

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
BEST REFRIGERATED EXPRESS, INC.,)	CASE NO. BK89-80169
DEBTOR)	A92-8042
)	
THOMAS F. HOARTY, TRUSTEE,)	CH. 11
Plaintiff)	
vs.)	
GATEWAY LIFE & CASUALTY)	
AGENCY CORP. OF OGALLALA,)	
Defendant &)	
Third Party Plaintiff)	
vs.)	
)	
CAROLINA CASUALTY INSURANCE CO.)	
Third Party Defendant)	

MEMORANDUM

Hearing was held on March 30, 1994. Appearing on behalf of Trustee was Roger Shiffermiller of Fraser, Stryker, Vaughn, Meusey, Olson, Boyer & Bloch, P.C., Omaha, Nebraska. Appearing on behalf of Gateway Life & Casualty Agency Corp. of Ogallala was Edward Steenburg of McQuillan & Spady, P.C., Ogallala, Nebraska. Appearing on behalf of Carolina Casualty Insurance Co. was John Ballew of Baylor, Evnen, Curtiss, Gritmit & Witt, Lincoln, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b) (2) (F).

Background

This is a preference action brought by the trustee to avoid a payment of \$72,800 made by the debtor to the debtor's insurance carrier on January 17, 1989, within ninety days of the Chapter 11 bankruptcy filing by the debtor on February 7, 1989.

This action was brought by the trustee pursuant to 11 U.S.C. § 547(b) which provides:

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 ninety days before the date of the filing of the petition;

or

(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) 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.

The parties have agreed that the first four elements of the preference section have been met. However, they cannot agree that the requirements of subsection 5 have been met. Therefore, the issue that will be dealt with in this order is "Whether the premium payment made by Best on or about January 17, 1989, in the amount of \$72,800 allowed the defendants to receive more than they would have received in a chapter 7 liquidation and, if so, do the defendants have an ordinary course of business defense under 11 U.S.C. § 547(c)?"

Facts

The contract of insurance between Best and Carolina Casualty Insurance Company (Carolina) was effective as of May 13, 1988, and expired by its own terms, unless renewed, on May 13, 1989. The contract, Exhibit 36, requires, at paragraph 5 of the endorsement entitled "Premium and Reports Agreements Composite Rating" that Best deposit a certain amount with Carolina which Carolina would hold in a special escrow account and which would not be considered as a payment of a policy premium. Upon termination, Carolina agreed to pay back the entire amount of the escrow deposit, less any part necessary to cover unpaid earned premiums.

The amount of the deposit was \$174,720 payable in installments as shown in that portion of Exhibit 36 entitled "Special Blank Endorsement." Those installments were in the amount of \$85,000 on May 13, 1988; \$30,000 on June 1, 1988; \$30,000 on July 1, 1988; and \$29,720 on August 1, 1988.

The policy, at paragraph 4 of "Premium and Reports Agreements Composite Rating," required that Best report to the company, through its agent Gateway Life & Casualty Agency Corp. of Ogallala (Gateway), its monthly gross receipts from which an earned premium could be calculated using a formula agreed upon by the parties. That report and the monthly premium based upon that report were to be provided to Gateway no later than fifteen days after the end of the previous month along with a payment based upon the higher of the actual earned premium calculated pursuant to the formula or a minimum monthly payment agreed to by the parties.

The premium due in mid-December of 1988 for the month of November was \$67,900 which was calculated by using the formula and exceeded the minimum monthly payment. Because, at the time that premium payment was due in December of 1988, the parties were renegotiating the minimum monthly payment, Best did not pay either the November minimum or earned premium in December, 1988.

The premium due in mid-January of 1989 for the month of December, 1988, was \$63,939 based upon the formula. This amount was in excess of the minimum monthly payment eventually determined through negotiation by the parties.

Gateway and Carolina, although agreeing to renegotiation of the minimum monthly payment, insisted in late December of 1988 and early January of 1989 that Best pay the original contractual minimum monthly payment for November. Best, therefore, paid

\$72,800 on January 16, 1989. It is this transfer that the trustee seeks to avoid as a preference.

The payment in January covered the premium for insurance coverage provided in November. As of the petition date, February 7, 1989, Best had not paid the premium due for the month of December, 1988. As of the petition date, February 7, 1989, no other monthly premiums were yet due. That is, the premium for the January insurance coverage was not due until February 15, 1989.

If the \$72,800 payment made on January 16, 1989, had not been paid, then, as of the petition date, February 7, 1989, Best would have owed the November earned premium of \$67,900 and the December earned premium of \$63,939 for a total of \$131,839. If liquidation had occurred on February 7, 1989, the insurance carrier, pursuant to its contract rights, could have applied \$131,839 of the escrow account and canceled the insurance contract.

In other words, Gateway and Carolina were fully secured with regard to the amounts actually due per the contract on the date of the petition.

