NOT FOR PUBLICATION

UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP NO. MB 08-047

Bankruptcy Case No. 03-10933-WCH

ELLIOTT M. ROWLANDS,
Debtor.

ARTHUR J. FRASER and
AJF FINANCIAL CORP.,
Appellants,

v.

ELLIOTT M. ROWLANDS,
Appellee.

Appeal from the United States Bankruptcy Court
for the District of Massachusetts
(Hon. William C. Hillman, U.S. Bankruptcy Judge)

Before
Haines, Kornreich, and Tester,
United States Bankruptcy Appellate Panel Judges.

Richard W. Bland, II, Esq., and Isaac H. Peres, Esq., on brief for Appellants.

Jonathon D. Friedmann, Esq., on brief for Appellee.

December 30, 2008

Tester, U.S. Bankruptcy Appellate Panel Judge.

Arthur J. Fraser ("Fraser") and AJF Financial Corp. ("AJF Financial") appeal from a bankruptcy court order dated June 3, 2008, sustaining the Debtor's objection to their proof of claim. The Appellants argue that the bankruptcy court: (1) misapplied the principles of Massachusetts corporate law by disregarding the proper corporate form of AJF Financial; and (2) made erroneous factual findings. For the reasons set forth below, we AFFIRM.

Procedural Background

Elliot M. Rowlands (the "Debtor") is a chapter 11 debtor.[1] The Appellants filed a proof of claim for an unsecured claim in the amount of $149,450, and the Debtor filed an omnibus objection which included an objection to the Appellants' claim. Thereafter, in a letter to the Debtor's counsel, the Appellants' lawyer confirmed that, despite the numerous claims previously alleged, they would be pursuing only two claims at trial: (1) a $50,000 loan made by Fraser in 1992 and 1995; and (2) a $29,000 loan made by Fraser in 2001. The Debtor filed a motion for summary judgment on all claims set forth in the Appellants' proof of claim. After a hearing, the bankruptcy court granted summary judgment in favor of the Debtor "by agreement" with respect to AJF Financial's claims and denied summary judgment with respect to Fraser's claims.

The bankruptcy court held a trial on Fraser's claims on June 3, 2008. At the close of Fraser's case, the Debtor presented two motions for a directed verdict, which the bankruptcy court construed as motions for a judgment on partial findings pursuant to Fed. R. Civ. P. 52(c)

[1] The Debtor originally filed a Chapter 13 case in February 2003, which he converted to Chapter 7 in November, 2003. Then, in February 2007, the bankruptcy court granted the Debtor's motion to convert the case to Chapter 11.

("Rule 52 (c)").[2] After hearing arguments from both parties, the bankruptcy court granted both motions. The bankruptcy court then entered a judgment in favor of the Debtor with respect to the Appellants' claims, and the Appellants appealed.

Factual Background

The Debtor owned and operated a used car business known as EMR, Inc., which did business under the name Kingston Motor Car Sales ("Kingston"). Fraser's claims against the Debtor arise from two transactions, as set forth below.

A. The $50,000 Loan

During 1992 and 1994, Fraser made three loans totaling $50,000 via checks and wire transfers to fund Kingston's business operations. At the time of the third loan, Fraser sent a letter to the Debtor, stating:

> Enclosed is a check for an additional thirty thousand dollars ($30,000.00) on loan per our agreement. On August 7, 1992 an initial ten thousand dollars was lent to you, December 5, 1992, ten thousand dollars more. I now have fifty thousand dollars lent to you and Kingston Motor Sales to buy and sell cars & trucks and from which I share in the net profits. It is our understanding that along with sharing profits ten thousand dollars will be paid back to me each year for the next five years.
>
> Please sign and have this witnessed or notarized and keep a copy on file as I will just in case something were to happen to either of us.

The Debtor signed the letter, and admits that by doing so, he agreed to be personally liable for the debt. He argues, however, that the letter was not a promissory note, but a personal guaranty of Kingston's corporate debt. Fraser characterizes the letter as a promissory note, and

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[2] A motion for directed verdict is appropriate only in a jury trial; when requested in a bench trial, a motion for directed verdict is treated as a motion for judgment on partial findings under Rule 52(c).

argues that both Kingston and the Debtor were primary obligors under the note and jointly and severally liable for the debt.

