

The court incorporates by reference in this paragraph and adopts as the findings and analysis of this court the document set forth below. This document has been entered electronically in the record of the United States Bankruptcy Court for the Northern District of Ohio.



Dated: July 06 2006

A blue ink signature of Mary Ann Whipple, written in a cursive style.

Mary Ann Whipple
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF OHIO
WESTERN DIVISION

In Re:)	Case No. 06-31157
)	
L&M Video Productions, Inc.,)	Chapter 11
)	
Debtor.)	
)	JUDGE MARY ANN WHIPPLE

MEMORANDUM OF DECISION GRANTING MOTION TO DISMISS

The court held an evidentiary hearing on a Motion for Abstention or Dismissal [Doc. # 10] filed by shareholder/creditor/asset purchaser Cornerstone Church, Inc. and creditor Teletech (collectively, “Movants”), Debtor’s response [Doc. # 20, 22], and Movants’ supplemental memorandum in support of their motion [Doc. # 23]. Movants ask the court to abstain from conducting further proceedings in this case under 11 U.S.C. § 305 or, alternatively, to dismiss the case for cause under 11 U.S.C. § 1112(b).

This memorandum of decision constitutes the court’s findings of fact and conclusions of law under Fed. R. Civ. P. 52, made applicable to this contested matter by Fed. R. Bankr. P. 9014 and 7052. Regardless of whether or not specifically referred to in this decision, the court has examined the submitted materials, weighed the credibility of the witnesses, considered all of the evidence, and reviewed the entire record of the case. Based upon that review, and for the reasons that follow, the court will grant Movants’ motion to dismiss the case due to a lack of corporate authority to seek relief under the Bankruptcy Code.

FACTUAL BACKGROUND

Debtor is an Ohio corporation that operates a low power television broadcasting station under a license from the Federal Communications Commission (“FCC”). At the time Debtor filed its Chapter 11 petition, the corporation had two shareholders, Cornerstone Church, Inc., (“Cornerstone”), which holds 37% of the common stock, and L&M Broadcasting, Inc., which holds 63% of the common stock. [Doc. # 1, Petition, List of Equity Security Holders; Debtor’s Ex. Y, ¶ 3; Cr. Ex. 3, ¶ 1]. Lamaree Miller (“Miller”) and his wife, Linda Miller, own 100% of the stock in L&M Broadcasting, Inc. Miller organized the Debtor corporation in 1995, was Debtor’s president until September 2003, and has managed the television station at all relevant times.

As early as 1997, Miller approached Robert Pitts, Vice President of Cornerstone, and requested that Cornerstone provide Debtor with operating capital in the form of a \$20,000 loan. He repeated his request several times and Cornerstone loaned Debtor the money each time. Miller explained to Pitts that Debtor’s individual shareholders were an obstacle in that they were not willing to invest any additional money in the business. Therefore, over the next few years, Cornerstone purchased all of the shares in Debtor except for those owned by L&M Broadcasting, Inc.

In 2003, after learning of a pending sale of Debtor, Cornerstone filed a motion for temporary restraining order in state court. The state action was settled pursuant to an agreement entered into between Cornerstone, Debtor, L&M Broadcasting, Inc., and Lamaree and Linda Miller on September 11, 2003 (“Settlement Agreement”). The Settlement Agreement recognizes Cornerstone’s 37% interest in Debtor and required the parties to enter into a close corporation agreement with respect to Debtor. [Cr. Ex. 3, ¶ 1, 13]. The Settlement Agreement also recognized that Cornerstone is a creditor of Debtor and required Debtor to execute an open-end note that includes all loans made by Cornerstone to Debtor and is secured by all of the assets of Debtor.¹ [*Id.*, ¶ 8].

The parties entered into the Close Corporation Agreement (“the Agreement”) on September 16, 2003. Although Miller and his wife continued to be employed by Debtor, the Agreement removed Miller as Debtor’s President and placed certain restrictions on him with respect to the company and its finances.²

¹ Although the Settlement Agreement provides that the note will be secured by all of the assets of Debtor, including its FCC broadcast license, [See Cr. Ex. 3, ¶ 8], a broadcast license “is not an owned asset or vested property interest so as to be subject to a mortgage, lien, pledge, attachment, seizure, or similar property right.” *Stephens Indus., Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986).

