IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF TEXAS
VICTORIA DIVISION

IN RE:	§	Chapter 11
	§	
HII TECHNOLOGIES, INC., *et al.,*	§	15-60070 (DRJ)
	§	(Jointly Administered)
Debtors.	§	

THE HAMILTONS' SUPPLEMENTAL RESPONSE TO DEBTORS' OBJECTION TO THEIR PROOF OF CLAIM, AND BRIEF IN SUPPORT OF THEIR RESPONSE
(relates to dkt. nos. 431 and 482)

TO THE HONORABLE DAVID R. JONES, UNITED STATES BANKRUPTCY JUDGE:

William Mark Hamilton ("***Mark***") and Sharon K. Hamilton ("***Sharon***") (collectively, the "***Hamiltons***") file their supplemental response to Debtors' objection to HII Claim No. 16 ("***Claim***"), and would respectfully show the Court as follows:

INTRODUCTION

1. Debtors' objection to the Hamiltons' proof of claim ("***Objection***") was filed at the last minute to prevent the Hamiltons from voting on the plan of reorganization. As such, it bears the hallmarks of a hurried pleading. It is factually incorrect in many ways, as set forth sentence by sentence in the Hamilton's response to the Objection.[1] Additionally, the Objection overlooks debtor HII Technologies, Inc.'s CEO's implied actual authority, and apparent authority, to act on behalf of a debtor in entering into the contested loan agreement. Further, regardless of the enforceability of the loan agreement, the underlying debt to the Hamiltons under the Stock Purchase Agreement remains unpaid, and is an alternative legal basis for the Hamiltons' Claim.

2. The Debtors' attack on the Hamiltons' Claim is not that the Claim is incorrect in amount, but that for various reasons the Claim is unenforceable against Debtors, and therefore

[1] Debtors' Objection is docket no. 431. The Hamiltons' response to the Objection is docket no. 482.

objectionable under 11 U.S.C. § 502(b)(1). However, these 502(b) objections, including claims of fraud, fraudulent transfer, breach of fiduciary duty, and conversion, are based on causes of action that must be tried in an adversary proceeding under Bankruptcy Rule 7001. Therefore, the Objection violates Bankruptcy Rule 3007(b), which prohibits a "demand for relief of a kind specified in Rule 7001 in an objection to the allowance of a claim…." Consequently, the section 502(b) objections should be dismissed without prejudice.

3. Further, Debtors' other objection to the Claim, which is based on 11 U.S.C. § 502(d), must be dismissed. A section 502(d) objection can only be asserted *after* the alleged transfer has been avoided in an adversary proceeding, and then only *after* the transferee has refused to turn over the property transferred, *after* the transferee has been given a reasonable time to do so. Here, Debtors have not even requested the transfers be avoided in their Objection, let alone filed and prevailed on fraudulent transfer claims in an adversary proceeding. Finally, it is highly unlikely § 502(d) will ever come into play because the Court has granted Debtors' motion to preserve setoff rights.[2]

THE HAMILTONS' CLAIM

4. As explained in the Affidavit of Mark Hamilton[3] (the "***Hamilton Affidavit***") in support of the Claim, the Hamiltons' Claim is based on a debt arising from a Stock Purchase Agreement ("***SPA***") by which debtor HII Technologies, Inc. ("***HII***") bought all of the stock in the Hamiltons' wholly-owned corporation, Hamilton Investment Group, Inc. ("***HIG***"). The SPA requires a post-closing payment by HII to the Hamiltons equal to the "Working Capital

[2] The Hamiltons' motion is docket no. 427, supplemented by docket no. 477, and the order granting the motion is docket no. 502.

[3] A copy of the Claim and the Hamilton Affidavit in support of the Claim is attached as Exhibit A (docket no. 482-1 to the response to the Objection.

Adjustment" ("***WCA***"), as defined in the SPA. Both the Hamiltons and HII agreed that the WCA sum is $2,428,871.39. *Therefore, there is no dispute as to the amount of the WCA.*

5. However, instead of paying the WCA to the Hamiltons, as required by the SPA, HII, through its CEO, Matt Fleming, requested that the Hamiltons loan the $2,428,871.39 representing the WCA to HII. The Hamiltons agreed to do so. In their Objection, Debtors admit that "[a]n accounts payable was kept on the books for the working capital adjustment …."[4] As explained by Mark in the Hamilton Affidavit, in September 2014, Matt Fleming, the CEO of HII, called Mark to see if he and his wife would agree to loan the WCA sum to HII, with the oral understanding (confirmed in e-mails that are attached to the Claim as exhibits) that the loan bear 10% interest to be paid monthly, with the principal to be paid back within a year.

