

UNITED STATES BANKRUPTCY COURT
For the Southern District of Iowa

In the Matter of :
PESTER REFINING COMPANY, : Case No. 85-340-C H
Debtor. : Chapter 11
----- :
ETHYL CORPORATION, : Adversary No. 85-0192
Plaintiff, :
v. :
PESTER REFINING COMPANY, :
Defendant. :

ORDER--SECOND TRIAL OF BIFURCATED PROCEEDING
ON RECLAMATION COMPLAINT UNDER 11 U.S.C. §546(c)

On April 9, 1990, the second trial of the Bifurcated Proceeding on the Reclamation Complaint was held. The following attorneys appeared on behalf of their respective clients: James M. Holcomb and Robert A. Simms for Plaintiff Ethyl Corporation ("Ethyl"); and John G. Fletcher and September Wethington-Smith for Defendant Pester Refining Company ("PRC"); and T. Randall Wright for Intervenor Unsecured Creditors Committee. At the conclusion of said hearing, the Court took the matter under advisement upon 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). The Court, upon review of the pleadings,

arguments of counsel, and briefs submitted, now enters its findings and conclusions pursuant to Fed.R.Bankr.P. 7052.

FINDINGS OF FACT

1. On February 25, 1985, PRC filed a Chapter 11 Petition.

2. On February 25, 1985, Pester Corporation, Pester Marketing, and Petroleum Special, Inc. of Iowa filed Chapter 11 petitions. At no time were any of the four bankruptcy cases substantively consolidated.

3. Ethyl is a corporation organized under the laws of the state of Virginia.

4. PRC is a corporation organized under the laws of the state of Kansas.

5. At all times material to the issues involved in this proceeding, PRC owned and operated a refinery located in El Dorado, Kansas.

6. The law of the state of Kansas governs the sale by Ethyl and the purchase by PRC of the products that are the subject of this proceeding.

7. By letter agreement between Ethyl and PRC dated May 21, 1982, which letter agreement was extended by letter agreement dated January 27, 1983, Ethyl agreed to sell to PRC and PRC agreed to purchase from Ethyl 100 percent of PRC's antiknock requirements, subject to the terms of such letters including the right of PRC to be released from the agreement.

8. During February of 1985 PRC issued to Ethyl its Purchase Order No. 36054 for the purchase on credit of 6,000 gals. of Ethyl Tel Motor Premix 33 White 8 ("Premix 33").

9. In mid-February of 1985, and before shipment, Ethyl issued and forwarded to PRC a document entitled "Order Acknowledgement" that pertained to the 6,000 gal. of Premix 33

10. On February 19, 1985, Ethyl instructed the Atchison, Topeka & Santa Fe Railway Co. to release to PRC the railroad tank car (No. EBAX006412) that contained the 6,000 gal. of Premix 33. On February 22, 1985, said railroad tank car was delivered to and received by PRC at its refinery at El Dorado, Kansas.

11. The purchase price for said 6,000 gal of Premix 33 was the sum of \$117,007.00.

12. On February 6, 1985, PRC issued to Ethyl its Purchase Order No. 35966 for the purchase of 12--55 gal. drums of ethyl antioxidant 733-PDA H-50 ("Antioxidant").

13. In early February of 1985, and before shipment, Ethyl issued and forwarded to PRC and PRC received a document entitled "Order Acknowledgement" that pertained to said 12--55 gal. drums of Antioxidant.

14. On February 11, 1985, Ethyl shipped to PRC via motor carrier said 12--55 gal. drums of Antioxidant.

15. On February 19, 1985, the 12--55 gal. drums of Antioxidant were delivered to and received by the PRC refinery

in El Dorado, Kansas.

16. The purchase price for said 12--55 gal. drums of Antioxidant was the sum of \$9,537.00 plus \$451.00 in shipping charges, for a total of \$9,988.00.

