

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
PESTER REFINING COMPANY, : Case No. 85-340-C
Debtor. : Chapter 11
----- :
PESTER UNSECURED CREDITORS : Adversary No. 86-0150
COMMITTEE, :
Plaintiff, :
v. :
KELLY MACLASKEY, d/b/a :
MACLASKEY OIL PURCHASING, :
Defendant. :
:

ORDER--COMPLAINT TO AVOID PREFERENTIAL TRANSFER

On November 9 and 10, 1988, a trial was held on the Official Unsecured Creditor's Committee's (hereinafter "Committee") complaint to recover an alleged preferential transfer of \$214,674.01 made by Debtor, Pester Refining Company (hereinafter "Pester") to Defendant MacLaskey Oil Purchasing (hereinafter "MacLaskey"). The following attorneys appeared on behalf of their respective clients: T. Randall Wright and Steven J. Kahler for the Committee; and Lawrence M. Gurney for MacLaskey. At the conclusion of the trial, the Court took the matter under advisement under a briefing schedule. Briefs were timely filed and the Court considers the matter fully submitted.

This is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(F). The Court has jurisdiction of this matter pursuant to 28 U.S.C. §1334. The Court, upon review of the pleadings, arguments of counsel, evidence presented and briefs, now enters its findings of

fact and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. The Committee was created by order of this Court dated March 1, 1985, and brings this action pursuant to the Court-approved First Amended Joint Plan of Reorganization of the Pester Companies, and specifically, amendments to Exhibit 4 of the Plan.

2. MacLaskey is an unsecured creditor in the Pester Company's bankruptcy.

3. MacLaskey runs an oil purchasing business with its principal place of business in El Dorado, Kansas. MacLaskey is a smaller purchasing company employing trucks for transportation of crude oil. He pays for purchased crude oil by the 15th day of the month.

4. During October or the early part of November 1984, MacLaskey discussed with Earl Williams, the manager of crude supply and transportation for Pester, the possibility of selling oil to Pester. As a result of these discussions, a letter agreement was entered into between Pester and MacLaskey on or about November 14, 1984, although MacLaskey commenced delivery of crude oil to Pester on November 12, 1984. Pursuant to the terms of the agreement, MacLaskey was to deliver approximately 200 barrels of crude oil per day to the Pester refinery in El Dorado, Kansas. Payments were to be no later than the 20th day of the month.

5. MacLaskey's sales to Pester were on an unsecured basis.

6. The November 1984 invoice in the amount of \$132,162.86 was

paid by Pester on December 21, 1984. The December 1984 invoice in the amount of \$91,728.19 was paid on January 22, 1985.

7. All payments to MacLaskey were by wire transfer which was Pester's normal method of effecting payment.

8. The agreement dated November 14, 1984, was amended effective January 1, 1985, by a subsequent letter agreement dated January 30, 1985. The written modification increased the quantity of oil delivered by MacLaskey to Pester from 200 barrels of oil per day to approximately 600 barrels per day. There was also a modification of the trucking charge. However, no written change in the payment date was made in this modification.

9. Pester financed its operation by a loan agreement with a bank group consisting of Continental Illinois National Bank and Trust Company of Chicago, First Interstate Bank of Denver and Bankers Trust Company of Des Moines, Iowa. The Bank Group made daily advances to Pester to allow Pester to pay its creditors.

10. As part of this financing procedure, Pester prepared a borrowing base on a daily basis. The inventories and receivables were calculated to determine how much money Pester had to pay payables. If the sum of the letters of credit and outstanding borrowings were less than the borrowing base, then Pester had an excess borrowing base which represented additional borrowing power.

11. Pester prepared a daily estimate of accounts payable. This was a projection of the approximate dollar amount and due date that those dollars would have to be paid.

12. MacLaskey appeared on the daily estimate of accounts payable as early as January 4, 1985, showing payment on the 15th day of the month.

13. The Pester Refinery had a need of 30,000 barrels of crude a day. MacLaskey furnished from 200 to 600 barrels a day. Southern Union Refining Company (SURCO) was the main supplier of crude from December 1984 through February 1985. SURCO and Inland Crude, Pester's other major supplier, delivered crude oil principally by pipeline.

