

IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE EASTERN DISTRICT OF TEXAS  
SHERMAN DIVISION

IN RE:	§	
	§	
AFFORDABLE BUILDING SYSTEMS, LLC & STRAWMEN, L.P.	§	Case No. 11-43655 (Chapter 11)
	§	
Debtor.	§	Jointly Administered

**FINDINGS OF FACT AND CONCLUSIONS OF LAW**

This case is before the Court on the objections by Ortech Industries, Pty. Ltd. (“Ortech”), a creditor in this case, to claim numbers 9 and 12-25. The Court conducted a hearing on the objection on October 24 and 25, 2013. The Court exercises core jurisdiction over this case and the objections to claims in accordance with 28 U.S.C. §§ 157 and 1334. The Court, having considered the evidence and argument presented by the parties, makes the following findings of fact:<sup>1</sup>

**Findings of Fact**

1. Jack Norman was a farmer who wanted to start a plant that would manufacture strawboard building products and systems. Strawboard is made principally from what would otherwise be waste wheat straw.

2. Mr. Norman and a small group of local investors worked together to develop a business plan. Ortech was helpful in this process. Ortech had a successful strawboard operation in Australia and provided advice to Mr. Norman and the other prospective investors, including advice on initial capitalization requirements.

3. Mr. Norman and the other investors eventually presented their plan to Dr. John Parker Burg. They anticipated that the strawboard plant would become profitable in

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<sup>1</sup> Any finding of fact that is construed to be a conclusion of law is hereby adopted as such. Likewise, any conclusion of law that is construed to be a finding of fact is hereby adopted as such.

two or three years. Dr. Burg agreed to help get the plant started by providing funding.<sup>2</sup> His initial investment of more than \$1 million all went to one of the debtors in these jointly administered cases, Strawmen, LP. Strawmen's general partner, Affordable Building Systems, LLC ("ABS"), was not capitalized. ABS obtained funds either from Strawmen or through loans.

4. In July 2000, Strawmen purchased an Easiboard machine from Ortech Industries Pty., Ltd., with which to manufacture strawboard products. In addition, Strawmen entered into an exclusive licensing agreement with Ortech for Strawmen to manufacture, distribute, and sell Easiboard building products. To house the Easiboard machine, Strawmen acquired 21 acres and built a manufacturing plant, offices, and storage barns.

5. ABS formed in June 2000 to market and install Strawmen's strawboard building systems. In 2004, ABS originated the "Durra" and "Durra Building Systems" names under which it marketed strawboard products. ABS was the operating entity that made sales and incurred expenses.

6. ABS attempted to obtain at least one loan from a third party bank, but its request was rejected.

7. In 2007, Strawmen conveyed the 21-acre manufacturing site to ABS, which allowed ABS to obtain two loans from Texas Rural Communities, Inc. ABS obtained a loan for the principal amount of \$300,000 as well as a revolving promissory note for \$450,000. ABS and Dr. Burg, individually, were liable for repayment of the

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<sup>2</sup> Dr. Burg and Mr. Norman testified that Ortech held a 10% equity interest in ABS and Strawmen. Dr. Burg testified that he offered Ortech's chief executive officer, Derek Layfield, an interest in the companies because he wanted to be sure to maintain a close relationship with Ortech. The bankruptcy schedules show that the holder of the 10% equity interest was an Australian company called Bepton Lodge Pty. Ltd. Dr. Burg and Mr. Norman testified that Bepton Lodge is identical to Ortech in terms of ownership.

indebtedness to the bank.<sup>3</sup> ABS was not able to repay the indebtedness, and the bank sought or threatened foreclosure. In December 2009, Dr. Burg paid off the indebtedness for \$233,540.26, and the bank thereafter released its lien on ABS' property.

8. Dr. Burg, his company, Entropic Processing, Inc., his children's various trusts, and several of his children have provided Strawmen and ABS with working capital since their inception. They provided some of the funds by advancing money without documentation. They documented other advances with promissory notes. The distinction was the amount advanced – the more money involved, the more likely the advance was to be documented by a promissory note.

9. In particular, on many occasions, Dr. Burg, his company, Entropic Processing, Inc., his children's various trusts, and Dr. Burg's children advanced amounts of less than \$50,000 directly to ABS and Strawmen without loan documentation. They also paid the businesses' creditors directly to satisfy relatively small debts without loan documentation. In contrast, the advances to ABS and Strawmen in excess of \$50,000 generally are evidenced by promissory notes.<sup>4</sup>

10. ABS and Strawmen did not repay, and never had the funds to repay, any of the promissory notes. All of the financing was unsecured.

11. The promissory notes are one-page forms. The maturity date for almost all of the notes is five years from the date of execution, and each note requires the borrower (ABS or Strawmen) to make annual interest payments. All of the notes state

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<sup>3</sup> Prior to testifying at trial, Dr. Burg did not understand that he was a co-borrower. He argued that he was compelled to pay the bank so that ABS would not lose its property to foreclosure. The release of lien from the bank shows that Dr. Burg was a co-borrower. The Court finds the documentary evidence more persuasive and accurate than Dr. Burg's testimony on this point.

<sup>4</sup> Mr. Norman acted as the president for Strawmen and ABS. He signed the promissory notes for Strawmen and ABS. He testified that some of the advances were made in a hurry, and in the press of business, he forgot to sign some of the promissory notes.

that the borrower consents that the time of payment may be extended by the lender without notice from time to time.

