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
----------------------------	:	
THE OFFICIAL UNSECURED CREDITORS COMMITTEE OF PESTER REFINING COMPANY,	:	Adversary No. 87-0187
Plaintiff,	:	
v.	:	
BLACKBURN, INC.,	:	
Defendant.	:	

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ORDER--TRIAL ON COMPLAINT TO AVOID PREFERENTIAL TRANSFER

On December 5, 1988, a trial was held on the complaint to avoid preferential transfer. The following attorneys appeared on behalf of their respective clients: T. Randall Wright and Jeffrey T. Wegner for Plaintiff Official Unsecured Creditors Committee of Pester Refining Company (hereinafter "Plaintiff"); and John D. White and Anita L. Shodeen for Defendant Blackburn, Inc. (hereinafter "Blackburn"). At the conclusion of said hearing, the Court took the matter under advisement under a briefing deadline. 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, upon review of the pleadings, arguments of counsel, evidence

admitted and briefs, now enters its findings of fact and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. On February 25, 1985, Pester Refining Company (hereinafter "Pester Refining") was one of four Pester Companies that filed for protection under Chapter 11 under the Bankruptcy Code. The other companies were Pester Corporation, Pester Marketing, and Petroleum Special.

2. Pester Refining operated a refinery in El Dorado, Kansas. The refinery itself was Pester Refining's major asset, and the operation of the refinery in El Dorado was Pester Refining's main business.

3. Pester Refining did business with Blackburn since the time Blackburn was formed in June of 1978. Blackburn performed refinery maintenance services, construction services and turnaround services for Pester Refining's refinery.

4. On or about January 12, 1984, Blackburn and Pester Refining entered into a contract for services to be provided by Blackburn in 1984. The contract called for Blackburn to invoice Pester Refining weekly for its fees plus expenses, and it called for payment of each invoice by Pester Refining within 30 days.

5. Pursuant to the contract, Blackburn sent weekly invoices to Pester Refining in 1984. Except for four wire transfers, these invoices were paid by check. Blackburn usually received payment

within 30-35 days after invoicing.

6. Blackburn performed routine maintenance and construction work for Pester Refining in 1984. In the fall of 1984, Blackburn began also performing "turnaround" services for Pester Refining. A "turnaround" is a process under which one or more of the processing units of the refinery are shut down for a period of time to allow the units to be cleaned, inspected and repaired.

7. During the several week period in which the turnaround was being performed by Blackburn, Pester Refining's chief financial officer, Phillip Walsh, determined Pester Refining was going to have some difficulty paying the substantial weekly invoices from Blackburn as they became due because of a cash flow problem. As a result, Walsh contacted Ralph Austin, the majority owner and president of Blackburn, in late November of 1984 to discuss a proposal to defer payment for a period of time that would fit better into Pester Refining's cash flow restrictions. Walsh traveled to Blackburn's place of business in El Dorado on November 20, 1984, to meet with Austin to discuss the proposal and the two talked about deferring payments until sometime in December.

8. At the time of the meeting, Blackburn had run up approximately $600,000.00 worth of costs relative to the turnaround work.

9. During the meeting of November 20, 1984, Phillip Walsh advised Ralph Austin that Pester Refining was experiencing financial

difficulties, "cash flow problems," and requested deferral of payments for a period of time. Phillip Walsh was concerned that if Pester

Refining let a payment date go by without talking to Ralph Austin, that Blackburn would pull off the job and not complete the work. The turnaround of the cataletic converter, with consequent down time, had a serious effect upon Pester Refining's production.

10. In return for accepting delayed payments, Ralph Austin required that the payments were to be made by wire transfer, instead of by check, and Pester Refining was to pay interest on these invoices which were deferred. Phillip Walsh agreed to these conditions.

11. Following the meeting between Austin and Walsh, Timothy Grothues, the financial officer for Blackburn, spoke to Walsh about precisely when the delayed payments could be expected. Walsh responded that his cash flow projections indicated Pester Refining would be able to pay Blackburn approximately $200,000.00 on the Thursday before Christmas of 1984, and the balance on the Thursday after Christmas. The oral arrangement was finalized on November 29, 1984. The payments were to be made by wire transfer instead of by check as was the usual mode of payment. In addition, Pester Refining agreed to pay a finance charge on the past-due invoices. Pester Refining never asked for a deferral of payment prior to this occasion and Blackburn never before charged Pester Refining interest on late

payments.