17. On February 26, 1985, Ethyl issued a letter to PRC that was received by PRC on February 27, 1985. This letter stated that the above-described products were shipped and delivered pursuant to a credit sale arrangement when PRC was insolvent and made demand upon PRC for the return of the product. The Premix 33 and the Antioxidant were in the possession of PRC on February 26 and 27, 1985, and were identifiable.

18. At the time of the filing of the PRC Chapter 11 petition (February 25, 1985), the parties agreed PRC was indebted to Ethyl in the amount of \$366,136.78. Of this amount, \$126,995.00 represents the invoice price for sale of the product which is the subject of this reclamation proceeding. As to the balance of \$239,141.78, Ethyl remains a general unsecured creditor. Ethyl filed its Proof of Claim in the PRC bankruptcy on December 16, 1985, in the total amount of \$369,500.73.

19. From and after December of 1981, and at all times material to this proceeding, Continental Illinois National Bank and Trust Company of Chicago, First Interstate Bank of Denver, N.A., and Bankers Trust Company (hereinafter

collectively the "Bank Group") held a perfected security interest in all present and future inventory, equipment, general intangibles, accounts, contract rights, goods and fixtures of PRC including the proceeds of the collateral and the products of the collateral, pursuant to the terms of a loan agreement generally referred to as the Bank Group Revolving Credit Agreement. In addition, from and after December of 1981, and at all times material to this proceeding, Bank Group held a properly recorded mortgage or deed of trust in all of the real estate of PRC pursuant to the loan agreement generally referred to as the Bank Group Term Loan Agreement. PRC's property which collateralized Bank Group Revolving Credit Agreement also collateralized the Bank Group Term Loan Agreement, and PRC's property which collateralized the Bank Group Term Loan Agreement also collateralized the Bank Group Revolving Credit Agreement.

20. From and after May-June of 1984, and at all times material to this proceeding, Southern Union Refining Company and Inland Crude Purchasing Corporation (hereinafter collectively the "Junior Lienors") held a perfected security interest in all present and future inventory, equipment, general intangibles, accounts, contract rights, goods and fixtures of PRC, including the proceeds and products thereof, as collateral security for the indebtedness owing by PRC to the Junior Lienors. In addition, from and after May-June of

1984, and at all times material to this proceeding, the Junior Lienors held a properly recorded mortgage or deed of trust in all of the real estate of PRC as security for the debt. Said security interest and mortgages or deeds of trust held by the Junior Lienors were junior only to the security interest in mortgage or deed of trust held by Bank Group. PRC's property which collateralized the security agreements granted to Junior Lienors also collateralized the mortgages or deeds of trust given the Junior Lienors, and PRC's property which collateralized the mortgages or deeds of trust given the Junior Lienors also collateralized the security agreements granted to Junior Lienors.

21. Both Bank Group and Junior Lienors were "good faith" purchasers within the meaning of Uniform Commercial Code §2-702 (Kans. Stat. Ann. 84-2-702 [1983]).

22. Ethyl's reclamation claim to the product is subject to the lien of both Bank Group and Junior Lienors upon the product.

23. In October of 1985, upon application of the Unsecured Creditors Committee of PRC, the Bankruptcy Court entered an order directing that Wright, Killiam & Feldman, Inc., of Houston, Texas, be retained to prepare an appraisal of the PRC Refinery in El Dorado, Kansas. In December of 1985, Wright, Killiam & Feldman, Inc. issued its appraisal, entitled Pester Refining Company Asset Valuation Report,

(hereinafter "WK&F Report") and the same was filed with the Bankruptcy court. The parties have consented to the Court taking judicial notice of the WK&F Report.

24. The WK&F Report concluded that, if PRC had been liquidated (on either the date of filing its bankruptcy petition or on the date of the WK&F Report), the net realization value of the PRC Refinery would range from a negative \$5,000,000.00 to a negative \$21,000,000.00.