12. Dr. Burg testified that he understood that ABS and Strawmen had no ability to immediately repay the promissory notes. In fact, ABS and Strawmen did not repay any of the promissory notes. They made only a few, sporadic repayments relating to the smaller amounts advanced to them by Entropic, Dr. Burg, and the trusts belonging to Dr. Burg's children.

13. A plant manager ran the strawboard operation. Mr. Norman dropped by the plant weekly or monthly and would relay information to Dr. Burg, who lived in California. Dr. Burg never had any involvement in the day-to-day operation of the plant.

14. ABS and Strawmen did not achieve profitability within a few years as anticipated in their original business plan. According to Mr. Norman, the strawboard operation was profitable for a short period of time in 2006 and 2007. He and Dr. Burg were optimistic that the companies would eventually become very profitable by working on theater projects.

15. ABS and Strawmen were not able to sustain profitability. They ultimately lost more than \$13,000,000.

16. ABS and Ready Worldwide Corporation entered into a series of output agreements requiring ABS to allocate most of its production capacity to Ready for the fulfillment of orders that Ready would obtain from third parties. ABS purchased straw in anticipation of orders from Ready and stored the straw in a leased warehouse. However, the owner of the warehouse sold the straw after ABS failed to pay warehouse storage fees.

17. The output agreement dated November 10, 2010, recognizes that Ready had deposited \$317,747 with ABS. The deposit was a pre-payment – not a loan – according to the agreement. Ready agreed that ABS could subtract \$70,000 from this amount if ABS provided documentation evidencing the loss of the straw. Ready subsequently deposited another \$50,000 with ABS.

18. Ready placed a few orders with ABS. It is not clear from the record whether these orders were placed prior to or during the existence of the output agreement. In the weeks before bankruptcy, Dr. Burg anticipated that Ortech might “take over,” and he attempted to communicate about the output agreement with Ortech’s chief executive officer.

19. On December 5, 2011, Strawmen, and ABS filed voluntary petitions for relief under Chapter 11 of the Bankruptcy Code. This Court entered an order jointly administering the two bankruptcy cases on January 11, 2012.

20. On December 8, 2011, the Court issued its Notice of Chapter 11 Bankruptcy Case, Meeting of Creditors and Deadlines. This Notice established the deadline for filing proofs of claim for non-governmental entities as April 5, 2012. Dr. Burg provided debtors’ counsel with the disputed proofs of claim on or about that date. Dr. Burg mistakenly thought that counsel would file the claims for him.<sup>5</sup>

21. Ownership of ABS and Strawmen is nearly identical. Dr. Burg owns approximately 41% of both entities. The Paul Andrew Burg Trust, Nathan Parker Burg Trust and Emily Diane Burg Trust each own approximately 7% of both entities.

22. Dr. Burg signed and verified the bankruptcy schedules of Strawmen and ABS. Dr. Burg is the president of ABS, and ABS is the general partner of Strawmen.

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<sup>5</sup> The proof of claim forms are each signed and dated April 9, 2012.

23. In its bankruptcy schedules, ABS listed Ready Corporation Worldwide as an unsecured creditor with an undisputed claim in the amount of \$295,000.

24. Ready timely filed a claim against ABS for the total amount of \$378,747, which included \$367,747 for “credit for prepayment of panel” and \$11,000 for “panel stored improperly; cannot be used.” Ready attached a copy of the parties’ agreement, among other things, to the proof of claim. Ready subsequently assigned its claim to Dr. Burg.

25. At some point, Dr. Burg realized that his proofs of claim had not been filed with the bankruptcy court. He filed claim numbers 12-25 on January 2, 2013, for himself, his children, as trustee for his children’s trusts, and as the president of Entropic Corporation. He also filed a *pro se* motion asking this Court to permit the untimely filing of the Burg claims. This Court granted Dr. Burg’s motion.

26. Ortech objects to the allowance of any portion of claim numbers 9 and 12-25 on various grounds. Ortech also, belatedly, objects to Dr. Burg’s motion requesting that this Court allow the untimely filing of claim numbers 12-25. Ortech now argues that this Court should have denied his motion to permit the untimely filing of the claims, because Dr. Burg is not an attorney and cannot represent interests other than his own in this Court.

27. Dr. Burg is not an attorney. He retained and was represented by counsel in connection with the Ortech’s objections to the claims.

28. Dr. Burg appeared and testified at the hearing on the objections to claim numbers 9 and 12-25. In addition, Jack Norman, the treasurer of Strawmen and ABS,

appeared and testified at the hearing. Mr. Norman was the treasurer and general partner of Strawmen and the treasurer and a member of ABS.

29. At trial, Ortech offered the expert testimony Donald Crisp. Mr. Crisp is a certified public accountant who specializes in providing accounting and consulting services in bankruptcy and other financially-troubled circumstances. Mr. Crisp testified regarding the issue of whether the loans to Ortech should be recharacterized as equity.

30. For ease of reference, the Court will refer to claim numbers 12-25 as the Burg claims and to the claimants as the Burg claimants. The Burg claimants assert liability in the total amount of \$3,435,000 against Strawmen in claim numbers 12-25. They assert liability in the total amount of \$5,865,967.49 against ABS in claim numbers 12-25. The Burg claimants assert that ABS and Strawmen are obligated to them as follows:

a. Dr. Burg filed three unsecured claims on his own behalf against ABS totaling \$903,017.49. These claims differ from the amounts listed in the bankruptcy schedules. Strawmen and ABS each filed bankruptcy schedules that included an unsecured claim by Dr. Burg in the amount of \$588,400.

