

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

IN RE:

ICS CYBERNETICS, INC.,

Debtor

CASE NO. 88-00478

Chapter 11

ICS CYBERNETICS, INC.,

Plaintiff

vs.

ADV. PRO. NO. 88-0103

WILLIAM SALVATERRA,

Defendant

APPEARANCES:

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STEPHEN D. GERLING, U.S. Bankruptcy Judge

MEMORANDUM-DECISION, FINDINGS OF FACT,
CONCLUSIONS OF LAW AND ORDER

Plaintiff, ICS Cybernetics, Inc. ("Debtor") has commenced the instant adversary proceeding against a former employee and officer of the Debtor to recover proceeds from the sale of certain computer equipment transferred by Debtor to the Defendant, William Salvaterra ("Salvaterra"), pre-petition. While no specific statutory or procedural basis has been alleged for this proceeding, the Court views it as falling within the scope of 28

U.S.C. §157(b)(2)(E) and Bankruptcy Rule ("Bankr. R.") 7001(1).

Salvaterra served an Answer and Counterclaim which alleged that Debtor had interfered with a contractual relationship between Salvaterra and the third party purchaser of the computer equipment. Salvaterra sought damages in the event that the contract was terminated.

A trial of the adversary proceeding was held before the Court on April 10, 1989. The parties thereafter submitted memoranda of law and the matter was submitted for decision on May 1, 1989.

FINDINGS OF FACT

1. The Debtor filed a voluntary petition pursuant to Chapter 11 United States Code on March 31, 1988.

2. The Debtor is engaged for profit in the purchase, lease and sale of computer equipment.

3. Salvaterra was offered, and ultimately accepted an employment and compensation package with Debtor and the offer for employment was made on behalf of Debtor by Jonathan W. Allen ("Allen"), President and Director of Debtor during the Spring of 1985.

4. Allen orally offered Salvaterra a compensation package which initially included a \$50,000 annual salary, \$25,000 annual draw against commissions, use of a Debtor-owned BMW automobile and an equity ownership interest in Debtor of between five and ten percent of the outstanding shares of its capital stock.

5. In exchange for the above compensation, Salvaterra was to

develop and expand the sales and marketing of the Debtor's computer leasing business.

6. Salvaterra accepted Debtor's offer and his employment with Debtor commenced on or about April 1, 1985, at which time he was appointed to the office of Vice-President.

7. Salvaterra's compensation from Debtor was deficient from April 1, 1985 and thereafter in that Debtor never provided him with the promised shares of Debtor's stock.

8. On approximately October 1, 1985 Debtor offered Salvaterra the opportunity to purchase an "equity package" from Debtor.

9. On November 1, 1985 Debtor and Salvaterra executed a contract for the purchase and sale of the equity package involving computer equipment then leased to a client, and assignment of the existing lease between Debtor and client to Salvaterra ("Master Purchase Agreement"). On the same date Debtor also executed and delivered to Salvaterra a "Confirmatory Bill of Sale" confirming the above sale.

10. The Master Purchase Agreement provides inter alia, that Salvaterra:

- a. Purchased identified computer equipment from Debtor;
- b. Is liable for the debt owed on the computer equipment to the lender;¹
- c. Is subject to all the terms in the lease as assignee, and
- d. That the consideration referred to in the Master Purchase Agreement was \$100.00, to be paid by Salvaterra within five

¹. Total debt was approximately \$80,000.00 as of November 1, 1985.

business days, and assumption of the outstanding indebtedness.

11. Estimated residual value of the computer equipment subject to the equity package at the time of the transaction was disputed by the parties. Salvaterra contends that the estimated residual value was approximately \$6,000.00 to \$9,000.00, while Debtor maintains that the estimated residual value at the end of the lease term was \$26,232.00.

12. Salvaterra's personal check for \$100.00 was not issued and delivered to Debtor until sometime in June or July of 1986.

ISSUE

Whether the pre-petition contract between the Debtor corporation and its officer for the purchase of an equity package is voidable by the Debtor?

