.'s, and no payment was made or is proposed to be made on account of it.

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