12. All Blackburn invoices were paid by Pester Refining by check except for four wire transfers. All wire transfers were made as a result of Blackburn's request which was made by Timothy J. Grothues to Phillip Walsh on November 29, 1984.

13. As a result of the November 29, 1984 agreement, Pester Refining made two wire transfer payments to Blackburn as follows: $197,420.00 on December 20, 1984, and $377,675.60 on December 27, 1984.

14. Historically, Pester Refining and Pester Marketing were subsidiaries of Pester Corporation. Pre-petition, Pester Refining had separate assets, separate bank accounts, and its own accounting system. There were separate financing arrangements for each of the companies. However, later on there was intertwining of financing where there was some cross-collateralization of marketing assets of Pester Marketing on the refinery secured loan agreement by Pester Refining.

15. The companies essentially had different employees, although some of the management employees worked for multiple Pester companies.

16. All of Blackburn's contact was with Pester Refining. Blackburn had no contact with any other Pester Company.

17. The Pester Companies filed separate bankruptcy petitions, and during bankruptcy the companies continued to operate as separate

debtors-in-possession. Post-petition the Pester Companies filed consolidated tax returns and financial statements. They were reorganized under a joint plan, but there was no substantive consolidation of the companies for the purpose of bankruptcy.

18. From December 27, 1984, through February 25, 1985, Blackburn advanced services in the amount of $248,077.53 as new unsecured value for the benefit of Pester. Of this amount, Pester Refining paid

Blackburn $54,022.09, leaving an unpaid new value balance of $194,055.44.

19. On its schedule A-3, Pester Refining listed Blackburn as an unsecured creditor. After Pester Refining filed its petition, Blackburn filed two mechanic's liens and filed a secured proof of claim.

20. In its plan, Pester Refining did not treat Blackburn as secured, and Blackburn did not participate in the confirmation hearings.

21. On March 21, 1986, the Court confirmed the Pester Companies' first amended joint plans of reorganization. In said plans, Blackburn was treated as unsecured and none of its alleged lien rights were preserved.

DISCUSSION

Three issues are presented in this case. The first is whether

Pester Refining's December of 1984 transfers of $575,095.60 to Blackburn were an avoidable preference under §547(b). The second issue is whether said transfers meet the §547(c)(2) "ordinary course" exception to avoidance. The third issue is whether new value was given which remains unpaid and must be offset.

A. Preference--§547(b)

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), Plaintiff has the burden of proving the avoidability of the transfer under §547(b).

In the case at bar, the parties have stipulated and the Court agrees the transfers meet §§547(b)(1), (2) and (4). A dispute exists over whether the transfers meet §§547(b)(3) and (5) and, as noted earlier, Plaintiff has met the burden of proof.

Regarding §547(b)(3)--whether the transfers were made while Pester Refining was insolvent--the Court notes §547(f) provides that a debtor is presumed insolvent during the 90 days preceding the date of the petition filing. 11 U.S.C. §547(f). This presumption shifts to the creditor the burden of producing at least some evidence of the debtor's solvency. In re Gilbertson, 90 B.R. 1006, 1009 (Bankr. D.N.D. 1988). If the creditor offers no evidence rebutting the presumption, the debtor's insolvency is established. Id. If, however, the creditor does introduce some evidence of the debtor's solvency, the trustee must pursuade the court of debtor's insolvency or lose the case if he or she cannot do so. Id.

It is uncontroverted that Pester Refining was insolvent on and during the 90 days prior to the filing of the petition. However, Blackburn contends (without submission of authority) that the solvency of all of the Pester companies is relevant to the

determination of the solvency issue. In effect, Blackburn is asking the Court to disregard the corporate entities.

Since corporations are creatures of state law, their affairs are generally governed by state law. Iowa courts will pierce the corporate veil and disregard the corporate entity where justice requires such actions. Briggs Transp. Co. v. Starr Sales Co., 262 N.W.2d 805 (Iowa 1978). The doctrine of separate autonomy may be disregarded when corporate form is being used to defeat the ends of federal law. Hansen v. Huston, 841 F.2d 862, 864 (8th Cir. 1988). This is particularly true where those who seek to benefit from the corporate form have themselves disregarded the corporate form. Id.