ARGUMENTS

Debtor argues that, due to Salvaterra's breach of a fiduciary duty to the Debtor corporation as Vice-President, the Master Purchase Agreement between Salvaterra and Debtor is voidable by the Debtor. Debtor asserts that the presumption is against the validity of the purchase and that, therefore, Salvaterra has the burden of showing its "fairness" to the corporation. (Debtor's

Memorandum of Law at 8.) Debtor claims that the transaction should be viewed as a sale of corporate assets for less than fair consideration which also permitted Salvaterra to obtain a significant tax benefit in 1985, thereby shifting the burden of proof to Salvaterra to show good faith, fairness and ratification by the corporation. Debtor also argues in the alternative, that if the transaction is viewed as bonus or commission, it must be voidable as it was never ratified by the Debtor's Board of Directors or shareholders. Id.

Salvaterra argues that the equity package which he received was offered both "to reward the Defendant for his highly successful efforts on behalf of the corporation and placate his continuing demands for the shares of stock of ICS that had been promised to him." (Salvaterra's Memorandum of Law at 10). He contends that the offer to purchase the equity package and the terms thereof were proposed by Debtor, thereby insuring fairness to the corporation. Salvaterra alternatively contends that the understanding between he and Debtor regarding the nature of the transaction was that it was "some sort of bonus to the Defendant and not as an arm's length purchase of assets." Id.

JURISDICTION

The Court has jurisdiction of this core proceeding pursuant to 28 U.S.C.A. §§1334 and 157(a), (b)(1) and (2)(E) (West Supp. 1989).

DISCUSSION

Neither party disputes that a contract was formed between the Debtor and Salvaterra for the sale and purchase of certain computer equipment and the assignment of the lease then in existence regarding the equipment. The Debtor argues that the transaction did not occur until sometime in mid-1986, as that was when the consideration of \$100.00 actually passed from Salvaterra to the Debtor.²

The Court finds that a valid contract came into existence on November 1, 1985. The parties, by virtue of their execution of the Master Purchase Agreement and the Confirmatory Bill of Sale, caused title to the computer equipment to vest in Salvaterra and the right to payment to vest in Debtor on that date. See In re Emergency Beacon Corp., 665 F.2d 36, 41 (2d Cir. 1981). See also N.Y.U.C.C. §2-401(1) (McKinney 1964)(title passes as explicitly agreed upon between parties). The fact that the \$100.00 check was not delivered to the Debtor until mid-1986 did not affect the validity of the contract nor the time at which it was formed.

Debtor asserts that the contract is voidable by the Debtor corporation because Salvaterra has not met his burden of establishing the fairness of the contract and that the presumption is against the validity of the purchase. Generally, directors and officers are called to account for their actions only when they

² Debtor also argues that Salvaterra, on behalf of the Debtor, contracted to sell the same computer equipment that was subject to the Master Purchase Agreement to Computer Leasing, Inc. in December 1985. Salvaterra refutes that by alleging that the proposed sale was in error and never actually occurred.

are shown to have engaged in fraud, self-dealing or have acted in bad faith. Geddes v. Anaconda Copper Co., 254 U.S. 590, 599 (1921). It is initially the plaintiff's burden to demonstrate a fiduciary's bad faith, interest or self-dealing. Crouse-Hinds Company v. Internorth, Inc., 634 F.2d 690, 702 (2d Cir. 1980). Once the plaintiff's burden is met, the burden shifts to the officer or director to prove that the transaction was fair and reasonable to the corporation. Id.

The Debtor has failed to provide a sufficient basis to find that it has met its burden of demonstrating Salvaterra's self-dealing or bad faith. Debtor seeks to infer that because Salvaterra obtained compensation through the purchase of a so-called "equity package" from Debtor, that he has acquired a personal financial benefit at the expense of the Debtor and its creditors. The inference, standing alone, is not persuasive. Salvaterra had no unilateral ability to vote himself a raise or structure and execute a benefit package for his own personal gain. There is also no evidence that he was an officer or director of a competing corporation with whom he divided his loyalty. See Hine v. Lausterer, 135 Misc. 397, 407 (N.Y.Sup.Ct. 1930). Thus he has not engaged in self-dealing and is not "interested" within the meaning of §713 of the New York Business Corporation Law ("NYBCL") (McKinney's 1986).