In 1998, Fraser created AJF Financial to provide financing to Kingston's customers for the purchase of used vehicles. He invested $255,000 of his own funds in AJF Financial, and was its sole officer, director and shareholder. Pursuant to an agreement between the parties, Kingston and AJF Financial agreed to share the profits generated by the sale and financing of used vehicles. Under this arrangement, Kingston purchased vehicles to resell through its used car business, and when Kingston sold a vehicle, AJF Financial provided financing to the consumer. When AJF Financial received payments from the consumers on their car loans, AJF Financial retained the first half of the money received from the consumer (the so-called "front-end money") and held the second half of the money received from the consumers (the so-called "back-end money") to be paid to Kingston. AJF Financial's financial records show that by mid-2000, AJF Financial owed Kingston more than $263,000 in back-end money.

On August 1, 2001, Daniel Finn (who maintained the accounting books for AJF Financial) sent an e-mail to Fraser explaining AJF Financial's financial position. In that e-mail, amongst other things, Finn explained that the $50,000 loan owed to Fraser had been incorporated into and made a receivable of AJF Financial.[3] Then, the $50,000 receivable was set off against what AJF Financial owed to Kingston for back-end monies. On August 3, 2001, Fraser replied to Finn's e-mail by writing: "WOW-EE Dynamite explanation!!!! Thanks so very much!!!!!"

[3] The Debtor claims Fraser transferred his rights to the $50,000 to AJF Financial as "additional paid-in capital." Fraser disputes that characterization.

Fraser argues that his response to the e-mail was a sarcastic comment and was not intended as an approval of Finn's explanation or of the setoff. Although Fraser admits that he did not dispute the setoff or demand that it be reversed, he denies agreeing to or condoning the setoff arrangement. According to Fraser, since the $50,000 was loaned from his personal accounts, the money was owed to him personally, not to AJF Financial. Therefore, the $50,000 could not be set off against money owed by AJF Financial to Kingston.

At the conclusion of the trial, the bankruptcy court found that the Debtor was jointly and severally liable with Kingston for the $50,000 loan as evidenced by his notarized signature on the letter, and that the Debtor did not repay the $50,000 personally.[4] However, noting that Kingston was a joint obligor on the $50,000 debt, the bankruptcy court concluded that the $50,000 debt had been properly set off against the monies AJF Financial owed to Kingston.

B. The $29,000 Loan

In 2000, Fraser deposited $30,000 into a bank account at Salem Five Cents Savings Bank jointly held by Fraser and the Debtor for Kingston's purchase of some trucks. This loan was not evidenced in writing. Thereafter, the Debtor wrote three checks from the joint account totaling $29,000, made payable to "Kingston Motor Car" or "Kingston Motor Car Sales." The Debtor claims that Kingston used these funds to buy vehicles, and Fraser does not dispute that they were used for Kingston's business purposes.

According to the Debtor, he was not the primary obligor of the $29,000 loan, he never agreed in writing to guarantee the $29,000 loan and, therefore, he had no personal obligation.

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[4] Although the Debtor attempted to make some payments towards the loan by writing two checks to Fraser in the amount of $5,000 each in August and September 2002, those checks were returned for insufficient funds.

Fraser claims that he intended the transaction to be a loan to the Debtor personally and not to Kingston so that the Debtor would be personally obligated to repay the loan. Although he admits that the Debtor never signed any written document evidencing his personal obligation for the $29,000 loan, he argues that since the loan was to the Debtor, he was the primary obligor.

The bankruptcy court ultimately concluded: "I do believe, based on Mr. Fraser's testimony, that the entire intent of this transaction was that money be available to Kingston for the purchase of vehicles. . . . And to that extent, any personal liability of the debtor, Mr. Rowlands, would be in the nature of a guarantee and under the Statute of Frauds would have to be in writing." Finding that the Debtor had never agreed in writing to guarantee the $29,000 loan as required by the Statute of Frauds, the bankruptcy court concluded that the Debtor could not be held personally liable for the $29,000 loan.