² Specifically, the Close Corporation Agreement provided that Miller was not permitted “to borrow funds on behalf of the Company, negotiate checks or withdraw funds from the bank accounts of the Company or enter into contracts on behalf of the Corporation without the specific prior written consent of the President or the Board of Directors.” [Cr. Ex. 1, ¶ 6].

The Agreement also provided that the Board of Directors shall be composed of six members, four of whom shall be designated by Cornerstone and two by L&M Broadcasting, Inc. [Cr. Ex. 1, ¶ ¶5, 6]. The Agreement further provides as follows:

The parties hereto agree that this Agreement is subject to the approval of the FCC. Paragraph 5 below empowers Cornerstone to name a majority of the members of the Board of Directors of the Company and thus constitutes a transfer of control. The parties hereby agree that this transfer of control shall be effective only upon receipt of approval of this Agreement from the FCC. In the event approval from the FCC has not been received within two hundred and seventy (270) days from the date of this Agreement either shareholder shall have the option to terminate this Agreement by providing written notice of termination to the other parties.

[*Id.* at ¶ 1]. Under the Agreement, Debtor's shareholders also adopted amended Articles of Incorporation and an Amended and Restated Code of Regulations (the "Regulations"). [*Id.* at ¶¶ 2, 4 and attached Ex. A & B].

The Regulations provide that "[t]he powers of the corporation shall be exercised, its business and affairs conducted and its property controlled by the Board of Directors," and that unless the number of directors is changed at a meeting of shareholders called for such purpose, there will be three directors of the corporation until changed as provided in the Close Corporation Agreement, that directors may be elected at a special meeting of shareholders called and held for that purpose, and that directors shall hold office until the annual meeting next succeeding their election or until their successors are elected and qualified. [*Id.*, Ex. B, Art. III, §§ 1-3, Art. IV, §1.]. The Regulations require written notice of meetings of shareholders and written notice to each director of any special meeting of the Board of Directors unless such notice is waived in writing by the director and the waiver is filed with or entered upon the record of the meeting. [*Id.* Art. II, § 4, Art. III, § 3]. But any action which may be authorized at a meeting of the directors may be authorized without a meeting in a writing signed by all of the directors. [*Id.* Art. III, § 6].

In accordance with the Regulations, Pitts became an elected member of Debtor's Board of Directors pursuant to an Action by Written Unanimous Consent in Lieu of Special Meeting of the Shareholders dated September 16, 2003. [Doc. # 10, Pitts Aff. ¶ 4 (attached thereto)]. The only other members of the Board of Directors are Miller and his wife, Linda. Also on September 16, 2003, pursuant to an Action by Written Unanimous Consent in Lieu of Special Meeting of Directors, Pitts was elected as Debtor's President. [Debtor Ex. GG].

Approval of the transfer of control of Debtor was not received within the 270 day period set forth in the Close Corporation Agreement and had not yet been received as of the date of the hearing on the

motion before the court. The record does not show whether such approval was ever sought. On January 26, 2005, Cornerstone provided written notice to Debtor, shareholder L&M Broadcasting, Inc. and the Millers of its election to terminate the Agreement pursuant to paragraph one of the Agreement.

On January 10, 2005, Teletech, the lessor of a transmitter used by Debtor, having not been paid under its lease and having received a money judgment against Debtor, filed a state court action against Debtor seeking the appointment of a receiver to enforce the judgment. [Movants' Ex. 14]. Cornerstone was joined in that action as a party defendant and also filed a cross-claim against Debtor, upon which it received a judgment of more than \$650,000. [Movants' Ex. 13]. By agreed order entered on February 16, 2005, the state court appointed Ralph DeNune as receiver. [Movants' Ex. 16]. The order appointing DeNune was approved by, among others, attorneys for Cornerstone, Debtor and the Millers.