Factors which should be considered in determining whether the corporate entity should be disregarded include the following: (1) under-capitalization of the corporation; (2) failure to maintain separate books and records; (3) intermingling finances, funds or assets; (4) failure to follow corporate formalities; (5) promotion of fraud or illegalities; (6) operation is merely a sham; and (7) the presence of any element of injustice or fundamental unfairness. Lakota Girl Scout C., Inc. v. Havey Fund-Rais, Man, Inc., 519 F.2d 634, 638 (8th Cir. 1975); In re WJM, Inc., 84 B.R. 268, 273 (D.C. Mass. 1986); Briggs Trans., supra, 262 N.W.2d at 810. However, mere identity of corporate management is not alone sufficient to permit piercing the corporate veil. In re Manchester Hides, Inc., 45 B.R.

794, 801 (Bankr. N.D. Iowa 1985).

The relevant period is the 90-day period preceding the date of the filing of the petition, specifically, on the two payment dates of December 20, 1984, and December 27, 1984. There is no evidence that during this period the Debtor corporations disregarded the separateness of the corporate entities. There is no evidence that one Pester corporation exercised substantial or total domination over any other Pester corporation. The Pester corporations maintained formalities of separate existence--separate books and records and no intermingling of funds or assets. The companies were operated separately. Partial identity of corporate management is not alone sufficient to permit disregarding the corporate identities. Neither is cross-collateralization of assets for the purposes of securing a debt to the Bank Group. None of the elements of injustice or fundamental unfairness are present to permit piercing of the corporate veil. Further, Blackburn dealt solely with Pester Refining and had dealt solely with Pester Refining for years. As a result, the Court concludes Blackburn has not rebutted the presumption of Pester Refining's insolvency and, thus, §547(b)(3) is met.

The next issue is whether the transfers meet §547(b)(5)--transfers resulted in Blackburn receiving more than it would have if the transfers had not occurred and the case was in Chapter 7. Unless the assets of the estate are sufficient to provide on liquidation a 100% distribution to creditors, any transfer made to an unsecured creditor by an insolvent debtor permits the creditor to receive more

than it would if the debtor was in Chapter 7. Matter of Lawrence, 82 B.R. 157, 160 (Bankr. M.D. Ga. 1988). If, however, a creditor is secured, it would receive the same amount it would under Chapter 7 so there would be no preference. Thus, §547(b)(5) depends upon whether Blackburn was a secured or unsecured creditor.

Blackburn argues it is secured because: 1) it holds mechanic's liens on which it filed a secured proof of claim; 2) Pester Refining did not request a §506 determination of Blackburn's status; and 3) active participation in a confirmation proceeding is unnecessary to preserve lien rights. Plaintiff, on the other hand, argues Blackburn is not secured because: 1) Pester Refining scheduled Blackburn as unsecured and while a secured proof of claim filed by a creditor will supersede the scheduling, Blackburn did not offer any claim into evidence; 2) Blackburn's failure to object to the admission of Pester Refining's schedules listing it as unsecured makes the schedules binding upon Blackburn; and 3) Blackburn is listed as unsecured in the confirmed plan to which it did not object.

Upon review of these arguments, the Court agrees with Plaintiff that Blackburn was not secured for the following reasons. First, Blackburn's failure to object to the admission of Pester Refining's schedule A-3 listing Blackburn as the holder of an unsecured claim in the amount of $194,055.44 bound Blackburn to the schedule's characterization of the claim. In re Air Conditioning, Inc. of Stuart, 845 F.2d 293, 297 (11th Cir. 1988).

Second, the Court has recently held the terms of a confirmed

Chapter 11 plan bind all creditors and pre-confirmation lien rights only survive to the extent they are included in a Chapter 11 plan. See Matter of Central Steel Tube Co., Case No. 83-856-DH, Adv. No. 87-0213, slip op. at 9 (Bankr. S.D. Iowa May 1, 1989); Matter of Gross, Case No. 84-794-WH, slip op. at 6 (Bankr. S.D. Iowa May 27, 1988). Moreover, all questions which could have been raised pertaining to the plan are *res judicata*. Central Steel, slip op. at 10-15. Blackburn did not participate in the confirmation process and did not object to its unsecured treatment under Pester Refining's plan. As a result, Blackburn is now precluded from arguing its alleged secured status due to the operation of §1141(c) and the doctrine of *res judicata*. Id. The Court, therefore, concludes Plaintiff has met its burden of proof under

§547(b)(5), thus establishing the preferential nature of Pester Refining's December of 1984 transfers to Blackburn under §547(b).