- (1) In Claim No. 12, Dr. Burg asserts an unsecured claim in the amount of \$233,417.50 against ABS. The claim attaches supporting documentation. The documentation consists of a letter from Texas Rural Communities, Inc. dated December 17, 2009, stating that it had received a payoff of a loan balance in the amount of \$233,417.50.
- (2) In Claim No. 13, Dr. Burg asserts an unsecured claim in the total amount of \$555,000 against ABS and Strawmen for “money loaned, promissory notes.” The claim attaches supporting documentation. The documentation consists of five promissory notes for debts owed to Dr. Burg. Two promissory notes in the total principal amount of \$230,000 are between Burg and ABS.

Three promissory notes in the total principal amount of \$325,000 are between Burg and Strawmen.

- (3) In Claim No. 14, Dr. Burg asserts an unsecured claim in the amount of \$114,599.99 against ABS for “money loaned or paid on behalf of ABS.” The claim attaches supporting documentation. The documentation consists of lists summarizing the date, purpose and amount of the expenditures. In addition, Dr. Burg introduced banking records at the hearing on the claim objection.

b. Dr. Burg filed two proofs of claim as the president of Entropic Processing. One claim is against ABS and the other is against both ABS and Strawmen. These claims differ from the amounts listed in the bankruptcy schedules. ABS and Strawmen each filed schedules that included an unsecured debt owed to Entropic Processing in the amount of \$3,354,000.

- (1) In Claim No. 15, Entropic Processing asserts an unsecured claim in the amount of \$67,650 against ABS for “money loaned.” The documentation consists of a list summarizing the date, purpose and amount of the expenditures. In addition, Dr. Burg introduced banking records at the hearing on the claim objection.
- (2) In Claim No. 16, Entropic Processing asserts an unsecured claim against ABS and Strawmen in the total amount of \$3,300,000 for “money loaned, promissory notes.” The documentation consists of 18 promissory notes for debts owed to Entropic. Thirteen of the promissory notes in the total principle amount \$2,400,000 are between Entropic and Strawmen. Six promissory notes in the total principle amount of \$550,000 are between Entropic and ABS. In addition, Claim No. 16 includes two loans to ABS in the total amount of \$350,000, which are supported by unsigned documents entitled “promissory notes.”

c. Dr. Burg filed six proofs of claim for the three trusts belonging to his children. These claims differ from the amounts listed in the bankruptcy schedules. ABS and Strawmen each filed schedules that included an unsecured claim by the Emily Diane Burg Trust in the amount of \$1,215,500, by the Nathan Parker Burg Trust in the amount of \$1,315,000, and by the Paul Andrew Burg Trust in the amount of \$1,614,500.



- (1) In Claim No. 17, the Paul Andrew Burg Trust asserts an unsecured claim against ABS in the amount of \$22,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of a list summarizing the date, purpose and amount of the expenditures. In addition, Dr. Burg introduced banking records at the hearing on the claim objection.
- (2) In Claim No. 18, the Paul Andrew Burg Trust asserts an unsecured claim against Strawmen and ABS in total principal amount of \$1,600,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of promissory notes. Eight promissory notes in the total principle amount of \$1,050,000 are between the Paul Andrew Burg Trust and ABS. The documentation also includes two promissory notes in the total principle amount of \$400,000 between the Paul Andrew Burg Trust and Strawmen. In addition, Claim No. 18 includes two loans to ABS in the total amount of \$150,000, which are supported by unsigned documents entitled “promissory notes.”
- (3) In Claim No. 19, the Emily Diane Burg Trust asserts an unsecured claim against ABS in the amount of \$50,800 for “money loaned.” The claim attaches supporting documentation. The documentation consists of a list summarizing the date, purpose and amount of the expenditures. In addition, Dr. Burg introduced banking records at the hearing on the claim objection.
- (4) In Claim No. 20, the Emily Diane Burg Trust asserts an unsecured claim against Strawmen and ABS in the total principle amount of \$1,200,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of eight promissory notes in the total principle amount of \$900,000 between the Emily Diane Burg Trust and ABS. The documentation also includes two promissory notes in the total principle amount of \$200,000 between the Emily Diane Burg Trust and Strawmen. In addition, Claim No. 20 includes a loan to ABS in the principle amount of \$100,000, which is supported by an unsigned document entitled “promissory note.”
- (5) In Claim No. 21, the Nathan Parker Burg Trust asserts an unsecured claim against ABS in the amount of \$47,500 for “money loaned.” The claim attaches supporting documentation. The documentation consists of a list summarizing the date, purpose and amount of the expenditures. In addition, Dr. Burg introduced banking records at the hearing on the claim objection.

- (6) In Claim. No. 22, the Nathan Parker Burg Trust asserts an unsecured claim against Strawmen and ABS in the amount of \$1,200,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of promissory notes. Ten promissory notes in the total principle amount of \$1,100,000 are between the Nathan Parker against ABS. One promissory note in the total principle amount of \$100,000 is between the Nathan Parker Burg Trust and Strawmen.

d. Finally, Dr. Burg filed proofs of claim for each of his three children -- Emily, Nathan and Paul. ABS and Strawmen each filed schedules that included unsecured debts owed to each of Dr. Burg’s children in the amount of \$300,000.

- (1) In Claim No. 23, Paul Andrew Burg asserts an unsecured claim against ABS in the amount of \$300,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of a promissory note dated November 16, 2010, for a debt owed by ABS in the total principle amount of \$300,000.
- (2) In Claim No. 24, Emily Diane Burg asserts an unsecured claim against ABS in the amount of \$300,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of a promissory note dated March 5, 2011, for a debt owed by ABS in the total principle amount of \$300,000.
- (3) In Claim No. 25, Nathan Parker Burg asserts an unsecured claim against ABS in the amount of \$300,000 for “money loaned.” The claim attaches supporting documentation. The documentation consists of a promissory note dated October 25, 2010, for a debt owed by ABS in the total principle amount of \$300,000.