DeNune entered into a purchase agreement with Cornerstone for its acquisition of all of Debtor's assets, including the FCC license. Beyond the satisfaction of the claims of certain other creditors, the consideration for the sale essentially consists of Debtor's existing debt to Cornerstone. Unsecured creditors were not generally given notice of or the opportunity to participate in the state court proceedings, and will not be paid anything through the receivership. On October 18, 2005, the state court confirmed DeNune's sale of Debtor's assets to Cornerstone. [Movants' Ex. 15]. The sale has not been completed because the FCC has not approved transfer of the license to Cornerstone, pending which the state court authorized Cornerstone to take control of the assets and operate the television station "subject to the supervision of the receiver." [*Id.*]. The receivership action remains pending in state court.

On May 19, 2006, Miller filed a Chapter 11 voluntary petition on behalf of Debtor and as President/Director of L&M Video. In addition, a Resolution of the Board of Directors ("Resolution") dated May 19, 2006, was filed purporting to authorize Miller, as President of the corporation, to file the petition. The Resolution is signed by LaMaree Miller and Linda Miller only. [Cr. Ex. 18]. At the hearing, Miller testified that the last meeting of the Board of Directors held before the May 19, 2006, meeting was on September 16, 2003. Written notice of the May 19, 2006, meeting was not provided to Pitts, and he did not attend the meeting. No resolution has been executed or shareholder meeting noticed or held that would have removed Pitts as a member of Debtor's Board of Directors.

LAW AND ANALYSIS

Movants ask the court to abstain from exercising jurisdiction over this case under 11 U.S.C. § 305(a), which provides the court discretion to abstain from exercising jurisdiction if "the interests of creditors and the debtor would be better served by such dismissal...", or alternatively, to dismiss the case

under 11 U.S.C. § 1112(b), asserting lack of good faith as cause for dismissal. A number of issues, as well as evidence in support of those issues, have been raised by the parties. Miller is upset with the result of the state court proceedings and DeNune's pending sale of assets to Cornerstone. Concerns raised include the lack of general notice and any potential distribution to Debtor's unsecured creditors through the state court proceedings; the lack of adequate information as to the value of the FCC license; Cornerstone's use of debt as consideration for purchase of, among other assets, an FCC license in which it does not appear to have an enforceable security interest; and the absence of an organized bidding process for the sale of Debtor's assets, including its FCC license. Movants argue in support of their motion that all of Debtor's assets have been sold by the receiver in state court, that there is no possibility of reorganization or liquidation and that Debtor did not file its Chapter 11 petition in good faith. However, Movants raise a threshold issue that must be determined before addressing arguments under §§ 305 and 1112(b). Specifically, the motion asserts that Miller was not authorized to file a bankruptcy petition on behalf of Debtor, thus, raising the issue of whether a voluntary case has been properly commenced. The court need not address the other issues, including lack of good faith or whether the interests of the debtor and creditors are better served by abstention, unless such authority exists.³