JURISDICTION

The bankruptcy appellate panel's jurisdiction includes appeals "from final judgments, orders and decrees." 28 U.S.C. § 158(a)(1) and (b); see also Fleet Data Processing Corp. v. Branch (In re Bank of New England Corp.), 218 B.R. 643, 645 (B.A.P. 1st Cir. 1998). "A decision is final if it 'ends the litigation on the merits and leaves nothing for the court to do but execute the judgment.'" Id. at 646 (quoting Catlin v. United States, 324 U.S. 229, 233 (1945)). A bankruptcy court order sustaining an objection to a proof of claim is a final, appealable order. See B-Real, LLC v. Melillo (In re Melillo), 392 B.R. 1, 4 (B.A.P. 1st Cir. 2008); Malden Mills Indus., Inc. v. Maroun (In re Malden Mills Indus., Inc.), 303 B.R. 688, 696 (B.A.P. 1st Cir. 2004).

STANDARD OF REVIEW

Generally, a bankruptcy court's factual findings are reviewed under the clearly erroneous standard and conclusions of law are reviewed *de novo*. See TI Fed. Credit Union v. DelBonis, 72 F.3d 921, 928 (1st Cir. 1995); Western Auto Supply Co. v. Savage Arms, Inc. (In re Savage Indus., Inc.), 43 F.3d 714, 719–20 n.8 (1st Cir. 1994). Therefore, a court reviewing a decision of the bankruptcy court may not set aside findings of fact unless they are clearly erroneous, giving "due regard . . . to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Fed. R. Bankr. P. 8013. Reviewing courts apply a clearly erroneous standard in the case of a judgment on the partial findings pursuant to Fed. R. Civ. P. 52(c). See Palmacci v. Umpierrez, 121 F.3d 781, 784 (1st Cir. 1997). The bankruptcy court's legal conclusions, drawn from the facts so found, are reviewed *de novo*. Id. (citing Martin v. Bajgar (In re Bajgar), 104 F.3d 495, 497 (1st Cir. 1997)).

DISCUSSION

I. Motions for Judgment on Partial Findings

At the close of Fraser's case, the Debtor filed two motions for directed verdict, which the bankruptcy court construed as motions for a judgment on partial findings pursuant to Rule 52(c).[5] Judgment on partial findings with respect to a particular count is appropriate where the party bearing the burden of proof has finished presenting evidence and the evidence is deemed by the

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[5] Rule 52(c) provides in relevant part:

> If during a trial without a jury a party has been fully heard on an issue and the court finds against the party on that issue, the court may enter judgment as a matter of law against that party with respect to a claim or defense that cannot under the controlling law be maintained or defeated without a favorable finding on that issue . . . .

Fed. R. Civ. P. 52(c).

trier insufficient to sustain the party's burden of proof as to that count. See Morales Feliciano v. Rullan, 378 F.3d 42, 59 (1st Cir. 2004); see also Federal Ins. Co. v. HPSC, Inc., 480 F.3d 26, 32 (1st Cir. 2007). Under this rule, the movant should prevail if the non-moving party has failed to make out a prima facie case, or if the court determines that a preponderance of the evidence goes against the non-moving party's claims. See Regency Holdings (Cayman), Inc. v. Microcap Fund, Inc. (In re Regency Holdings (Cayman), Inc.), 216 B.R. 371, 374 (Bankr. S.D.N.Y. 1998).