25. On March 21, 1986, (the date of confirmation of PRC's Plan of Reorganization) the amount of the deficiency of the allowed secured claim of Bank Group against PRC, after giving credit for the inventory, receivables and other properties of PRC that were sold, or were collected, and applied on the Bank Group debt, was the sum of \$25,912,823.00.

On March 21, 1986, the amount of the deficiency of the allowed secured claim of the Junior Lienors against PRC was the sum of \$17,061,436.00.

26. Under the terms of the Plan of Reorganization, the Bank Group wrote off in excess of \$500,000.00 of the debt owing to it by PRC, which indebtedness exceeded \$60,000,000.00.

27. Shortly after the filing of PRC's petition, the Court entered an Order, on application and notice, granting Bank Group a "super-priority" lien, pursuant to Bankruptcy Code §364(c)(1) and (3), on all of PRC's property as security

for credit extended to PRC by Bank Group during the administration of the estate.

28. The parties have agreed that the Court may take judicial notice of the First Amended Joint Disclosure Statement filed by PRC that was approved by the Court together with the First Amended Joint Plans of Reorganization (hereinafter the "Plan") filed by PRC that was approved and confirmed by the Court on March 21, 1986. Under the Plan, Ethyl is the holder of a Class 9 Claim. The parties have also agreed that the Court may also take judicial notice of all filings in the bankruptcy proceedings of the Pester Corporation, Pester Refining Company and Petroleum Special, Inc. of Iowa.

29. Under the First Amended Joint Disclosure Statement and the Plan, reclamation claimants, such as Ethyl, could elect to either (a) pursuant to paragraph 1 of Exhibit 3 to the Plan, pursue their reclamation claims, or (b) pursuant to paragraphs 2 and 3 of Exhibit 3 of the Plan, elect to compromise and settle their claims by sharing pro rata in certain proceeds from the MAPCO-Burke Natural Gas Liquids litigation then pending in the court. All of the reclamation creditors, except Ethyl, elected alternative (b). Ethyl elected alternative (a) and is pursuing its reclamation claim as permitted under paragraph 1 of Exhibit 3 to the Plan.

30. Following confirmation of the Plan, PRC, for

administrative purposes, treated Ethyl as having elected alternative (b) and, by reason thereof, Pester Marketing Company paid to Ethyl its pro rata portion of the interest in the promissory note referred to in Exhibit 4 to the Plan. Said payments to Ethyl were \$764.41 in June of 1987 and \$1,146.61 on March 31, 1988.

31. Ethyl voted to approve the Plan that was filed by PRC.

32. Because PRC did not have funds available to pay its administrative expense claimants, PRC's allowed administrative claims (meaning expenses of administration under Bankruptcy Code §503(b) and §507(a)(1)) were paid by Pester Marketing Company.

33. During the month of February 1985, PRC was insolvent as such term is defined in Bankruptcy Code §101(29). During the month of February 1985, Pester was insolvent for purposes of Bankruptcy Code §546(c) and for purposes of §2-702 of the Uniform Commercial Code of Kansas.

34. Neither the 6,000 gals. of Premix 33, nor the Anti-oxidant, are in possession of PRC. PRC has been unable to give any information as to the disposition of the product and it was never returned to Ethyl.

35. The railroad tank car (No. EBAX006412) has been returned to Ethyl.

36. On January 12, 1987, PRC, Pester Marketing Company,

Pester Refining Company, and Petroleum Special, Inc. of Iowa (collectively "Pester") filed a motion to modify the Plan in order to permit Pester to enter into a lease agreement with Coastal Branded Marketing, Inc. ("Coastal") and permit Pester to use the rental income to pay allowed claims. The proposed lease agreement with Coastal ("Master Agreement") provided for a lease with an option to purchase on certain Pester service stations.

37. The Court entered an order approving the modification and incorporating the Master Agreement in the Plan on March 11, 1987, and a judgment was entered on March 16, 1987.