³ This case was commenced under the Bankruptcy Code as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"). Section 1112(b) was substantially amended by BAPCPA, effective October 17, 2005. Lack of good faith as argued by movants was generally construed as cause for dismissal under the pre-BAPCPA § 1112(b). The parties have not argued to the court the impact of the BAPCPA amendments as to cause for dismissal or all of the components of amended § 1112(b), some of which are difficult to understand. Ultimately, however, the statutory basis for this court's decision granting the motion and dismissing this case is 11 U.S.C. §§ 105(a) and 301, not § 1112(b). See Fed. R. Bankr. P. 1017(a), (f). Other courts addressing corporate authority issues differ in their treatment of the very nature of the issue and the statutory basis for decision, which is sometimes left unstated. See, e.g., *Price v. Gurney*, 324 U.S. 100, 106-07 (1945)(addresses corporate authority issues under Bankruptcy Act in terms of jurisdiction, but does not expressly specify whether subject matter or personal); *In re Martin-Trigona*, 760 F.2d 1334, 1340-41 (2d Cir. 1985)(treats lack of corporate authority as waivable issue akin to personal jurisdiction); *Hager v. Gibson*, 108 F.3d 35 (4th Cir. 1997)(addresses issue in terms of subject matter jurisdiction, but affirms denial of motion to dismiss on grounds of ratification of unauthorized corporate act and relation back of same to create jurisdiction in bankruptcy court); *In re American Globus Corp.*, 195 B.R. 263 (Bankr. S.D.N.Y. 1996)(basis for motion to dismiss not identified, but motion overruled on grounds of estoppel of other shareholder to object); *In re Stavola/Manson Electric Corp.*, 94 B.R. 21 (Bankr. D. Conn. 1988)(shareholder's motion to dismiss granted due to lack of corporate authority; basis for motion not stated); *In re Farner Boring & Tunneling, Inc.*, 26 B.R. 29 (Bankr. E.D. Tenn. 1982)(same); *In re Gen-Air Plumbing & Remodeling, Inc.*, 208 B.R. 426, 430 (Bankr. N.D. Ill. 1997)(treats lack of corporate authority as independent unenumerated cause for dismissal under pre-BAPCPA § 1112(b)); *In re Autumn Press Inc.*, 20 B.R. 60, 63 (Bankr. D. Mass. 1982)(grants motion to dismiss for lack of corporate authority without identifying statutory basis for motion, but notes in dicta that it "can conceive of circumstances where dismissal of a bankruptcy proceeding, for non-compliance with corporate by-laws or state law upon the motion of a stockholder who holds what otherwise might be a preferential transfer, would be unjustified in both law and equity."). Even though the motion is not expressly premised on §§ 105(a) and 301, Debtor has been given clear and fair notice of Movants' arguments as to Miller's lack of corporate authority and presented evidence on this issue at the hearing. Movants argued the lack of corporate authority as one component of an overall lack of good faith under § 1112(b). In the court's view, the issue of authorization to file the voluntary petition stands on its own under § 301 irrespective of the Debtor's (or Miller's) good faith or bad faith. See *In re Avalon Partners, LLC*, 302 B.R. 377 (Bankr. D. Ore. 2003)(treats lack of corporate authority issue separately from lack of good faith under pre-BAPCPA § 1112(b)).

I. Do Movants Have Standing to Challenge Corporate Authority?

Initially, the court addresses an issue raised by Debtor in opposition to the motion to dismiss, specifically the standing of Movants to raise the corporate authority issue. Debtor argued at the hearing and in its opposition filings that Cornerstone is not actually a shareholder in the corporation, questioning whether it had paid for and properly acquired certain shares. Cornerstone's status as a shareholder is important, because the case law is split as to whether a creditor, such as Teletech, has standing to raise the lack of corporate authority as a ground for dismissal of a bankruptcy petition.⁴ *Compare Royal Indem. Co. v. American Bond & Mortgage Co.*, 289 U.S. 165, 171 (1933) ("Creditors have no standing to plead statutory requirements not intended for their protection. If the stockholders' rights had been infringed, and they chose to waive them, a creditor could not assert them in opposing an adjudication.") and *Still v. Fundsnet, Inc. (In re Southwest Equipment Rental)*, 152 B.R. 207, 210 (Bankr. E.D. Tenn. 1992) (finding that *Royal Indemnity* is controlling and still valid under the Bankruptcy Code, court denies creditors' motions to dismiss petition because the company's directors did not authorize it on standing grounds) with *In re Giggles Restaurant, Inc.*, 103 B.R. 549, 555 (Bankr. D.N.J. 1989) (distinguishes *Royal Indemnity*, and finds that landlord as creditor has standing to challenge validity of resolution authorizing bankruptcy petition and to seek dismissal of case) and *In re Vermont Fiberglass, Inc.*, 38 B.R. 151, 152 (Bankr. D. Vt. 1984) (allowing secured creditor to object to corporate authorization without discussing standing issue).

The court need not resolve whether Teletech has standing solely as a creditor to raise the corporate authority issue, because the court finds that Cornerstone is a shareholder in Debtor, in addition to its status as a creditor, with standing to raise the lack of corporate authority to commence the case.⁵ *In re Consolidated Auto Recyclers, Inc.*, 123 B.R. 130, 138 (Bankr. D. Me. 1991) (creditor that was also a majority shareholder has the right to contest authorization); *Autumn Press*, 20 B.R. at 63 (same) ("Dreier's creditor status and the fact that he may benefit monetarily from dismissal should not automatically abrogate his standing as a stockholder to contest an invalid corporate act."). The Debtor's arguments about whether Cornerstone is a shareholder of Debtor are now foreclosed by the Settlement Agreement, which was entered into among the Debtor, L&M Broadcasting, Inc., and the Millers, individually and as shareholders of L&M

⁴While Debtor challenged Cornerstone's position as a shareholder, it did not explicitly raise any challenge to Teletech's standing to bring the motion to dismiss on the grounds of lack of corporate authority. However, if Cornerstone is not a shareholder and does not have standing as such, then the issue of a creditor's standing to assert such an argument is directly implicated, be it Cornerstone as creditor pursuant to the state court judgment, instead of Cornerstone wearing its shareholder hat, or Teletech as judgment creditor.