B. Exception to Preference Avoidance--§547(c)(2)

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)).

Pursuant to 11 U.S.C. §547(g), Blackburn, the creditor, has the burden of proof on its §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 transfers were in payment of a debt incurred in Pester

Refinings's ordinary course of business.

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) 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 §547(c)(2):

> Subsections (C) and (D) [which are currenntly 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 (emphasis added). Therefore, under §547(c)(2)(B), Blackburn must prove the transfers in question were ordinary as between it and Pester Refining.

Blackburn cites to many cases for the proposition that the payments were in the ordinary course of business between it and Pester Refining because they were made pursuant to the terms of a "new agreement" which modified prior business terms between the parties. See, e.g., In re Xonics Imaging, Inc., 837 F.2d 763 (7th Cir. 1988); In re Gilbertson, 90 B.R. 1006 (Bankr. D.N.D. 1988); In re Magic Circle Energy Corp., 64 B.R. 269 (Bankr. W.D. Okla. 1986). The common thread running through those cases is that the parties reached a new agreement prior to the 90-day preference period and then made payments pursuant to the agreement within the 90-day preference period. The Court agrees with this proposition generally but limits it to cases where the "new agreement" was executed before the preference period begins to run. Xonics, 837 F.2d at 766. Moreover, the new agreement can shield only those payments made according to "ordinary business terms" under §547(c)(2)(C). Id.

In the case *sub judice* the "new agreement" between Pester Refining and Blackburn was not finalized until November 29, 1984, 88 days before Pester Refining filed its Chapter 11 petition on February 25, 1985. This falls within the preference period (88 days pre-petition which is two days after the preference period began to run) and thus is not a valid "new agreement" for purposes of §547(c)(2)(B). As a result, the Court concludes Blackburn has failed to meet its burden of proof under §547(c)(2)(B) which, in turn, makes a determination under §547(c)(2)(C) of whether the payments were made according to "ordinary business terms" moot.

C. New Value--§547(c)(4)

Although the parties' transfers were a preference under §547(b) which did not meet the ordinary course of business exception under §547(c)(2), the Court cannot determine the amount of Plaintiff's recovery without taking into account any new advances by Blackburn under §547(c)(4). Section 547(c)(4) provides that Plaintiff cannot avoid the preferential transfers to Blackburn to the extent that after said transfers, Blackburn gave new value to Pester Refining that was unsecured and remains unpaid. See In re Camelot Motors Corp., 86 B.R. 520, 522 (Bankr. W.D. Mich. 1988); 11 U.S.C. §547(c)(4). Thus, any new value given which is unsecured and remains unpaid must be offset from any claim Plaintiff is entitled to recover as a preference.

In the case *sub judice* Blackburn advanced services from December 27, 1984, through February 25, 1985, in the amount of $248,077.53 as new unsecured value for the benefit of Pester Refining. Of this amount, Pester Refining paid Blackburn $54,022.09, leaving an unpaid new value balance of $194,055.04. This new value balance meets the requirements under §547(c)(4). The Court, therefore, concludes Blackburn's preference of $575,095.60 must be reduced by the new value of $194,055.44 to $381,040.16.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes Plaintiff has met its burden of proving the preferential nature of the transfers under §547(b) and Blackburn has failed to meet its

burden of proving the ordinary course of business exception under §547(c)(2).

FURTHER, the Court concludes Blackburn is entitled to receive its §547(c)(4) setoff for new value in the amount of $194,055.44.

IT IS ACCORDINGLY ORDERED that Plaintiff, the Official Unsecured Creditors Committee of Pester Refining Company, is entitled to judgment against the Defendant, Blackburn, Inc., in the amount of $381,040.16, with interest thereon at the legal rate commencing upon the date the complaint was filed, and its costs of action.

Dated this 31st day of May, 1989.

RUSSELL J. HILL
United States Bankruptcy Judge