RESPONSE TO DEBTOR'S OBJECTIONS

HII's CEO Had Actual or Apparent Authority to Enter into the Loan

6. None of the foregoing facts relating to the loan are disputed by Debtors. Rather, Debtors' begin by attacking, although not wholeheartedly, the validity of the WCA loan in a footnote on page three of the Objection by claiming the loan had to be approved by HII's Board of Directors. Specifically, Debtors assert "[n]umerous legal restrictions applicable to HII prevent it from incurring a $2.4 Million loan obligation without a board-authorized note, a fact of which the Hamiltons are keenly aware."[5] Yet, nowhere in the Objection are these "numerous" restrictions identified. Nor do Debtors' proffer any evidence of the restrictions or evidence that the Hamiltons were aware of these phantom restrictions. The only evidence accompanying the Objection relating to the loan is a *single sentence* in the Affidavit of Loretta Cross ("***Cross***

[4] Objection (dkt. 431), p. 3, paragraph 7, n. 3.
[5] Objection, p. 3, paragraph 7, n. 3.

Affidavit"), who, in page two, paragraph four of her affidavit,[6] states "Debtors have no record of board authorization for a loan of approximately $2.4 million from William Mark Hamilton and Sharon K. Hamilton, for which [the Hamiltons] filed HII Claim No. 16." This is hardly proof that no authorization occurred, as a record of an act and the occurrence of an act are not conterminous. Further, as explained below, such authorization need not be in writing, but can be established by acquiescence by the board to a corporate officer's acts. And, as pointed out in the original Response, the Cross Affidavit is deficient in that it fails to establish that each statement is made on personal knowledge, and therefore fails to comply with Bankruptcy Local Rule 3007-1(b).

7. Indeed, it is telling that although Debtors include the unsworn declaration of Matt Fleming, the CEO of HII (both then and now), in support of the Objection, *Fleming, who arranged and agreed to the loan on HII's behalf, does not address the loan transaction.* The realpolitik implication is that Fleming cannot truthfully refute any of the facts supporting the Hamiltons' Claim, nor substantiate that the loan was not approved by the Board of Directors, nor even substantiate that the loan needed to be approved by the Board of Directors.

8. In any event, a "corporation may validly act through its directors and officers as authorized corporate agents. In general, an officer's powers stem from the organic law of the corporation, or a board delegation of authority which may be express or implied." *Schoonejongen v. Curtiss-Wright Corp.*, 143 F.3d 120, 127 (3rd Cir. 1998) (citing 2 William M. Fletcher, Fletcher Cyclopedia of the Law of Private Corporations § 434, at 339 (perm. rev. ed.1992) ("***Fletcher Cyclopedia***"). Thus, where there is a broad grant of authority in the corporation's by-laws, a CEO has the power to "do anything the corporation could do in the

[6] Dkt. 431, p. 15.

general scope and operation of its business." *Id.* at 128; *In re WL Homes, LLC*, 476 B.R. 830, 842 (D. Del. 2012).

9. Further, the doctrine of apparent authority applies "when a corporate official, such as a president, takes action in the name of an entity in a situation when he lacks formal authority, but where by dint of his title and other circumstantial facts the entity creates a reasonable impression that the official can bind the entity." *In re WL Homes, LLC*, 476 B.R. at 842. Thus, in *WL Homes*, the court held that the president of the debtor's subsidiary, who pledged collateral held by the subsidiary for a bank loan made to debtor, and signed as the CFO (not CEO) of the debtor, had apparent authority to pledge the collateral, even though the pledge was not authorized by a board of directors resolution. *Id.* at 841-42. *Accord Great Southern Sulfur Co. v. Ritter*, 233 S.W. 1115, 1116 (Tex. Civ. App. – El Paso 1921, no writ) (general manager of company did not have express authority to borrow money for corporation, but was clothed with apparent authority where money was used for corporation's benefit).

10. Moreover, the actual authority of a corporate officer to act for the corporation may be implied by the "acquiescence of the directors." *See Haliburton Benefits Comm. v. Graves*, 463 F.3d 360, 373 (5th Cir. 2006) (quoting Fletcher Cyclopedia § 437). Here, the evidence establishes there was an acquiescence by the directors of HII to the loan. *HII paid interest on the loan for eight months before defaulting. And, Fleming repeatedly acknowledged the loan in e-mails to the Hamiltons over this time period.* It is also clear that the reason that HII stopped making interest payments is that it ran out of money, not because the directors had repudiated the loan.

