11 USC § 548
11 USC § 550
ORS 95.220

Mitchell v. Pacificorp Credit, Inc. Adv. No. 92-3384-S

In re Hanna Case No. 390-33990-S11

11/18/93 DDS unpublished

The trustee sued Pacificorp for transfers totalling over $600,000. The trustee claimed that the payments were avoidable as preferences or fraudulent transfers, that they were made within one year of the chapter 11 filing and that the transfers benefitted an insider creditor, HAC.

On cross motions for summary judgment, the bankruptcy court found that the debtor received adequate value for the transfers and dismissed the fraudulent transfer claims.

The court found that Pacificorp was the initial transferee of the funds. The transfer agent that received the funds from the debtor and paid them to Pacificorp was merely a conduit, and not the initial transferee. The insider creditor that was benefitted by the transfers reduced the balance on it's claim against the debtor by the amount of the transfers, but it never had control of the money.

The settlement between the Hanna estate and the chapter 11 estate of the insider creditor did not constitute a single satisfaction of the claim.

The motions were granted in part, and the remaining issues were set for trial. (Outcome of trial is in P94-1(14).

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re: DANIEL C. HANNA, et al, Debtors, JOHN MITCHELL, INC., Trustee of the Hanna Liquidating Trust, Plaintiff, v. PACIFICORP CREDIT, INC., an Oregon corporation, Defendant.	)	Bankruptcy Case Nos. 390-33990-S11 390-34210-S11 390-34211-S11 Adversary Proceeding No. 92-3384-S MEMORANDUM GRANTING IN PART AND DENYING IN PART CROSS-MOTIONS FOR SUMMARY JUDGMENT

The trustee under a confirmed plan sued Pacificorp to recover money represented by prepetition checks signed by the debtor, Daniel C. Hanna ("Hanna"). Hanna wrote the checks on various accounts to pay debts which he and Hanna Acceptance Corporation ("HAC") owed to Pacificorp Credit Inc. (Pacificorp). Mitchell claims that the payments were either

fraudulent conveyances or preferential transfers. He seeks to recover the transfers from Pacificorp as the initial transferee of the funds under 11 U.S.C. § 550.[1]

Pacificorp filed a motion for summary judgment, and the trustee filed a cross-motion for partial summary judgment. Pacificorp's motion for summary judgment should be granted as to count five, the fraudulent transfers. There remain genuine issues of material fact which must be tried concerning the recovery of the preferential transfers, so the balance of the motion must be denied. Portions of the trustee's motion for partial summary judgment should be granted, and trial scheduled for counts three and four. My reasons and specific rulings follow.

Pacificorp made four distinct loans to Hanna and HAC. It made two loans directly to Daniel Hanna. Payments on those loans are no longer an issue in this case, because the court dismissed counts one and two of the second amended complaint as time barred by order entered February 26, 1993.

On July 28 and August 3, 1987, Pacificorp loaned money to HAC through the purchase of a $4 million and a $1 million Series B commercial note of HAC. Those notes are collectively referred to as Note 4. Eighteen months later, on October

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[1] Unless otherwise specified, all statutory references are to the Bankruptcy Code, 11 U.S.C. § 101 et. seq.

22, 1988, Pacificorp loaned another $2,250,000 to HAC. That loan is referred to as Note 3. As part of the Note 3 transaction, Daniel Hanna executed a guaranty dated October 20, 1988. The guaranty obligated Hanna for both Note 3 and Note 4.

Mitchell claims that the guaranty and any payments made by Hanna to reduce his liability on the guaranty are fraudulant transfers under §§ 544(b) and 548(a) because Hanna did not receive reasonably equivalent value for incurring the underlying obligation. However, the payments at issue did more than reduce Hanna's contingent liability on the guaranty to Pacificorp. Hanna had an independent obligation to HAC because HAC loaned him the proceeds of both Note 3 and Note 4. By receiving the money from HAC, Hanna received adequate consideration to support the repayment of the obligations to HAC. When Hanna wrote checks to Pacificorp, HAC reduced the outstanding balance on Hanna's debt to HAC.