## **II. Conclusions of Law**

With these facts in mind, the Court reaches the following conclusions.

1. In chapter 11 cases such as these, an unsecured creditor seeking to recover from the estate must file proof of its claim if the debtor schedules the claim as disputed, contingent or unliquidated. The unsecured creditor also must file proof of its claim if the claim is not listed in the debtor’s schedules, or if the creditor does not agree with the amount. *See* 11 U.S.C. § 1111; FED. R. BANKR. P. 3003.

2. The filing of an objection to a proof of claim initiates a contested matter. *See* FED. R. BANKR. P. 9014.

3. Section 502(b) of the Code sets forth nine grounds for disallowance of a claim. 11 U.S.C. § 502(b)(1)-(9). As relevant to this case, a bankruptcy court may disallow a claim if the claim is “unenforceable against the debtor ... under any agreement or applicable law,” § 502(b)(1), or was not timely filed, § 502(b)(9).

4. A properly executed proof of claim is entitled to *prima facie* validity. FED. R. BANKR. P. 3001(f). Once a valid objection is made to the claim, the burden of proof shifts back to the claimant. *See, e.g., In re Allegheny International, Inc.*, 954 F.2d 167, 173 (3d Cir. 1992).

**A. Order Allowing Late Filing of Claims**

5. April 5, 2012, was the deadline for filing non-governmental proofs of claim in these cases. Dr. Burg filed disputed claim numbers 12-25 on January 2, 2013. On the same day, he filed a *pro se* motion requesting that the Court allow him to file the claims after the bar date. *See* FED. R. BANKR. P. 9006(b)(1) (allowing bankruptcy court’s to permit late filings where the movant’s failure to comply with the deadline “was the result of excusable neglect”).

6. Ortech was served with a copy of Dr. Burg’s motion and raised no objection. This Court entered an order granting the motion and allowing the claims to be filed after the bar date on February 2, 2013.

7. Ortech now seeks to disallow the late-filed claims. As an initial matter, however, Ortech seeks to vacate or avoid this Court’s order allowing Dr. Burg to file untimely proofs of claim for anyone other than himself.

8. Dr. Burg is not an attorney, and, in general, a non-attorney may not represent other individuals or entities in federal court. Ortech argues that Dr. Burg engaged in the unauthorized practice of law by filing a *pro se* motion to permit the untimely filing of the Burg claims. Thus, Ortech argues that this Court's order granting Dr. Burg's motion to allow him to file untimely claims for individuals or entities other than himself is avoidable. Ortech further argues that all of the claims Dr. Burg filed for his company, his children, and his children's trusts should be disallowed as untimely.

9. Federal Rule of Bankruptcy Procedure 3001(b) specifically allows a proof of claim to be executed by a creditor's authorized agent. Bankruptcy Rule 9010(a)(1) authorizes a creditor to appear *pro se* in a case and act in its own behalf, or by an attorney authorized to practice in the court. Subsection (a)(2) of Bankruptcy Rule 9010 provides that an authorized agent may perform an act not constituting the practice of law. Thus, collectively, the Bankruptcy Rules afford creditors limited instances in which to appear and act *pro se* in bankruptcy court.

10. A non-lawyer agent does not engage in the unauthorized practice of law by filing a proof of claim. *Unauthorized Practice of Law Committee v. Paul Masson & Assocs., Inc.*, 46 F.3d 469, 472 (5th Cir. 1995). And the Texas unauthorized practice of law standards do not apply to Bankruptcy Rule 9010(a)'s authorization for administrative practice by nonlawyer agents. *Id.*

11. Even if Dr. Burg exceeded his authority under Bankruptcy Rule 9010 by filing the motion, Ortech's motion to reconsider the order allowing the late filing of the Burg claims is untimely. Ortech failed to explain its long delay in presenting the avoidance request to the Court. For all of the foregoing reasons, the Court finds and

concludes that Ortech has failed to establish good cause to reconsider or avoid its order allowing the claim numbers 12-25 to be filed after the bar date.

**B. Docketing of Claims in ABS's Case**

12. Three of the claims filed by Dr. Burg, claim numbers 23-25, assert on their faces that ABS is liable to the claimants. These claims are for loans made by his children's trusts to ABS. The other claims filed by Dr. Burg, claim numbers 12-22, assert, on their faces, that both Strawmen and ABS are liable to the claimants.

13. All of the Burg claims were docketed in ABS's bankruptcy case. None of the Burg claims were docketed in Strawmen's bankruptcy case. Thus, Ortech argues that the Burg claims against Strawmen should not be allowed, because Dr. Burg filed them in the wrong case.

14. Dr. Burg did not electronically file the Burg claims. He mailed paper copies to this Court. Although claim numbers 12-22 assert claims against both Strawmen and ABS, this Court docketed the claims in ABS' bankruptcy case. If any error occurred with respect to the docketing, it was made by the Court, not by Dr. Burg. The Court, therefore, finds that Ortech's objection on this ground should be **OVERRULED**.