11. Further, this is not a situation where Fleming as CEO was unilaterally creating a debt without the directors' approval. Rather, *the debt* – the WCA payment that was due under

the SPA – *was already in existence*. The underlying SPA was signed on behalf of debtor by Fleming, the CEO, and approved by the board of directors. *Thus, the underlying WCA debt arising from the SPA was, in fact, approved by debtor's board.* These circumstances are more than sufficient to give rise to Fleming's implied actual or apparent authority as CEO to act on the HII's behalf in procuring a loan back to the debtor of the required WCA payment. *See WL Homes*, 476 B.R. at 842.

Even if the Loan is Unenforceable, the WCA Debt is Enforceable

12. Additionally, even if the loan is somehow unenforceable as being unauthorized, the underlying debt under the WCA still exists and is enforceable. Any argument that the loan was a novation of the WCA obligation must fail. "To establish a novation, the party must prove: (1) a previous valid obligation; (2) an agreement of the parties to a new contract; (3) the extinguishment of the old contract; and (4) the validity of the new contract." *Tenet Health Systems Dallas Hospitals, Inc. v. North Texas Hosp. Physicians Group, P.A. ("**Tenet**")*, 438 S.W.3d 190, 200 (Tex. App. – Dallas 2014, no pet.) (citing *Goldman v. Olmstead*, 414 S.W.3d 346, 358 (Tex. App. – Dallas 2013, pet. denied)). Here, debtor is arguing the loan is unenforceable, so the fourth element of novation cannot be met. Nor can the third element be met, as no agreement was reached between the Hamiltons and HII that the loan would extinguish the WCA debt. Indeed, the issue was never discussed. A novation can occur "only when the parties to both contracts intend and agree that the obligations of the second shall be substituted for and operate as a discharge of the obligations of the first." *Tenet*, 438 S.W.3d at 200 (quoting *Fulcrum Cent. v. AutoTester, Inc.*, 102 S.W.3d 274, 277 (Tex. App. – Dallas 2003, no pet.)).

Amendment of the Claim Should be Liberally Granted

13. In the unlikely event the Court were to find the loan unenforceable, the Hamiltons should be given the opportunity to amend the Claim to assert breach of the WCA. Amendment of a proof of claim should be liberally granted when the amendment, even if requested after the bar date, is to plead a new theory of recovery on the facts stated in the original claim. *In re Kolstad*, 928 F.2d 171, 175 (5th Cir. 1991) *cert. denied* 502 U.S. 958, 112 S.Ct. 419, 116 L.Ed.2d 439 (1991). Here, the genesis of the Claim is clearly stated in the Hamilton Affidavit. Therefore, an amendment of the Claim to assert liability under the SPA, instead of under the loan, would clearly fall within the ambit of the original Claim, and no prejudice to debtors would arise from such an amendment.

Debtors' Objections Under 502(b) Must be Brought as an Adversary Proceeding

14. Federal Rule of Bankruptcy Procedure 3007(b) provides that a "party in interest shall not include a demand for relief of a kind specified in Rule 7001 in an objection to the allowance of a claim, but may include the objection in an adversary proceeding." By their 502(b) objections, Debtors assert that the Claim is "unenforceable"[7] under a variety of state-law theories. These theories include the unfounded allegations that (i) the Hamiltons "committed fraud in connection with inducing HII to enter into the SPA,"[8] (ii) the Hamiltons and S& M Assets converted certain assets of HII, "which, in equity, excuses any failure to perform"[9] under the terms of the loan, (iii) a related conspiracy claim, and (iv) that the Hamiltons breached their fiduciary duty to HII by which HII was "injured,"[10] and therefore Debtors are entitle to offset

[7] Objection, p. 5, paragraph 15.
[8] Objection, p. 5, paragraph 16.
[9] Objection, p. 7, paragraph 23.
[10] Objection, p. 7, paragraph 24.

their damages against the "alleged 'loan' or contractual claim of the Hamiltons."[11] There is also a breach of contract claim in the Objection, but by which Debtors assert they "were injured….,"[12] although they fail to state why.

15. Under Bankruptcy Rule 7001(1), "a proceeding to recover money or property" is defined, and must be brought, as an adversary proceeding. *See In re Soporex*, 446 B.R. 750,790 (Bankr. N.D. Tex. 2011). Under Bankruptcy Rule 7001(2), "a proceeding to determine the validity … of an interest in property…" is also defined as an adversary proceeding. Therefore, claim objections constituting "direct attacks against an asserted interest" must be filed as an adversary proceeding. *In re Food Management Group, LLC*, 484 B.R. 574, 582 (S.D.N.Y. 2012); *In re Citrus Tower Boulevard Imaging Center, LLC*, 524 B.R. 895, 897 (Bankr. N.D. Georgia 2014).