Although the debtor attempted, by check dated February 6, 1989, to pay the December installment, the check did not clear the bank prepetition and was not paid. However, debtor did, by wire transfer, make the December payment shortly after the petition date. The next payment for the insurance coverage in January of 1989 was received on a timely basis in the ordinary course of business on February 17, 1989. The payment for the insurance coverage in February was received on a timely basis in March of 1989. The payment for the March insurance coverage was received on a timely basis in April of 1989 and the payments for April and May coverage were received on a timely basis in May and June of 1989.

At the termination of the Policy in May of 1989, Carolina performed an audit, pursuant to the terms of the contract, and determined that Best had overpaid premiums and that from the date the January 17, 1989, payment was received, Carolina had carried on its books an overpayment amount with a minimum of \$13,586 as of the January 17 payment date and a maximum of \$19,875 thereafter. Therefore, pursuant to the contract, Carolina, in June of 1989, paid to Best, as debtor-in-possession, the overage of \$19,875 plus the premium deposit of \$174,720. By the end of the policy period, the estate had received uninterrupted insurance coverage throughout the policy period from May 13 of

1988 through May 13 of 1989 and received from Carolina all premium overpayments plus the premium deposit security amount.

Discussion

1. 11 U.S.C. § 547(b)(5)

The purpose of permitting the trustee to avoid a preferential payment and recover such payment for the benefit of the estate is to make certain all unsecured creditors receive similar treatment on distribution of a debtor's estate. If one creditor with an unsecured claim receives a payment that puts that creditor in a better position than others of the class, the estate has been harmed and the preferential payment should be returned for distribution according to the chapter 7 distribution scheme. However, in this case it is difficult to see how the class of unsecured creditors was harmed by the January payment even if it technically was preferential. Because the payment was made, the state and federally mandated liability insurance remained in effect permitting the debtor to continue to operate and potentially, if not actually, increase the return to the unsecured class.

To determine if Carolina received a greater percentage of its claim than it would have received had the transfer of January 17, 1989, not taken place and had the debtor's assets been liquidated and distributed in the chapter 7 proceeding, the trustee must show, by a hypothetical chapter 7 liquidation as of the petition date, that Carolina was put in a better position by receipt of the payment than it would have been had the transfer not taken place. 1 **Robert E. Ginsberg & Robert D. Martin, Bankruptcy: Text, Statutes, Rules** § 8.02[g] at 8-18 (3d ed. 1992).

As of the petition date, February 7, 1989, the total earned and minimum payments required to be paid by Best equal \$611,779. This amount is calculated by adding the \$409,937 in premiums due and paid as of the end of October, 1988, as shown on Exhibit 35, and then adding the November earned premium of \$67,900, the December earned premium of \$63,939, the January earned premium of \$57,650, and the pro rata premium for February up through the 6th day of February of \$12,353. From the \$611,779 which was actually due from Best as of the petition date must be subtracted the amount paid, exclusive of the January 16, 1989, payment of \$72,800 (the transfer in question). The difference is \$201,842. On the petition date, Carolina held, as security for premium payments, \$174,720. The difference between the amount due of \$201,842 and the security deposit of \$174,720 is \$27,122. This

is the amount which would have been the unsecured claim of Carolina as of the petition date if there had been a liquidation on the petition date. By receiving the \$72,800 payment in January of 1989, Carolina received full payment of its unsecured claim and, therefore, received more than it would have under a chapter 7 distribution. Gray v. A.I. Credit Corp. (In re Paris Indus. Corp., 130 B.R. 1 (Bankr. D. Me. 1991); Sichernan v. Massachusetts Mutual Life Ins. Co. (In re Serv. Bolt & Nut Co., Inc.), 97 B.R. 892 (Bankr. N.D. Ohio 1989); Armstrong v. John Deere Co. (In re Gilbertson), 90 B.R. 1006, 1010 (Bankr. D.N.D. 1988).

As a result of this analysis, it is clear that the trustee has met his burden with regard to all of the elements of 11 U.S.C. § 547(b) because, in addition to the above analysis, evidence was presented that the unsecured creditors in a hypothetical chapter 7 liquidation would not receive 100% payment of their claims.

2. 11 U.S.C. § 547(c)

A. Legal Framework

The Court must next consider whether the transfer of January 16, 1989, although preferentially made, may be excepted from avoidance. Section 547(c)(2) provides that a transfer may not be avoided to the extent that it 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 burden of proof is upon the defendant. Sichernan v. Massachusetts Mutual Life Ins. Co., 97 B.R. at 894.

In Lovett v. St. Johnsbury Trucking, 931 F.2d 494, 497 (8th Cir. 1991), the circuit court, quoting various cases, found that in attempting to make a determination of whether payments by the debtor during the ninety-day period prior to the petition were made in the ordinary course of business, a trial court must engage in a "peculiarly factual" analysis and must make findings that the creditor has demonstrated some consistency with other business transactions between the debtor and the creditor.