38. Section 12.18 of the Master Agreement provides that Pester shall appoint a depository bank as its designated paying agent and Coastal shall make payments of rent and other payments to such designated paying agent. Section 12.18 also provides that Pester, by written notice, shall direct such designated paying agent to make the payment of Pester Plan obligations in accordance with Appendix F of the Master Agreement.

39. Appendix F to the Master Agreement establishes the allocation of the rents received from the leasing of the Pester service stations to a list of creditors classified according to the type of claim, the Pester entity that the creditors claims are against, the terms of payment and the

amount of the payment. Appendix F to the Master Agreement does not specifically designate Ethyl's treatment.

40. On March 30, 1987, PRC, Pester Marketing Company, Bank Group, and Junior Lienors entered into an agreement designating Bankers Trust Company as paying agent ("Paying Agent Agreement").

41. Exhibit A, Schedule 3 of the Paying Agent Agreement lists Ethyl as an unsecured creditor of PRC with a claim of \$366,136.78.

42. On February 26, 1985, the standard price at which Ethyl sold the Premix 33 was \$1.551 per lb, the price at which Ethyl sold Premix 33 to Pester. Ethyl sold Premix 33 at a price of \$1.551 per lb in 1985 on February 25th, February 27th, March 26th, April 9th, April 23rd, and June 27th--all at the price which Ethyl sold the Premix 33 to Pester. The market price for the 6,000 gallons of Premix 33 on February 26, 1985, was \$117,007.00.

43. The price at which the Antioxidant was invoiced and sold to Pester (\$1.87 per lb) was the market price for this product on February 26, 1985. The market price for the 12--55 gallon drums of Antioxidant on February 26, 1985, was \$9,988.00.

44. Any of the preceding findings of fact which may be considered conclusions of law are hereby incorporated into the following discussion and conclusions of law.

DISCUSSION

I. Bifurcation of Trial.

The parties previously agreed that the issues presented in this adversary proceeding would be bifurcated into separate trials. In the first trial, the Court concluded as follows:

- 1) Ethyl has a valid and enforceable right of reclamation regarding the 6,000 gal. of Premix 33 and the 12-55 gal. drums of Antioxidant.
- 2) Ethyl's rights of reclamation are subordinate to, but not extinguished by, the perfected security interests of the Bank Group and Junior Lienors.
- 3) Ethyl, as a holder of a class 9C Claim under the Plan is entitled to be paid in full in an amount to be determined by the Court in the second proceeding of the bifurcated trial.
- 4) Ethyl is not barred or estopped from asserting its claim by the doctrines of res judicata, election of remedies, laches, or equitable estoppel.
- 5) The date of Ethyl's reclamation demand, February 26, 1985, is the date for valuation of Ethyl's reclamation claim.

In the second trial, the Court must determine the amount due Ethyl and the source of funds to pay said amount. See Ethyl Corporation v. Pester Refining Company (Matter of Pester Refining Company), Case No. 85-340, Adversary No. 85-0192 at p. 9 (Bankr. S.D. Iowa September 29, 1989).

II. Amount Due Ethyl.

PRC asserts that Ethyl's claim is valueless because the prior perfected creditor's claims are under-secured and extinguish Ethyl's reclamation rights. The Court rejected PRC's argument in the first trial. Ethyl's rights of reclamation are subordinate to, but not extinguished by, the perfected security interests of the Bank Group and Junior Lienors. Ethyl Corporation v. Pester Refining Company (Matter of Pester Refining Company), case No. 85-340, Adversary No. 85-0192 (Bankr. S.D. Iowa September 28, 1989).