**C. Statute of Frauds**

15. Ortech objects that Burg claim numbers 14 — 21 are barred by the general statute of frauds in Texas. *See* TEX. BUS. & COM. CODE § 26.01(a). The Texas statute of frauds requires that an agreement that cannot be performed within one year of the date of the agreement must be in writing. *Id.* However, the one-year provision does not apply to 1) "a contract which is performed on one side at the time it is made, such as a loan of money," or 2) "any contract which has been fully performed on one side, whether the

performance is completed within a year or not.” *Estate of Kaiser v. Gifford*, 692 S.W.2d 525, 527 (Tex. App. – Houston [1st Dist.] 1985, writ ref’d n.r.e.).

16. In 1989, the legislature enacted § 26.02 — a specific statute of frauds for loan agreements involving loans exceeding \$50,000. *See* TEX. BUS. & COM. CODE. § 26.02. Under this statute, a loan agreement is not enforceable unless the agreement is in writing and signed by the party to be bound or by that party’s authorized representative. *Id.* § 26.02(b).

17. Here, Mr. Norman testified that ABS’s office manager would contact Dr. Burg when ABS needed money. At the manager’s request, Dr. Burg (for himself and as president of Entropic Processing and as the trustee for the Paul Andrew Burg Trust, the Emily Diane Burg Trust, and the Nathan Parker Burg Trust) or his children provided funds to ABS and Strawmen.

18. The smaller loans and advances (that is, those under \$50,000) were not documented with promissory notes. In addition, several of the proofs of claim include debts relating to documents entitled “promissory notes” that were not signed by ABS or Strawmen. In particular, (1) Claim No. 16 includes two unsigned notes in the total amount of \$350,000 (each of which exceeds \$50,000); (2) Claim No. 18 includes two unsigned notes in the total amount of \$150,000 (each of which exceeds \$50,000); (3) Claim No. 20 includes one unsigned promissory note in the amount of \$100,000; and (4) Claim No. 22 includes one unsigned promissory note in the amount of \$100,000.

19. The unsigned promissory notes in excess of \$50,000 are not enforceable under Texas law. The Court, therefore, **SUSTAINS IN PART** Ortech’s objection and

concludes that claim numbers 16, 18, 20 and 22 should be disallowed to the extent they include debts for unsigned promissory notes.

20. With respect to the undocumented advances, each loan or advance described in claim numbers 14, 15, 17, 19, and 21 involved amounts of less than \$50,000. These loans or advances, therefore, fall outside the documentation requirements of § 26.02 of the Texas Business and Commerce Code.

21. Ortech also objects to the allowance of claim numbers 14, 15, 17, 19, and 21 on the grounds that the proofs of claim only attached a ledger listing the advances or payments. At trial, however, Dr. Burg presented copies of the checks as well as bank statements in support of claim numbers 14, 15, 17, 19, and 21.

22. There is no dispute that the transfers described in claim numbers 14, 15, 17, 19, and 21 occurred or that ABS and Strawmen benefitted from the transfers.

23. ABS and Strawmen made several repayments with respect to the undocumented loans. Proofs of claim numbers 14, 15, 17, 19, and 21 are for the balance owed to the claimants.

24. These claims, as previously discussed, include amounts paid directly to the businesses' creditors in order to extinguish outstanding debts. To the extent the claimants paid debts on behalf of ABS or Strawmen, the claimants seek to equitably subrogate to the rights of the prior creditors.<sup>6</sup> *See Mid-Continent Ins. Co. v. Liberty Mut. Ins. Co.*, 236 S.W.3d 765, 774 (Tex. 2007) (discussing equitable subrogation under Texas law). *See*

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<sup>6</sup> In Claim No. 12, Dr. Burg also seeks to equitably subordinate to the claim of Texas Rural Communities, Inc., because he paid off the outstanding loan in order to avoid a threatened foreclosure. His request is based on a misunderstanding of his obligations to the bank. The only loan documents introduced into evidence show that Dr. Burg was a co-obligor on the loan agreements. He may have a right to contribution from ABS or Strawmen (which he has not requested), but he failed to establish a right to equitable subrogation.

generally TEX. JUR. 3d. *Subrogation* § 39 (“Persons Paying or Advancing Money Upon Request”).

25. The Court finds and concludes that the debts described in claim numbers 14, 15, 17, 19, and 21 are not barred by the general Texas statute of frauds. The Court further finds that the claimants have sufficiently documented their claims in compliance with Federal Rule of Bankruptcy Procedure 3001. The Court concludes that Ortech’s objection to claim numbers 14, 15, 17, 19 and 21 based on Bankruptcy Rule 3001 and the statute of frauds set forth in § 26.02 of the Texas Business and Commerce Code should be **OVERRULED**.

**D. Statute of Limitations**

26. The petition date in these jointly administered cases was December 5, 2007. Ortech objects to the allowance of portions of claim numbers 13-25 on the grounds that the deadline for enforcing some of the debts described in the claims had already expired under Texas law when the debtors filed for bankruptcy. Claim numbers 13-25 encompass all of the funds loaned or advanced to ABS and Strawmen by the Burgs and Entropic.

27. The limitations period for breach of contract claims is four years. TEX. CIV. PRAC. & REM.CODE. § 16.051; *Stine v. Stewart*, 80 S.W.3d 586, 592 (Tex. 2002). “Limitations begins to run upon accrual of the cause of action.” *Barker v. Eckman*, 213 S.W.3d 306, 311 (Tex. 2006). A breach of contract claim accrues when the contract is breached. *Stine*, 80 S.W.3d at 592. When recovery is sought on an obligation payable in installments, the statute of limitations runs against each installment from the time it



becomes due. *Hollander v. Capon*, 853 S.W.2d 723, 726 (Tex. App. – Houston [1st Dist.] 1993, writ denied).