⁵The state court's money judgment on Cornerstone's cross-claim against Debtor in the receivership action confirms Cornerstone's status as a creditor. This court cannot disregard that judgment.

Broadcasting, Inc., on September 11, 2003. The Settlement Agreement acknowledges that “Cornerstone is recognized as a shareholder of L&M Video...”, Movants’ Ex. 3, ¶ 1, and states that “L&M Video, L&M Broadcasting, Marty Miller and Linda Miller, jointly and severally, represent and warrant, to the best of their knowledge after due inquiry, that (i) other than a stock pledge to Tony Scott, no other person has any right or option or stock or interest in L&M Video...,” Movants’ Ex. 3, ¶ 6. The Debtor’s evidence attempting to challenge Cornerstone’s status as a shareholder all predates the Settlement Agreement concluding that issue as between these parties.

II. Was the Corporation Authorized to File a Voluntary Bankruptcy Petition?

Under the Bankruptcy Code, a case is commenced by the filing of a petition by an entity that may be a debtor under the chapter for which relief is sought. 11 U.S.C. § 301. While corporations are clearly entities eligible to file voluntary petitions commencing cases under Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 109(b)[who may be a debtor], 109(d)[same], 101(15)[definition of entity, including person], 101(41)[definition of person, including corporation] and 301[voluntary cases], neither the Bankruptcy Code nor the Federal Rules of Bankruptcy Procedure establish the internal requisites for initiation of a voluntary corporate bankruptcy proceeding. *Cf.* 11 U.S.C. § 303(b)(who may commence involuntary cases against eligible debtors); Fed. R. Bankr. P. 1004 (procedure for involuntary partnership cases); Fed. R. Bankr. P. 1004.1 (who may file a petition for an infant or incompetent person). Therefore, the authority to file a bankruptcy petition on behalf of a corporation must derive from state law. *Keenihan v. Heritage Press, Inc.*, 19 F.3d 1255, 1258 (8th Cir. 1994) (citing *Price v. Gurney*, 324 U.S. 100, 106-07 (1945)). If the court finds that such authority does not exist, “it has no alternative but to dismiss the petition.” *Price*, 324 U.S. at 106; *see Keenihan*, 19 F.3d at 1259 (explaining that “[i]n the absence of a valid petition, a bankruptcy court has no basis upon which to dispose of a corporation’s assets or resolve its debt status”); *In re Arcko Prop., Inc.*, 207 B.R. 624, 628 (Bankr. E.D. Ark. 1997).

Because Debtor is a corporation created under Ohio law, the court must look to Ohio law to determine the authority issue. Under Ohio law, “[e]xcept where the law, the articles, or the regulations require action to be authorized or taken by shareholders, all of the authority of a corporation shall be exercised by or under the direction of its directors.” Ohio Rev. Code § 1701.59(A). A minimum of three directors are required. *Id.* § 1701.56(A)(1). “Unless the articles or the regulations provide for a different term . . . each director shall hold office until the next annual meeting of the shareholders and until his successor is elected, or until his earlier resignation, removal from office, or death.” *Id.* 1701.57(A). The Ohio statutes set forth the circumstances that must exist in order for a director to be removed from office,

none of which apply in this case. *See id.* § 1701.58. Ohio law requires that notice of a meeting of shareholders be given to every shareholder of record entitled to notice unless notice has been waived in writing and that notice of a meeting of the board of directors be given to every director. *Id.* §§1701.41(A), 1701.42, 1701.61(C). In addition, any action that may be authorized at a meeting of shareholders or of the directors, may be authorized without a meeting “with the affirmative vote or approval of, and in a writing or writings signed by all the shareholders who would be entitled to notice of a meeting of shareholders held for such purpose, or all the directors, respectively.” *Id.* § 1701.54(A). Finally, a close corporation agreement may contain provisions that bind the corporation and its shareholders and regulate any aspect of the internal affairs of the corporation or the relations of the shareholders among themselves “irrespective of any other provision of [Chapter 1701].” *Id.* § 1701.591(C).