In the first trial, the Court also determined that the date of Ethyl's reclamation demand, February 26, 1985, is the correct date for valuing Ethyl's reclamation claim. Ethyl Corporation v. Pester Refining Company at p. 24. The value of Ethyl's reclamation claim on February 26, 1985, is measured by the value of the reclamation product in PRC's possession on February 26, 1985. See In re Davidson Lumber Company, 22 B.R. 775 (Bankr. S.D. Fla. 1982); In re Coupon Carriers Company, 77 B.R. 650 (N.D. Ill. 1987); Matter of Bosler Supply Group, 74 (B.R. 250 N.D. Ill. 1987). The value of the reclamation product is often represented by the invoice price. See e.g., In re In re Davidson Lumber Company, 22 B.R. 775 (Bankr. S.D. Fla. 1982); In re Wheeling-Pittsburgh Steel Corp., 74 B.R. 656, (Bankr. W.D. Pa. 1987); Matter of Bosler Supply Group, 74 (B.R. 250 N.D. Ill. 1987); In re Flagstaff Foodservice, Corp.

56 B.R. 910, 914, n. 9 (Bankr. S.D.N.Y. 1986).

The value of the Premix 33 and Antioxidant on February 26, 1985, was \$126,995.44, the price at which Ethyl sold and invoiced the reclamation product to PRC. The price of the Premix 33 and of the Antioxidant reflect the market value of each on the dates of their sale. The market price of each did not change in the two or three week period from the date in which PRC ordered the reclamation product to the date on which Ethyl made its reclamation demand. Therefore, the purchase price of the Premix 33 and of the Antioxidant, \$126,995.44, reflects the market price for the reclamation product as of February 26, 1985.

On February 26, 1985, the standard price at which Ethyl sold Premix 33 was \$1.551 per lb, the price at which Ethyl sold Premix 33 to Pester. Ethyl sold Premix 33 at a price of \$1.551 per lb in 1985 on February 25, February 27, March 26, April 9, April 23, and June 27--all at the price at which Ethyl sold the Premix 33 to Pester. The market price for the Premix 33 on February 26, 1985, was \$117,007.00.

Pester has taken the position that the lead phase-down rules promulgated by the EPA on March 7, 1985, adversely affected the value of the Premix 33. As the Court has already ruled, the critical date for valuing the reclamation product is February 26, 1985, the value of the Premix 33 in late 1985 or in 1986 is irrelevant. Ethyl v. Pester Refining Company,

at p. 24. The Court is not persuaded that the regulations had an adverse impact on the price of the Premix 33 on February 26, 1985.

The price at which the Antioxidant was invoiced and sold to Pester (\$1.87 per lb) was the market price for this product on February 26, 1985. This is the price at which Ethyl sold its product to other buyers at arms-length commercial transactions. The lead phase-down rules referred to by Pester have no effect on the Antioxidant, since there is no lead in the Antioxidant. The market price for the Antioxidant on February 26, 1985, was \$9,988.00 and therefore the market value for the total reclamation product was \$126,995.44.

III. Source of Funds and Plan Modification.

The parties assert various arguments concerning the source of funds that should be used to pay Ethyl and whether the Plan needs to be and can be modified.

PRC asserts that Ethyl is barred and estopped from asserting that its class 9C claim under the Plan should be paid as an administrative priority from the rents generated by the lease arrangement with Coastal, because the Plan as modified on March 11, 1987 allocates all of PRC's funds to specific creditors under a distribution schedule which treats Ethyl as an unsecured creditor. The Court disagrees with this assertion. In the first trial, the Court ruled that Ethyl is

a holder of a class 9C claim under the Plan and is entitled to be paid in full. See Ethyl v. Pester Refining Company, at p. 25. Further, while Appendix F to the Master Agreement does establish the allocation of the rents to specific creditors under a distribution schedule, it does not specifically designate Ethyl's treatment under the Plan. Instead, PRC, for administrative purposes only, has treated Ethyl as an unsecured creditor and therefore Ethyl has been paid as an unsecured creditor.