Section 502 of the Bankruptcy Code provides that a proof of claim filed under 11 USC § 501 is allowed in the absence of objection, and Fed. R. Bankr. P. 3001(f) states that a properly executed proof of claim "shall constitute prima facie evidence of the validity and amount of the claim." An objection does not overcome this presumption unless it has substantial merit. Juniper Dev. Group v. Kahn (In re Hemingway Transport, Inc.), 993 F.2d 915, 925 (1st Cir. 1993). "It is often said that the objector must produce evidence equal in force to the prima facie case." In re Allegheny Int'l, Inc., 954 F.2d 167, 173 (3d Cir. 1992). If the objection contains such evidence, the claimant "is required to come forward with evidence to support its claims . . . and bears the burden of proving its claims by a preponderance of the evidence." In re Organogenesis, Inc., 316 B.R. 574, 583 (Bankr. D. Mass. 2004). Generally, a preponderance of the evidence is that evidence which is of greater weight or more convincing. Hale v. Department of Transp., Federal Aviation Admin., 772 F.2d 882-85 (Fed. Cir. 1985). Therefore, this Panel must determine whether the record supports the bankruptcy court's conclusion that the Appellants did not establish their claims by a preponderance of the evidence.

II. The $50,000 loan

The bankruptcy court found that the Debtor and Kingston were "jointly and severally liable" for the $50,000 loan, and that the $50,000 loan had been properly set off against money owed by AJF Financial to Kingston. It is not disputed that by signing the letter from Fraser, the Debtor agreed to be personally liable for the $50,000 loan, either as a primary obligor (as Fraser contends) or as a personal guarantor (as the Debtor contends). Either way, the loan was evidenced in writing so there was no Statute of Frauds issue. Nor is it disputed that Kingston was "jointly and severally liable" for the $50,000 loan.

Although Fraser argues that he did not agree to the set off arrangement, his agreement can be inferred. In August 2001, Dan Finn, in response to an e-mail inquiry from Fraser, explained that, from an accounting standpoint, the $50,000 loan had been incorporated into AJF Financial as a receivable and set off against the money owed to Kingston. Specifically, he stated that as cash profits were received, "the balance on the [$50,000] loan was reduced and the money owed to Kingston was reduced." In addition, AJF Financial's books showed that the $50,000 was incorporated into AJF Financial as a receivable, and that the receivable was set off against monies owed to Kingston was reflected on AJF Financial's books.

In addition, the evidence shows that AJF Financial did, in fact, owe money to Kingston. Thus, under common law set off principles, Kingston could properly set off monies owed to AJF Financial against the back-end money owed by AJF Financial to Kingston.[6] However, the

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[6] Rooted in the common law, the setoff mechanism "allows entities that owe each other money to apply their mutual debts against each other, thereby avoiding 'the absurdity of making A pay B when B owes A.'" Citizens Bank of Maryland v. Strumpf, 516 U.S. 16 (1995) (quoting Studley v. Boylston Nat'l Bank, 229 U.S. 523, 528 (1913)). Stated another way, the right of setoff allows parties that owe mutual debts to each other to assert the amounts owed, subtract one from the other, and pay only the

$50,000 loan was made by Fraser, not AJF Financial. The bankruptcy court determined that the distinction did not matter because "AJF Financial was a creature of Mr. Fraser" -- it was "his entity." The bankruptcy court concluded, therefore, that "it is appropriate for a liability that [the Debtor] owed to Mr. Fraser to be set off against the money going the other way, or, technically, since the money was not due to [the Debtor] but to Kingston, and Kingston was a co-obligor on the $50,000, what we're doing is allowing Kingston to set off in a direct fashion without any undue complications."

On appeal, Fraser argues that the bankruptcy court erred in "disregarding AJF Financial's separate existence as a corporation," i.e. that the bankruptcy court improperly pierced the corporate veil. The Debtor contends, however, that the bankruptcy court did not "reach beyond the corporate walls of AJF Financial to access the $50,000. To the contrary, Mr. Fraser, by his own actions, brought the $50,000 loan with [sic] the walls of the corporation." We agree with the Debtor. According to the Debtor, given the degree of Fraser's control over AJF Financial, there was nothing preventing him from assigning his interest in the $50,000 loan to AJF Financial in order to set off a portion of the amounts AJF Financial owed to Kingston, and this is ultimately what occurred.

Given the level of control Fraser had over AJF Financial, it is significant that he took no action to reverse the setoff transaction. By failing to dispute the transactions, Fraser actually agreed to or condoned the transactions. See Sisk v. Saugus Bank & Trust Co. (In re Saugus Gen.