Recently, the circuit court, in the case of Jones v. United Sav. and Loan Ass'n. (In re USA Inns of Eureka Springs, Arkansas), 9 F.3d 680 (8th Cir. 1993), determined that for a payment to qualify under the exception of § 547(c)(2), the transferee must prove by a preponderance of the evidence that the

debtor incurred the underlying debt in the ordinary course of business of the debtor and the transferee, that the transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee and that the transfer was made according to ordinary business terms. Evidence is required on each of the elements and, concerning the "ordinary business terms" element, the transferee must present evidence on the ordinary business terms in the industry, which is a separate and discreet inquiry from the practice between the parties. Id. at 684. Section 547(c)(2)(C) does not require a creditor to establish the existence of some uniform set of business terms within the industry in order to satisfy the burden. According to the court, it requires evidence of a prevailing practice among similarly situated members of the industry facing the same or similar problems. The trial court should determine whether the terms between the parties were particularly unusual in the relevant industry and should deem Section 547(c)(2)(C)'s burden as met if evidence is presented of a prevailing practice among similarly situated members of the industry facing the same or similar problems. Id. at 685.

B. Facts

Although monthly premiums were to be paid beginning on the 15th day of June, 1988, and the 15th day of each month thereafter, the first monthly payment was made June 20th. The next payment was made July 21st. The next payment was made August 30th. The next payment was made September 20th. The next payment was made September 30th. The next payment was made October 25th. The last payment prior to the transfer was made November 21. It is clear that, notwithstanding the contractual terms requiring payment by the 15th day of the month following the month the insurance coverage was provided, the practice between the parties from day one was to permit late payments. No notice of cancellation or demand for payment on a more timely basis was given by either Gateway or Carolina to Best from the beginning of the term, May 13, 1988, through December 28, 1988.

The letter of December 29, 1988, Exhibit 23, was from Carolina to the president of Best in response to a letter from Best to Carolina discussing the potential reduction in premium which would result from a renegotiation of the contract terms. In the correspondence from Best to Carolina, the president of Best explained that although no demand for payment had been made by either Gateway or Carolina, Best wanted everyone to understand that the only reason payment had not been made was because of the ongoing negotiations and the likelihood that premiums would be significantly reduced. At trial, the president of Best also testified that the monthly payment due for November was not

timely made because of the renegotiation process which was then ongoing as represented by letters between the various parties admitted into evidence as Exhibits 18, 19, 20, 21, 37 and 39.

The responsive letter from Carolina to Best dated December 29, 1988, Exhibit 23, which informed Best of its contractual requirements with regard to payment was followed by a meeting between the owner of Best, the Gateway agent and Carolina officials at the headquarters of Carolina on January 9, 1989. The result of that meeting was an actual modification of the contract effective November 1, 1988, which reduced the minimum monthly payment and changed the formula for determining the actual earned premium. Seven days after that meeting which changed the terms of the contract, Best paid \$72,800 to Carolina.

A representative of Gateway testified at the trial that it was not unusual in the industry for monthly installment payments on a minimum payment contract to be delayed or deferred pending a renegotiation of the contract terms with regard to such minimum payments. He further testified that the delay in payment, from his point of view as the agent in charge of administering the contract, collecting the payments on behalf of Carolina and being the organizational buffer between the insurer, Carolina, and the insured, Best, was not out of the ordinary in the industry.

From and after some point in November of 1988, this insurance contract was under renegotiation or restructuring. It was apparent to all parties that the projected monthly gross revenues upon which the minimum monthly and minimum annual payment as well as the formula for the monthly earned premiums was based was not realistic. All parties agreed that the numbers needed to be reprojected, substantiated and the payment amounts renegotiated. The renegotiation culminated at the meeting of January 9, 1989. The renegotiated contract terms were retroactive to November 1, 1988, and a totally new payment structure was put in place. Within approximately one week after the restructured agreement was put in place, the transfer under consideration in this case was made.

There is no question that the obligation to pay an amount due for insurance coverage in November was incurred in the ordinary course of business of all of the parties. The evidence recited above leads this Court to conclude that the payment made on January 16, 1989, was, due to the nature of the renegotiation of the contractual obligation of Best, in the ordinary course of business of both Best and the insurance agency and the insurance carrier. Finally, the testimony of the representative of Gateway is un rebutted that the delay in payment during a renegotiation is not unusual or out of the ordinary in the industry.

Conclusion

The trustee has met his burden to show that the transfer on January 16, 1989, was preferential. He has met all of the elements of 11 U.S.C. § 547(b). However, the transferees have met all of the elements of the exception to avoidance under 11 U.S.C. § 547(c)(2). Therefore, the transfer is not avoided and judgment will be entered in favor of the defendants and against the trustee.

Separate journal entry shall be entered.

DATED: July 8, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copy faxed by Court to:

BALLEW, JOHN JR.

8-402-475-9515

Copies mailed by Court to:

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United States Trustee

Movant (*) is responsible for giving notice of this journal entry to all other parties (that are not listed above) if required by rule or statute.