In this case, it is undisputed that Pitts was not given notice of and did not attend the meeting at which the Board of Directors purportedly authorized Miller to file a bankruptcy petition on behalf of Debtor. Both the Regulations and Ohio law require that all of the directors be provided notice of a special meeting of the directors. Debtor contends that such notice was unnecessary because Pitts had in effect resigned as a director based on Cornerstone’s termination of the Agreement. The court disagrees. Cornerstone’s notice of its election to terminate the Agreement provides only for such termination; it is silent with respect to the office of director to which Pitts was elected. [*See Debtor’s Ex. Z*]. The Agreement does not name the individuals that are to hold the directors’ positions. Rather, Pitts was elected director pursuant to an Action by Written Unanimous Consent in Lieu of Special Meeting of the Shareholders, a document separate and distinct from the Close Corporation Agreement. He was also elected President of the corporation pursuant to an Action by Written Consent in Lieu of Special Meeting of Directors, also a document separate and distinct from the Agreement. Termination of the Agreement may have altered various rights and restrictions on the conduct of the parties to that Agreement that are set forth in the Agreement, and may even have terminated the applicability of the Regulations adopted in the Agreement, an issue not addressed by the parties. But it did not change the number and composition of the directors of the corporation. Nothing in the notice of termination indicates that Pitts was resigning his office as director. His term of office, absent his resignation, removal from office, or death, under either the Regulations or the Ohio statute, continues until his successor is elected at a meeting of the shareholders. *See Ohio Rev. Code* § 1701.57(A); [*Cr. Ex. 1, Art. III, § 3*]. Under the Regulations, and under Ohio law to the extent that the Regulations were not effective after the Agreement was terminated, Pitts was a director of the corporation at the time the Board of Directors ostensibly authorized Miller to file a bankruptcy petition on behalf of Debtor. Because a

meeting of the directors can only occur on notice to all of the directors, and because Pitts was not given notice, the court concludes that Miller had no authority to file a bankruptcy petition on behalf of Debtor. *See In re A-K Enterprises, Inc.*, 111 B.R. 149, 150 (Bankr. N.D. Ohio 1990) (explaining that a corporate resolution that authorizes the filing of a bankruptcy petition “must originate at a validly held meeting of directors”).

Alternatively, Debtor argues that, if Pitts is a director, he is only one of three directors, that “two of the directors in an action without a meeting elected to seek protection under Chapter 11,” and that such an election is proper under Ohio law. While a board of directors may take action without a meeting, Debtor’s argument is flawed since both the Regulations and Ohio law require that an action may be authorized or taken without a meeting only if approved in a writing signed by all of the directors. *See* Ohio Rev. Code § 1701.54(A); [Cr. Ex. 1, Art. IV, § 6]. The corporate resolution in this case was signed by only two directors, Lamaree and Linda Miller.

Moreover, to the extent still effective, the Regulations provide that “all of the directors elected and in office shall constitute a quorum.” [Cr. Ex. 1, Art. IV, § 4]. A “quorum” is “[s]uch number of the members of a body as is competent to transact business in the absence of the other members.” *McDonald v. Dalheim*, 114 Ohio App. 3d 543, 450 (1996). As the corporate resolution in this case was approved by less than a quorum, it was insufficient to confer authority on Miller to file the bankruptcy petition on behalf of Debtor.

As this case was filed without the requisite authority, a voluntary case was not properly commenced by the Debtor; the eligible “entity” has not filed with the bankruptcy court a voluntary petition. And there is no pretense of an involuntary petition being filed so as to require analysis under 11 U.S.C. § 303, which is the only statutory vehicle through which an eligible entity that has not commenced a voluntary case may become a debtor. Accordingly, this case must be dismissed. A separate order granting the motion and dismissing this case for lack of corporate authority will be entered by the court.