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balance. See Darr v. Muratore, 8 F.3d 854, 860 (1st Cir. 1993) (citing In re Bevill, Bresler & Schulman Asset Mgmt. Corp., 896 F.2d 54, 57 (3d Cir. 1990)). Under the common law right of setoff in Massachusetts, mutuality requires that the debts be between the same parties, standing in the same capacity. See In re Liquidation of Am. Mut. Liab. Ins. Co., 747 N.E. 2d 1215 (Mass. 2001).

Hosp., Inc.), 698 F.2d 42, 45 (1st Cir. 1983) (parties are free to modify common-law setoff rules by contract). For the reasons set forth above, we conclude that the bankruptcy court's finding that the $50,000 receivable was properly set off against monies AJF Financial owed to Kingston was not clearly erroneous.

III. The $29,000 loan

The bankruptcy court found that "the entire intent of this transaction was that money be available to Kingston for the purchase of vehicles. . . . And to that extent, any personal liability of the debtor, Mr. Rowlands, would be in the nature of a guarantee and under the Statute of Frauds would have to be writing." Finding that the Debtor had never agreed in writing to guarantee the $29,000 loan as required by the Statute of Frauds, the bankruptcy court concluded that the Debtor could not be held personally liable for the $29,000 loan.

In Massachusetts, a signed writing is required to hold a person personally liable for the debt of another. See Mass. Gen. Laws ch. 259, § 1.[7] Therefore, the bankruptcy court was correct in concluding that personal guarantees must be in writing under the Statute of Frauds. Fraser does not dispute that the Debtor never signed a written agreement to be personally liable on the $29,000 debt. Rather, he argues that no writing was required because the Debtor was a primary obligor on the loan rather than a mere guarantor of Kingston's debt, and, therefore, that the bankruptcy court's finding was erroneous. We disagree.

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[7] This section provides, in relevant part:

> No action shall be brought . . .[t]o charge a person upon a special promise to answer for the debt, default or misdoings of another . . . [u]nless the promise, contract or agreement upon which such action is brought, or some memorandum or note thereof, is in writing and signed by the party to be charged therewith or by some person thereunto by him lawfully authorized.

Mass. Gen. Laws ch. 259, §1.

Fraser testified that the Debtor approached him in 2000, asking to borrow money "to purchase trucks for the winter season in the 2000/2001 year." Thereafter, Fraser deposited $30,000 from his personal funds into a bank account jointly held by Fraser and the Debtor. He testified that he "assumed" that the money would be used to buy vehicles for Kingston Motors "to further the business arrangement [he] had with Kingston Motors for the sale of vehicles and the financing of vehicles . . ." He does not dispute that the funds were used solely for Kingston's business purposes. Thereafter, the Debtor wrote three checks totaling $29,000 from the joint account. All three checks were made out to "Kingston Motor Car" or "Kingston Motor Car Sales."

Although he knew that the funds would be used to purchase vehicles for resale in Kingston's business, Fraser argues that he intended the loan to be to the Debtor rather than to Kingston. On direct examination, Fraser testified that the reason he did not write a $30,000 check directly to Kingston was because he intended to structure the loan "similar to the initial . . . $50,000 note which was a loan to [the Debtor], not to Kingston Motor Cars . . . ," and that he expected the Debtor to repay the loan. However, as the Debtor points out, it is reasonable to conclude that the $30,000 deposit into a joint account was not a personal loan to the Debtor since Fraser retained the right to withdraw those funds at any time, and the Debtor had no obligation to repay Fraser for the $30,000 deposit. The obligation to repay arose only after the checks totaling $29,000 were written *to Kingston*. Because the checks were paid from a joint account within Fraser's control, were made out to Kingston, and were used solely for Kingston's business purposes, it was not clearly erroneous for the bankruptcy court to conclude that the loan was made to Kingston and not to the Debtor personally. Other than Fraser's testimony of his intent

when he structured the loan, there is no evidence that this was a loan to the Debtor personally. The Panel must give "due regard . . . to the opportunity of the bankruptcy court to judge the credibility of the witnesses." Fed. R. Bankr. P. 8013..

CONCLUSION

For the reasons set forth above, we AFFIRM.