14. Pester's crude oil suppliers were on a secured basis except for MacLaskey and Eureka Crude. Eureka Crude was also to be paid on the 15th day of the month. Eureka Crude did not receive payment in February of 1985 because it did not submit a timely invoice.

15. The industry practice of payment on the 20th day of the month was governed by pipeline practices. Invoices and pipeline statements arrived about the 15th day of the month. Payment on the 20th gave the refinery five days to set up the payment.

16. However, the size of the crude supplier and area make a difference on the industry standard as to when payment is made.

17. MacLaskey telephoned Earl Williams on February 11, 1985, to request payment for January deliveries on February 15, 1985. February 15 fell on a Friday. Monday, February 18, 1985, was a bank holiday. The original expectation between Pester and MacLaskey was that MacLaskey would be paid on Friday, February 15, 1985. However,

since Monday, the 18th, was a bank holiday, payment on or before Tuesday February 19, 1985, would cover MacLaskey's checks issued on Friday, February 15, 1985. This arrangement was satisfactory to MacLaskey and Pester.

18. Earl Williams did not have authority to accelerate any of Pester's payment dates for crude oil suppliers without consulting Phillip Walsh or Jack Pester of Pester Refining Company. Pester's ordinary course of business was to make payment date changes in writing, although oral agreements were made and later memorialized in writing.

19. Earl Williams directed Pester's accounting department to pay MacLaskey on February 19, 1985. On February 19, 1985, MacLaskey's account at Citizens National Bank in Eureka, Kansas, was wire transferred \$214,674.01 for 8,480 barrels delivered to Pester during January of 1985.

20. MacLaskey delivered over \$100,000.00 worth of oil between February 11, 1985, and February 20, 1985. MacLaskey delivered approximately \$18,300.00 worth of oil on February 19, 1985, and \$9,400.00 worth of oil on February 20, 1985, when MacLaskey stopped delivering oil upon notification from Pester.

21. Prior to the notification on February 20, 1985, MacLaskey did not know Pester was in financial trouble.

22. On February 20, 1985, the Bank Group refused to advance additional funds to Pester. After February 20, 1985, Pester was unable to pay creditors whose obligations were not secured by letters

of credit.

23. On February 25, 1985, Pester filed a Chapter 11 petition.

DISCUSSION

Two issues are presented in this case. The first is whether Pester's February 19, 1985 transfer of \$214,674.01 to MacLaskey was an avoidable preference under §547(b). The second issue is whether said transfer meets the §547(c)(2) "ordinary course" exception to avoidance.

A. Preference

Bankruptcy Code §547(b) deals with preferences and provides:

- (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--
 - (1) to or for the benefit of a creditor;
 - (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
 - (3) made while the debtor was insolvent;
 - (4) made--
 - (A) on or within 90 days before the date of the filing of the petition;
 - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
 - (5) that enables such creditor to receive more than such creditor would receive if--
 - (A) the case were a case under Chapter 7 of this title;

- (B) the transfer had not been made; and
- (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. §547(b). Pursuant to §547(g), the Committee has the burden of proving the avoidability of the transfer under §547(b).

In the case *sub judice*, the parties have stipulated that the transfer on February 19, 1985, from Pester to MacLaskey was a preference under §547(b) and the Court agrees for the following reasons. First, the transfer was made to and for the benefit of MacLaskey. Second, the transfer was for an antecedent debt owed by Pester because the transfer in question was in response to a MacLaskey invoice for crude oil delivered to Pester in January of 1985. Third, the transfer was made at a time when Pester was presumed insolvent pursuant to 11 U.S.C. §547(f). Fourth, the transfer occurred within 90 days prior to Pester filing its Chapter 11 petition because the transfer occurred on February 19, 1985, 6 days before Pester filed for bankruptcy on February 25, 1985. Finally, the transfer enabled MacLaskey to obtain more than it would have received if: 1) Pester had filed a Chapter 7 liquidation case because MacLaskey received its full invoice amount; 2) the transfer had not been made because had the transfer not been made MacLaskey would most assuredly have received less than the total amount due; and 3) MacLaskey had received payment under Chapter 11 because MacLaskey would have had to share the available funds or property of Pester along with all of Pester's unsecured creditors. Therefore,

the Court concludes Pester's transfer to MacLaskey of \$214,674.01 on February 19, 1985, was an avoidable preference under §547(b).