In addition, Hanna received reasonably equivalent value for the guaranty of Note 3 as the intended beneficiary under third party contract principles. He executed the guaranty simultaneously with the note, and he received the proceeds of the loan directly from the escrow company. The parties have not located a note to document that the transfer of the Note 3 proceeds to Hanna was a loan from HAC to Hanna. However, the deposition testimony, the ledgers supplied to the court, and

the fact that Hanna made payments on the loans lead to the conclusion that HAC loaned Hanna the Note 3 money. See, Ray v. City Bank and Trust Co. (In re C-L Cartage Co.), 899 F.2d 1490 (6th Cir. 1990).

HAC loaned the proceeds from Note 4 to an entity called Hanna Franchise Development Corporation. This was in fact a loan to Hanna. Daniel Hanna guaranteed the loan from HAC to Hanna Franchise by a written guaranty dated June 30, 1987. Hanna frequently created different names for his business activities, and thereafter ignored any separate existence that may have been initially intended. The disclosure statement described this practice. The plan and a later order covering the Hanna Auto Wash companies officially recognized this conduct by substantively consolidating, for all purposes, the chapter 11 estate of Daniel Hanna with his corporate and non-corporate businesses other than HAC.

The substantive consolidation eliminated any argument that the Hanna businesses were separate entities. Therefore, a loan to Hanna Franchise Development Corp. must be considered to be a loan to Daniel Hanna and a check from Hanna Auto Wash-Memphis must be considered to be a transfer of property of Hanna. Gill v. Sierra Pacific Construction, Inc. (In re Parkway Calabasas Ltd.), 89 Bankr. 832 (Bankr. C.D. Ca. 1988), aff'd and adopted at 949 F.2d 1058 (9th Cir. 1991). Nothing in

the plan or order exempted these transfers from the effects of substantive consolidation.

Since the payments on Note 3 and 4 reduced Hanna's direct obligation to HAC, he received adequate value under § 548(d)(2)(A) and O.R.S. 95.220(1). As a result, the transfers are not avoidable as fraudulent transfers under § 548 or ORS 95.230(b), 95.240(1), and § 544, and count five of the complaint should be dismissed.

Mitchell alternatively sought to recover the payments as preferential transfers. The transfers at issue were in the form of checks Hanna wrote on accounts held in the name of Hanna Distribution Center, Hanna Car Wash International, Hanna Car Wash International-Alaska, and Hanna Auto Wash-Memphis, Inc. As discussed above, the money in the accounts was Hanna's because the entities listed on the checks were substantively consolidated with Hanna in the confirmed plan.

Hanna made the payments at issue more than 90 days and less than one year before filing chapter 11. To recover a transfer made during the extended preference period allowed by § 547(b)(4)(B), the transfer must have been made for the benefit of a creditor that was an insider. At all relevant times HAC was an insider of Hanna, and Pacificorp was not an insider of either Hanna or HAC.

Because the payments from Hanna to Pacificorp reduced

his liability to HAC, the transfers were made for the benefit of HAC who was an insider creditor. HAC was Hanna's creditor because it loaned the Note 3 and 4 money to Hanna. HAC received a benefit when Hanna wrote checks to Pacificorp because the payments reduced HAC's liability to Pacificorp on Notes 3 and 4. Therefore, this is not a "reverse Deprizio" case as Pacificorp argued based on the interpretation in this district of the tax section of Deprizio. Hostmann v. First Interstate Bank of OR. (In re XTI Xonix Corp), 156 Bankr. 821 (Bankr D. Or. 1993) and Levit v. Ingersoll Rand Financial Corp., (In re V.N. Deprizio Construction Co.), 874 F.2d 1186, 1191-92 (7th Cir. 1989).

To the extent that the transfers are avoidable under § 547, they may be recoverable from Pacificorp under 11 U.S.C. § 550. Official Unsecured Creditors Committee v. U.S. National Bank of Oregon (In re Suffola, Inc.), 2 F.3d 977 (9th Cir. 1993). The trustee must establish all of the elements of 11 U.S.C. § 547(b) as to HAC. Pacificorp is entitled to assert any defenses that HAC would have under 11 U.S.C. § 547(c). Harrison v. Brent Towing Co., Inc., (In re H & S Transportation Co., Inc.), 939 F.2d 355 (1991).