The evidence presented indicates that Salvaterra dealt with Debtor at arm's length and the Debtor's assertion of collusion or bad faith on the part of Salvaterra lacks support. While it is true, as Debtor asserts, that a purchase from the corporation by a

corporate officer is voidable if not fairly made for adequate consideration, and the corporation was adequately represented by others, Hine, supra 135 Misc. at 401-02, here the corporation was represented by its President who was also a Director. Salvaterra's dealings regarding compensation were always through Allen as President of the Debtor. The terms of the Master Purchase Agreement, including the consideration, were unilaterally proposed by the Debtor, and there is no evidence suggesting self-dealing through Salvaterra's insider influence or through lack of representation of the Debtor in the transaction. Also, while the Debtor's conclusion that the contract lacks adequate consideration may be warranted when viewed from within the four corners of the Master Purchase Agreement, the issue of adequacy need not be reached since the Court concludes that, in part, the consideration for the equity package contract was provided outside of the Master Purchase Agreement. The evidence indicates that the stated consideration was merely that which the Debtor believed necessary to refute a possible allegation that the contract was illusory and, therefore, to analyze the transaction as a straightforward purchase and sale of a corporate asset is not supported by the intent of the parties or the circumstances surrounding the transaction. Since the Court, therefore, finds that the Debtor has failed to demonstrate Salvaterra's self-dealing, interest or bad faith, he is relieved of his burden of showing the fairness of the transaction to the Debtor corporation.

Debtor also contends that the transaction constituted a "bonus" or commission, and is voidable if not ratified by the

Board or if it does not bear a reasonable relationship to the services that Salvaterra rendered to the corporation. Salvaterra maintains alternatively, that the equity package was offered and accepted in partial satisfaction for the nondelivery of Debtor's stock and as increased compensation due to his highly successful efforts on Debtor's behalf between April and November of 1985. The Court, agreeing with Salvaterra, concludes that the transaction was neither a bonus nor commission, but was in fact substitute compensation for the stock which was not delivered to Salvaterra, and for his outstanding performance in the first few months of employment which resulted in significant profit to the Debtor.

The essential facts are not in dispute. Salvaterra was earning approximately \$100,000.00 per year with his former employer, as a broker for used computer equipment, during the Spring of 1985 when approached by Allen on behalf of Debtor concerning an offer of employment. He accepted the offer but Debtor failed to provide, inter alia, the stock of Debtor as promised. Salvaterra's inquiries into these deficiencies during the summer and early fall of 1985 were met with verbal assurances from Allen that the stock was to be forthcoming. After further inquiries by Salvaterra concerning the stock, and as a result of Salvaterra's efforts which led to Debtor profits of \$775,000.00 in August or September of 1985, he testified that Allen, on behalf of Debtor, offered him enhanced compensation. The compensation proposed by Allen was to increase Salvaterra's salary to \$75,000.00 per year without any commissions, to purchase a country club membership for him,

reimburse him for lease payments on his private vehicle, and to offer him the opportunity to purchase the so-called equity package. Given Salvaterra's uncontroverted testimony, it is apparent that, the transfer of the equity package was motivated by not only the desire to increase Salvaterra's compensation, but also to provide a substitute for the undelivered stock.

Accordingly, the Court finds that the transaction involving the equity package was simply part of increased compensation and as a substitution for the Debtor's failure to issue stock, rather than a bonus or commission requiring ratification. A bonus is consideration beyond that which is due and a commission is based on a percentage of a transaction. The value of the equity package is clearly not beyond the value of what was due Salvaterra under the facts of this case. Also, the circumstances precipitating the transaction do not support its characterization as a commission. Since the value of the equity package, together with the circumstances surrounding the transaction fail to support its interpretation as either a bonus or a commission, the Court finds that ratification by the corporation on those grounds is unnecessary. Therefore the Master Purchase Agreement is not voidable by the Debtor.

It further appears that during the course of the adversary proceeding the sale of the computer equipment actually occurred, thus mooting Salvaterra's counterclaim for damages, and that pursuant to a Stipulation and Order dated November 9, 1988 the \$30,000.00 sale price was paid over to Salvaterra's attorney to be held in escrow pending either a settlement of the adversary

proceeding or final judgment or Order.

By reason of the foregoing it is

ORDERED that Debtor's complaint be and hereby is dismissed, and
it is further

ORDERED that Salvaterra's counterclaim be and hereby is denied.

Dated at Utica, New York

this day of October, 1989

STEPHEN D. GERLING
U.S. Bankruptcy Judge