B. Exception to Preference Avoidance

Bankruptcy Code §547(c)(2) prevents the avoidance of a preferential transfer to the extent that such a transfer was:

- (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
- (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
- (C) made according to ordinary business terms.

11 U.S.C. §547(c)(2). The purpose of the ordinary course of business exception "is to ensure that normal transactions are not caught in the net of the . . . avoidance powers." In re Colonial Discount Corp., 807 F.2d 594, 600 (7th Cir. 1986) (citing Barash v. Public Finance Corp., 650 F.2d 504, 510 (7th Cir. 1981)). It protects those payments which do not result from "unusual" debt collection or payment practices. In re Sunup/Sundown, Inc., 66 B.R. 1021, 1022 (Bankr. S.D. Fla. 1986) (emphasis in original) (citing Marathon Oil Co. v. Flatau, 785 F.2d 1563, 1566 (11th Cir. 1986)).

"The purpose of this exception is to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." In re Economy Milling Co., Inc., 37 B.R. 914, 922

(D.S.C. 1983) (quoting H.R. Rep. No. 595, 95th Cong., 1st Sess., 373-74 (1977)).

Pursuant to 11 U.S.C. §547(g), MacLaskey has the burden of proof on the §547(c)(2) defense. Three elements must be proven to invoke the "ordinary course" exception under §547(c)(2): 1) transfer in payment of debt incurred in the ordinary course of business between debtor and transferee; 2) transfer made in the ordinary course of business of debtor and transferee; and 3) transfer made according to ordinary business terms. See 11 U.S.C. §547(c)(2). The Court will separately address each element.

1. Transfer In Payment of Debt Incurred in the Ordinary Course of Business Between Debtor and Transferee-- §547(c)(2)(A)

In the case at bar, the first element of the ordinary course of business exception is not in dispute. The parties and the Court agree the wire transfer was in payment of a debt incurred in Pester's ordinary course of business. The debt involved is Pester's obligation to pay MacLaskey for oil delivered to Pester's refinery between January 1 and January 31, 1985. MacLaskey's business involved the purchase and resale of crude oil, and Pester was in the business of buying crude oil and converting it to finished products for resale. Consequently, the Court finds the debt in question was incurred pursuant to the normal day-to-day business operations of the respective parties.

2. Transfer Made in the Ordinary Course of Business of Debtor and Transferee--§547(c)(2)(B)

The term "ordinary course of business" in §547(c)(2)(B) refers to a transfer that is "ordinary" as between the parties. In re Production Steel, Inc., 54 B.R. 417, 423 (Bankr. M.D. Tenn. 1985) (citing In re Williams, 5 B.R. 706, 707 (Bankr. S.D. Ohio 1980)). In Production Steel, the court was discussing §547(c)(2) prior to the implementation of the Bankruptcy Amendments and Federal Judgeship Act of 1984 because its discussion involved the requirement that the transfer was made not later than 45 days after such debt was incurred. Id. at 420-22. Although that requirement has been removed subsequent to the Production Steel decision, the remainder of the decision relating to the other requirements found in §547(c)(2) is still persuasive. Namely, the court explained the kind of test to be applied to subsections (B) and (C) of section 547(c)(2):

Subsections (C) and (D) [which are currently subsections (B) and (C) respectively] test the transaction to determine whether as a whole, it was in the ordinary course of business or financial affairs. Subsection (C) [which is currently subsection (B)] provides a subjective test: was the transfer ordinary as between the debtor and creditor?

Id. at 423. Therefore, in consideration of the second element in the ordinary course of business exception, MacLaskey must prove the transfer in question was ordinary as between it and Pester.

The term "ordinary course of business" in §547(c)(2)(B) refers to a subjective test; what is the ordinary course of business between the parties, and not the "intent" of either of the parties. See id.; but see In re Craig Oil Co., 785 F.2d 1563 (11th Cir. 1986). Consequently, the Court must determine whether the events leading up to the wire transfer on February 19, 1985, were, or could be considered, in the ordinary course of business between Pester and MacLaskey. This task is made difficult by the short-term nature of the parties' relationship. However, the Court agrees with the decision in In re AOV Industries, Inc., 64 B.R. 933 (Bankr. D. Dist.Col. 1986) wherein the court stated:

. . . the requirements of the ordinary course exception should usually be easy to meet: . . . an extensive showing that such transactions occurred often, or even regularly, is not necessary. The transaction need not have been common; it need only be ordinary. A transaction can be ordinary and still occur only occasionally.