16. *Citrus Tower* is instructive. In *Citrus Tower*, certain of the debtor's claim objections, in an adversary proceeding brought by debtor, were based on alleged misconduct of the creditor by which debtor sought equitable disallowance or equitable subordination of the creditor's claim. 524 B.R. at 896. After the debtor's objections based on equitable disallowance or subordination were dismissed by the bankruptcy court, the court held that the remaining objections, which related to the amount of the claim, could go forward as a contested matter. In other words, Citrus Tower stands for the proposition that objections to proof of claims based on equitable disallowance must be tried in an adversary proceeding under Bankruptcy Rule 7001(2). Essentially, all of Debtors' objections amount to assertions that the Claim should be equitably disallowed, either in whole or in part.

[11] Objection, p. 8, paragraph 25.
[12] Objection, p. 8, paragraph 26.

17. Moreover, the various legal theories asserted by Debtors in defense of the Claim are essentially requests for a declaratory judgment that Debtors suffered damages, which implicate Bankruptcy Rule 7001(9), and therefore must be pursued within the ambit of an adversary proceeding. *In re Formatech, Inc.*, 496 B.R. 26, 35 (Bankr. D. Mass. 2013). Therefore, the Hamiltons request that all of the Debtors' objections under section 502(b) be dismissed, without prejudice, as having been incorrectly brought as a contested matter, rather than as an adversary proceeding.

Debtors' Objections under Section 502(d) Must Also be Dismissed

18. Debtors also object to the Claim under 11 U.S.C. § 502(d). Section 502(d) provides for the disallowance of a creditor's claim who is a transferee of a transfer avoided under a chapter 5 avoidance action, "unless [the creditor] has paid the amount, or turned over any such property, for which … such transferee is liable…." 11 U.S.C. § 502(d); *In re Odom Antennas, Inc.*, 340 F.3d 705, 708 (8th Cir. 2003). "The purpose of section 502(d) is to ensure compliance with judicial orders." *Odom*, 340 F.3d at 708. Consequently, a creditor must first be adjudged liable before the provision can apply, "otherwise, the court could not determine if the exception applies." *Id.* (citing *In re Davis*, 889 F.2d 658, 661 (5th Cir. 1989)). As the Fifth Circuit explained in *Davis*, section 502(d) "is designed to be triggered after a creditor has been afforded a reasonable time in which to turn over amounts adjudicated to belong to the bankruptcy estate." 889 F.2d at 662.

19. Although Debtors assert that the SPA is avoidable as a constructive fraudulent transfer under §§ 544 and 548,[13] and also assert that assets the Hamiltons (and S&M Assets) allegedly converted are recoverable under § 542,[14] Debtors do not actually request that the

[13] Objection, pp. 9-10.
[14] Objection, P. 11-12.

transfer be avoided or the property recovered. Certainly, there has been no adjudication of any Chapter 5 causes of action against the Hamiltons. And § 502(d) "does not permit affirmative relief of any kind." *In re Parker North America Corp.*, 24 F.3d 1145, 1155 (9th Cir. 1994). Therefore, until such time, if ever, Debtors file and then prevail in an adversary proceeding on Chapter 5 avoidance claims, they will be unable to use section 502(d) as a defense to the Hamiltons' Claim. Further, since the Court has granted the setoff motion filed by the Hamiltons, only if Debtors prevail in an avoidance action in an amount greater than the amount the Hamiltons can setoff will § 502(d) come into play.

20. Finally, a fraudulent transfer action must be brought as an adversary proceeding. *In re Indri*, 126 B.R. 443, 444 (Bankr. D. N.J. 1991); Bankruptcy Rule 7001(1). *Accord In re Eakin*, 153 B.R. 59, 60 (Bankr. D. Idaho 1993) (citing Fed.R.Bankr.P. 7001; 9 Lawrence P. King, *Collier on Bankruptcy* ¶ 7001.05[1], at 7001–13 (15th ed. 1993)) ("Exercise of the avoidance powers under 544 requires the filing of an adversary proceeding.").

REQUEST FOR RELIEF

WHEREFORE, the Hamiltons respectfully request that the Court dismiss the §502(b) Objections as being improperly brought as a contested matter, dismiss the § 502(d) Objections as premature, and deny the Objections if properly brought, and further request that they be granted such additional and alternative relief as is just.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on June 20, 2016, this supplemental response was filed via the ECF system, and therefore all persons and entities entitled to notice of the filing were served electronically on that date. Additionally, claimants also served this supplemental response on the following persons and entities, by U.S. mail, postage prepaid, on June 20, 2016.

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