28. Here, claim numbers 14, 15, 17, 19 and 21 are based on funds advanced to ABS, as well as payments made to creditors of ABS, over a period of several years. These advances were made without any loan documentation. However, the parties testified that they intended that the transactions would be “short term” loans.

29. Each of these claims includes several advances made more than four years before bankruptcy. In particular, claim number 14 includes a claim for \$49,400 in advances made to ABS more than four years before bankruptcy; claim number 15 includes a net claim of \$30,000 for advances made to ABS more than four years before bankruptcy; claim number 17 includes a claim for \$10,000 for an advance made to ABS more than four years prior to bankruptcy; claim number 19 includes a claim for \$15,000 for an advance made to ABS more than four years prior to bankruptcy; and claim number 21 includes a claim for \$15,000 for an advance made to ABS more than four years prior to bankruptcy.

30. While these loans were made more than four years prior to the bankruptcy filing, limitations does not begin running until the due date of any payments or the maturity of the loan. *See Hollander*, 853 S.W.2d at 726. Here, parties agreed that the advances described in claim numbers 14, 15, 17, 19, and 21 would be due and payable when funds became available. ABS and Strawmen never had the funds to repay the advances. The statute of limitations, therefore, did not begin accruing prior to bankruptcy.

31. Ortech's objection to the allowance of the full amount of claim numbers 14, 15, 17, 19 and 21 based on the statute of limitations is **OVERRULED**.

32. The Court now turns to claim numbers 13, 16, 18, 20 and 22-25, which are based on promissory notes. Although ABS and Strawmen never made any of the required annual interest payments, the claimants did not accelerate the notes or sue to collect those payments. The claimants are not seeking to recover for the missed interest payments in these bankruptcy cases. Rather, their claims are for the principal amount of the loans due on their respective maturity dates.

33. Most of the promissory notes matured within four years of bankruptcy. A few of the notes matured outside the four-year limitations period. In particular,

- **Claim No. 13** includes three promissory notes signed by Strawmen (totaling \$325,000) that matured more than four years prior to bankruptcy.
- **Claim No. 16** includes four promissory notes signed by Strawmen (totaling \$900,000) that matured more than four years prior to bankruptcy. Of these four promissory notes, two notes (totaling \$400,000) matured more than six years prior to bankruptcy.
- **Claim No. 18** includes two promissory notes signed by Strawmen (totaling \$400,000) that matured more than four years prior to bankruptcy.
- **Claim No. 20** includes two promissory notes signed by Strawmen (totaling \$200,000) that matured more than four years prior to bankruptcy.
- **Claim No. 22** includes one promissory note signed by ABS (in the amount of \$100,000) and one promissory note signed by Strawmen (in the amount of \$100,000) that matured more than four years prior to bankruptcy.

34. Dr. Burg argues that a six-year limitations period applies to the claims that are based on promissory notes. He argues that the promissory notes are negotiable instruments under the Uniform Commercial Code and, therefore, are governed by the longer limitation period. *See* TEX. BUS. & COM.CODE § 3.118(a) (“[A]n action to enforce

the obligation of a party to pay a note payable at a definite time must be commenced within six years after the due date or dates stated in the note or, if a due date is accelerated, within six years after the accelerated due date.”).

35. Subject to exceptions not relevant here, “ ‘negotiable instrument’ means an unconditional promise or order to pay a fixed amount of money, with or without interest or other charges described in the promise or order....” TEX. BUS. & COM.CODE § 3.104(a). A promissory note is payable at a definite time even if the note states that the maker, holder, or acceptor retains an opinion to extend it for a further definite time. *Id.* at 3.108(b). *See also Cartwright v. MBank Corpus Christi, N.A.*, 865 S.W.2d 546, 549 (Tex. App. – Corpus Christi 1993).

36. Here, each of the promissory notes is for a fixed amount of money, with interest to be paid annually, and each of the notes is payable “to the order of” the lender. The Court concludes that the notes are negotiable instruments, and that the six-year statute of limitations applies. The Court, therefore, overrules Ortech’s objection to the allowance of claim numbers 13, 18, 20 and 22-25 based on the applicable limitations period.

37. With respect to Claim No. 16, as previously noted, two of the promissory notes matured more than six years prior to bankruptcy. Dr. Burg testified that he had unilaterally extended the maturity date of the notes as the terms of the notes permit him to do. Each of the promissory notes states that Strawmen or ABS “consent that the time of payment may be extended without notice from time to time.”

38. Dr. Burg did not establish that the extensions were for a definite time. Dr. Burg testified that he did not intend to collect the notes until ABS and Strawmen could

afford to repay them – whenever that might be. In order for an agreement to extend the time for payment of a negotiable instrument to be valid and enforceable, the duration of the extension must be for a definite period. In *Sonfield v. Thomas*, 424 S.W.2d 250, 251 (Tex. Civ. App. – Houston [1st Dist.] 1968, writ ref'd n.r.e.), for example, the alleged extension of a note's due date to a time when 2,000 shares of the capital stock of a named corporation should become marketable was invalid, since the parties had not extended the due date to the happening of an event that was certain to occur.

39. Thus, in this case, the Court concludes that the promissory notes were negotiable instruments. The Court further concludes that Ortech's objection to the allowance of Claim No. 16 should be **SUSTAINED IN PART**, and the two notes that matured more than six years prior to bankruptcy are unenforceable based on the applicable statute of limitations.

**E. Claim of Ready Worldwide Corporation**

40. ABS scheduled Ready as an unsecured creditor with an undisputed claim in the amount of \$295,000. Ready filed a timely proof of claim against ABS, which the Court assigned Claim No. 9, in the amount of \$378,747. Ready subsequently assigned its claim to Dr. Burg.