Id. at 944 (citing In re Economy Milling Co., Inc., 37 B.R. 914, 922 (D.S.C. 1983)). Therefore, the fact Pester and MacLaskey only had three previous transfers between them does not preclude the Court from determining the final transaction was ordinary.

MacLaskey and Pester entered into a business relationship in November of 1984. At the time Pester filed for relief, they were still adjusting their relationship to provide for mutual optimum financial benefits. The prior agreements between the parties were reduced to writing, but in each instance after performance had been

commenced.

The written contract provided that payment was to be made no later than the 20th day of the month. However, Pester's business records reflect that payment by the 15th day of the month was contemplated as early as January of 1985. This was approximately two months after MacLaskey started delivering crude to Pester and approximately 1 1/2 months before Pester filed for relief under Chapter 11.

The December 1985 and January 1985 payments were made on the 21st and 22nd days of the month. The February payment was made on the 19th day. This is a span of three days which is not unusual or abnormal in and of itself.

The circumstances surrounding the February of 1985 payment are relevant. MacLaskey wished to ensure that his business account was sufficient to cover his checks to the producers and Pester was engaged in its normal business practice of paying as late as it could.

The Committee places a great deal of emphasis on MacLaskey's desire to be paid "early." "Early" is a very relative term. As used in this case, it meant a payment date closer to the date that MacLaskey paid his producers, when compared to the December and January payments. Payment on the 19th satisfied MacLaskey's concerns and satisfied his desire to be paid "early." "Early" under these circumstances does not refer to the relative payment date of other creditors.

MacLaskey had contracted to triple his business with Pester. As a result of the January deliveries, not only were the accounts receivable tripled but so were the accounts payable. MacLaskey and Pester reached an understanding whereby both of their financial concerns could be met. There was nothing unusual or extraordinary about this arrangement. As such, the February 15, 1989 payment was part of the normal business relationship between MacLaskey and Pester and was ordinary for purposes of §547(c)(2)(B).

3. Transfer Made According to Ordinary Business Terms: Industry Standard--§547(c)(2)(C)

The Court agrees with the parties that §547(c)(2)(C) relates to what is "ordinary" in the industry as a whole. See Production Steel, 54 B.R. at 423. In Production Steel, the court explained what kind of test should be applied to subsection (C) of section 547(c)(2):

Subsection (D) [referring to what is currently subsection (C)] provides an objective test: was the transaction made according to ordinary business terms?

Id. Therefore, MacLaskey must negate the Committee's assertion that the industry's standard payment date is the 20th of each month.

The Committee did present evidence at trial showing that there is an industry standard that payment is on the 20th day of each month. However, the evidence reflects this is an industry standard for large pipeline suppliers, not for small truck transport suppliers like MacLaskey.

MacLaskey presented evidence showing the smaller supplier can expect payment on any day of the calendar month that he can negotiate. The evidence supports the conclusion that there is no industry-wide standard regarding payment date to the smaller supplier, especially those who transport by truck. Indeed, the Committee in its own post-trial brief gives an example of another smaller supplier (Eureka) with a payment date on the 15th day of the month. As a result, the Court concludes MacLaskey has met his burden of proof in establishing there is not an industry-wide standard payment date for the smaller supplier who transports by truck. Consequently, since Pester's payment to MacLaskey was made according to ordinary business terms under §547(c)(2)(C), MacLaskey has established all the elements under §547(c)(2).

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Pester's transfer to MacLaskey was a preferential transfer under §547(b).

FURTHER, the Court concludes MacLaskey has met its burden of proving said transfer met the ordinary course of business exception under §547(c)(2).

IT IS ACCORDINGLY ORDERED that the Committee's complaint is dismissed.

Dated this 30th day of May, 1989.

RUSSELL J. HILL
United States Bankruptcy Judge