Exhibit A to the Paying Agent Agreement does list Ethyl as an unsecured creditor of PRC in the amount of \$366,136.78. However, as stated above, this treatment is for administrative purposes only. In addition, the Paying Agent Agreement and attached Exhibit A are not binding components of the Plan. The Paying Agent Agreement was entered on March 30, 1987, pursuant to the Plan as modified on March 11, 1987. See §12.18 of the Master Agreement. However, the Paying Agent Agreement does not establish the value of creditors' claims under the Plan. In fact, paragraph 17 of the Paying Agent Agreement states that nothing in the Paying Agent Agreement shall be deemed to modify or otherwise affect the rights and obligations of Pester Creditors, under the various agreements executed by them in connection with the Plan or the Master Agreement. Further, paragraph 4 of the Paying Agent Agreement recitals specifically states that Exhibit A may be amended

from time to time upon the giving of notice by Pester Marketing to the Paying Agent and other parties.

The parties have asked the Court to designate a source of funds. However, the Court need not specify the source of funds to pay Ethyl's reclamation claim. The Court has ruled that Ethyl, as a holder of a Class 9C claim under the Plan is entitled to be paid in full in the amount of \$126,995.44. To comply with the Plan, PRC must therefore pay Ethyl in full. If PRC fails to pay Ethyl in full, Ethyl is entitled to pursue those remedies available to it under state and federal law. In re Ernst, 45 B.R. 700, 702 (Bankr. D. Minn. 1985); In re Balogun, 56 B.R. 117 (Bankr. E.D. Ala. 1985); In re Currie, 99 B.R. 409 (Bankr. C.D. Ill. 1989).

The Unsecured Creditors Committee asserts that to the extent payment to Ethyl disrupts the current flow of payments to the creditors under the Paying Agent Agreement, the Court's order would effect a modification to Pester's Plan contrary to 11 U.S.C. §1127. However, as stated by the Unsecured Creditors Committee in the first trial the Court ruled that Ethyl's complaint only requires the Court to interpret, not amend or modify, the Plan. In addition, as discussed, supra, the Paying Agent Agreement may be altered without modifying the Plan. If Pester fails to alter the Paying Agent Agreement, Ethyl may pursue its remedies under state and federal law.

IV. Interest on PRC's Obligation to Ethyl.

Ethyl asserts that it is entitled to recover interest on its claim. The Plan does not provide for the payment of interest on a class 9C claim. Further, the majority of cases which discuss the payment of interest on an 11 U.S.C. §546(c) claim deny the payment of interest. See Western Farmers Association v. Ciba Geigy (In re Western Farmers Association), 6 B.R. 432, 437-38 (Bankr. W.D. Wash. 1980); Matter of Melvin Liquid Fertilizer Co., Inc., 37 B.R. 587 (Bankr. S.D. Ohio 1984). Finally, Kansas law governs the reclamation claim. K.S.A. §84-2-702 does not provide for the payment of interest or costs of recovery for reclamation claims. Ethyl's request for interest is denied.

As stated above, K.S.A. §84-2-702 does not provide for the recovery of costs for reclamation claims. Further, Ethyl provides no other statutory or contractual basis for granting Ethyl costs in this action. See In re Coast Trading Company, Inc., 744 F.2d 686, (9th Cir. 1984). Ethyl's request for costs is denied.

CONCLUSION AND ORDER

WHEREFORE, based on the foregoing analysis, the Court concludes as follows:

- 1) Ethyl, as a holder of a class 9C claim is entitled

to be paid \$126,995.44.

2) Ethyl is not entitled to interest on the \$126,995.44 and is not entitled to costs of this action.

3) The Court need not specify the source of funds to pay Ethyl's reclamation claim. If PRC fails to pay Ethyl in full, Ethyl may pursue its remedies under state and federal law.

IT IS ACCORDINGLY ORDERED that the Clerk of Bankruptcy Court is directed to enter judgment for the Plaintiff, Ethyl Corporation, and against the Defendant, Pester Refining Company, in the amount of \$126,995.44.

Dated this 19th day of September, 1990.

RUSSELL J. HILL
United States Bankruptcy Judge