41. Ortech objects to the allowance of Ready's claim. First, Ortech objects that Ready failed to attach sufficient documentation to its claim. The Court, having reviewed Claim No. 9, Ready's response to Ortech's objection, and the evidence introduced at the hearing, concludes that Ready has submitted sufficient documentation of its claim and Ortech's lack of documentation objection should be **OVERRULED**.

42. Second, Ortech objects that Ready breached its contract with ABS and, therefore, Ready Corporation is excused from performing the contract. Ortech asserts that Ready promised to purchase all of the strawboard ABS produced, but did not actually place any orders. Ortech asserts that, if the deposit is returned, there would be a failure of consideration and the parties' agreement would become unconscionable. *See* TEX. BUS. COM. CODE § 2.302(a) (defining an unconscionable contract or clause under Texas law).

43. Dr. Burg denies Ortech's interpretation of the agreement between Ready and ABS. The Court agrees with Dr. Burg that Ready had a right, but not an obligation, to purchase strawboard from ABS pursuant to the parties' contract. ABS had an obligation to produce a certain amount of linear feet of strawboard per month for Ready to the extent Ready placed orders with ABS. The evidence introduced at trial does not suggest any oppression or unfair surprise with respect to the contract or that the parties' contract was unconscionable under Texas law. *See* TEX. BUS. COM. CODE § 2.302, Official Comment 1 ("The basic test is whether, in the light of the general commercial background and the commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract.").

44. Ready's claim includes the \$350,000 deposited with ABS by Ready as a prepayment for anticipated strawboard orders. These amounts are supported by documentary evidence.<sup>7</sup> However, ABS's bankruptcy schedules reflect a deduction of

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<sup>7</sup> Ortech objects that ABS' balance sheet shows that ABS owed nothing to Ready as of December 2011. However, Ortech's expert testified that the debtors' tax and financial documents are sometimes conflicting. Ortech's reliance on a statement in a particular balance sheet, which conflicts with other documents and evidence presented to the Court, is not persuasive.

\$70,000 for damages due to the unexpected sale of stored straw by the warehouse owner as permitted by the parties' agreement. In addition to the schedules, Dr. Burg testified regarding the damages incurred by ABS as a result of the sale of the straw.

45. The record does not include any evidence supporting Ready's claim for an additional \$11,000 owed for damaged panels.

46. The Court, therefore, concludes that Ortech's objection to Ready's claim should be **SUSTAINED IN PART AND OVERRULED IN PART**. Ortech's objections to Ready's claim based on unconscionability and failure of consideration are **OVERRULED**. Ortech's objection to the amount of Ready's claim is **SUSTAINED IN PART**. The preponderance of the evidence introduced at trial establishes that Ready has an unsecured claim in the amount of \$280,000. Ready's claim against ABS's bankruptcy estate should be allowed in this amount.

**F. Repayment of the Loan from Texas Rural Communities**

47. In Claim No. 12, Dr. Burg asserts an unsecured claim for what he paid Texas Rural Communities in order to satisfy an outstanding and overdue loan received by ABS. Dr. Burg testified that he paid the loan because the lender was threatening to foreclose on ABS' property. Dr. Burg, however, was co-liable on the loan.<sup>8</sup> Dr. Burg has not established that he has any right to recovery from ABS for repaying Texas Rural Communities. The Court, therefore, **SUSTAINS** Ortech's objection to Claim No. 12, and Claim No. 12 will be disallowed.

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<sup>8</sup> In his testimony during trial, it was clear that Dr. Burg did not understand that he was co-liable to Texas Rural Communities or the legal ramifications of that status.

**G. Recharacterization of Debt as Equity**

48. Finally, Ortech seeks to recharacterize all of the claims, except the claim of Ready as equity. Ortech's request for recharacterization, if successful, would revive the claims that otherwise fail due to limitations and the statutes of frauds and transform those claims into equity investments. On the other hand, Ortech's argument, if successful, would reduce the status of Burg claimants to equity investors.

49. Actions for recharacterization differ from actions for equitable subordination. In an "equitable subordination" action, the analysis focuses on the behavior of a creditor, reducing the status of a claim where a creditor engages in inequitable conduct. "Recharacterization" focuses on the underlying substance of the disputed transaction, that is, whether the filed claim satisfies the Bankruptcy Code's definition of "claim." 11 U.S.C.A. §§ 101(5), 510(c). *In re Airadigm Communications, Inc.*, 616 F.3d 642 (7th Cir. 2010).

50. If a particular advance is an investment, it never becomes a claim. The debt-versus-equity inquiry is an exercise characterizing an advance's true character.

51. In *In re Lothian Oil Inc.*, 650 F.3d 539, 544 (5th Cir. 2011), the Fifth Circuit cited *Arch Petroleum Inc. v. Sharp*, 958 S.W.2d 475, 477 n. 3 (Tex. Ct. App. 1997), as a source of Texas law for determining whether a purported debt should be recharacterized as an investment. *Arch Petroleum* in turn cited factors announced in a federal tax law opinion, namely *Fin Hay Realty Co. v. United States*, 398 F.2d 694, 696 (3d Cir. 1968), in which these tax law-based factors governing recharacterization are set forth as follows:

In attempting to deal with this problem courts and commentators have isolated a number of criteria by which to judge the true nature of an investment which is in form a debt:

- (1) the intent of the parties;
- (2) the identity between creditors and shareholders;
- (3) the extent of participation in management by the holder of the instrument;
- (4) the ability of the corporation to obtain funds from outside sources;
- (5) the “thinness” of the capital structure in relation to debt;
- (6) the risk involved;
- (7) the formal indicia of the arrangement;
- (8) the relative position of the obligees as to other creditors regarding the payment of interest and principal;
- (9) the voting power of the holder of the instrument;
- (10) the provision of a fixed rate of interest;
- (11) a contingency on the obligation to repay;
- (12) the source of the interest payments;
- (13) the presence or absence of a fixed maturity date;
- (14) a provision for redemption by the corporation;
- (15) a provision for redemption at the option of the holder; and
- (16) the timing of the advance with reference to the organization of the corporation.

52. In *Lothian Oil*, the claimant would be paid from royalties and “equity placements,” and there was no specified interest rate, term of repayment, or maturity date. The bankruptcy court ruled that, despite language referring to a “loan,” the investments underlying the claims were equity. The Fifth Circuit affirmed.

53. Applying the *Arch Petroleum* factors to this case, the following factors weigh against recharacterization. Dr. Burg and Mr. Norman testified that they intended the transactions would be loans. The Burg claimants did not participate in the day-to-day management of the companies. They provided funding to the companies upon request. Some of the loans were documented by signed promissory notes with fixed rates of interest and maturity dates.

54. However, the following factors weigh in favor of recharacterization. Dr. Burg and his children’s trusts held ownership interests in ABS and Strawmen. ABS and



Strawmen were undercapitalized and were not able to pay their bills as they came due without the funds that Dr. Burg provided from himself, Entropic Processing, his children's trusts, and his children.

55. Many of the advances from the Burg claimants were not documented with promissory notes. Although Dr. Burg testified that he intended that he and the other Burg claimants would ultimately be paid back with interest, he did not expect to be paid prior to, or even on par with, the businesses' unsecured creditors. He testified that he expected to be repaid when ABS became successful. The risk that the Burg claimants would never be repaid was high – especially in light of the failure of ABS and Strawmen to achieve any sustained profitability.

56. ABS and Strawmen could not obtain funding from third party lenders. Dr. Burg co-signed the loan from Texas Rural Communities and, eventually, paid off the loan because ABS and Strawmen could not do so. The obligation of ABS and Strawmen to repay the loans they received from ABS and Strawmen were contingent on the availability of funds.

57. For all the foregoing reasons, the Court concludes that Ortech's objections to the claims based on its argument that the claims should be recharacterized as investments is **SUSTAINED IN PART** and the following debts are recharacterized as equity: (1) the debts associated with the unsigned documents entitled "promissory notes" between the Burg claimants and ABS and Strawmen; (2) the cash advances made by Dr. Burg and his children's trusts without and loan documentation; (3) the debts associated with the unsigned documents entitled "promissory notes" between Entropic and ABS.

**H. Claimants' Request for Attorney's Fees under § 1927.**

58. Finally, the Burg claimants assert a counterclaim against Ortech for their attorney's fees. The Burg claimants assert that Ortech filed these claim objections as "retaliation" after Dr. Burg received an assignment of Ready Corporation's claim. The Burg claimants assert that Ortech's counsel has violated 28 U.S.C. § 1927 by filing 14 objections to each and every claim asserted by Dr. Burg, his company, or members of his family. Further, they assert that Ortech's objections are improper because Ortech lacks personal knowledge of the debts at issue.

58. Under the American Rule used in the federal courts, "absent statute or enforceable contract, litigants pay their own attorney's fees." *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 257 (1975). Section 1927 of Title 28 creates an exception to the American Rule, as follows:

Any attorney or other person admitted to conduct cases in any court of the United States or any Territory thereof who so multiplies the proceedings in any case unreasonably and vexatiously may be required by the court to satisfy personally the excess costs, expenses, and attorneys' fees reasonably incurred because of such conduct.

28 U.S.C. § 1927. The Fifth Circuit has interpreted the requirement that an attorney's conduct must be vexatious and unreasonable as requiring evidence of bad faith, improper motive, or reckless disregard of the duty owed to the court. *See Edwards v. Gen. Motors Corp.*, 153 F.3d 242, 246 (5<sup>th</sup> Cir. 1998).

59. Here, Ortech, as a creditor of the debtors, had standing to object to the proofs of claim. *In re Hudson Shipbuilders, Inc.*, 794 F.2d 1051, 1055 (5<sup>th</sup> Cir. 1986).

60. It is not at all uncommon for trustees, debtors-in-possession, or creditors to use bankruptcy to recharacterize various transactions. Bankruptcy courts routinely

deal with those issues. So there is nothing improper about attempting to recharacterize the debts owed to the Burg claimants.

61. The Court concludes that the Burg claimants have not established any bad faith, improper motive, or reckless disregard of the duty owed to this Court by Ortech's counsel. The Court, therefore, finds and concludes that their claim for their attorney's fees should be **DENIED**.

### CONCLUSION

For all the foregoing reasons, Ortech's objections to the disputed claims are sustained in part and overruled in part. Ortech's objections to Dr. Burg's pro se motion to allow the Burg claims as late-filed claims are overruled. The request by the Burg claimants for their attorneys' fees is denied.

The Court will enter orders with respect to each proof of claim consistent with these findings of fact and conclusions of law. Any finding of fact that may be construed as a conclusion of law is adopted as such. Likewise, any conclusion of law that is construed as a finding of fact is adopted as such.

Signed on 3/31/2014

*Brenda T. Rhoades*

MD

HONORABLE BRENDA T. RHOADES,  
CHIEF UNITED STATES BANKRUPTCY JUDGE