Pacificorp argued that, for purposes of § 550(a), it is not the initial transferee of the Note 4 transfers and that, for purposes of § 550(c), Mitchell already received a

satisfaction through the settlement between the Hanna and HAC estates that was included in their confirmed plans of reorganization.

Pacificorp was the initial transferee of all of the payments involved. The checks for Note 3 were written on Hanna checking accounts and payable to Pacificorp. The checks for Note 4 were written on Hanna checking accounts and payable to U.S. National Bank ("USNB"). USNB was the paying agent for HAC on the commercial notes. USNB had very limited and restricted authority under the Paying Agreement. It was to receive and disburse the principal and interest payments on the HAC commercial notes.

USNB was a conduit, and not the initial transferee of the money. Pacificorp argued that because USNB was HAC's agent that HAC was the initial transferee. The trustee claimed that HAC had no control over the money, so Pacificorp was the initial transferee. The trustee is correct on this issue.

Pacificorp relied on the case of Lowry v. Security Pacific Business Credit, Inc. (In re Columbia Data Products, Inc.), 892 F.2d 26 (4th Cir. 1989). While close, there are some differences between the facts in Columbia Data and this case. The most significant differences are the additional layer of transferees involved in Columbia Data, and the fact that Logan, the direct creditor of the debtor, had physical

control over the transfer at issue. The transfers from Hanna to USNB were more like the transfers involved in C-L Cartage, 899 F.2d at 1493-94, and the cases distinguished by the court in Columbia Data.

HAC had no control over the four checks written to USNB. Even if an employee of HAC physically received the checks from Hanna and delivered them to USNB, HAC could not have negotiated the checks without someone forging them.

After USNB received the money, HAC could not get it back. USNB was only authorized to hold funds in an interest bearing account and to make contractually authorized payments to the registered owners of the commercial notes. The Paying Agreement could not be modified, revoked or terminated except upon the mutual consent of the parties. Resignation or removal of USNB would not be effective until sixty days after written notice was provided to the other party. Even upon termination, USNB was not authorized to return funds to HAC, but was required to deliver all funds it had to a designated successor paying agent. Any successor agent would be subject to the terms of the Paying Agreement.

Since HAC did not control the money, Pacificorp was the first creditor to have actual control and possession of the money transferred by Hanna for Notes 3 and 4. Pacificorp was the initial transferee of the checks, and HAC was a creditor of

Hanna that was benefitted by the transfers. In re Bullion Reserve of North America, 922 F.2d 544, 548 (9th Cir. 1991). To the extent avoidable, the trustee may recover the value of the property transferred from Pacificorp as initial transferee under § 550(a)(1). The trustee's motion for summary judgment on this issue should be granted.

Finally, Pacificorp claims that the Hanna estate received a satisfaction of the avoidable transfers or destroyed the underlying cause of action by the settlement with the HAC estate. Since the trustee is only entitled to a single satisfaction under § 550(c), and the entire basis for recovery under § 547 hinges on the transfer being avoidable against HAC, Pacificorp argues that there is nothing left to avoid. Avoidability and recoverability are two separate concepts. The post-petition settlement between the two estates does not necessarily destroy the avoidability of the transfer. As a result of the settlement, Mitchell could not recover the avoidable transfers from HAC, but the avoidability of the transfers was not affected when the recovery is sought from Pacificorp. Pacificorp is entitled to rely on the defenses available to HAC under § 547(c), but the settlement between the estate and another potential defendant is not within the scope of the defenses listed in that statute.

A preferential transfer is not a tort but a unique

cause of action created by the Bankruptcy Code. Pacificorp cites Sims v. DeArmond, (In re Lendvest Mortgage, Inc.), 123 Bankr. 623 (Bankr. N.D. Cal 1991) to support its argument. The statutes and cases analyzing the effect of a settlement by one joint tortfeasor as to a non-settling joint tortfeasor are not convincing authority in this case. Whether Mitchell settled with HAC or simply decided not to pursue HAC should not affect his right to recover from Pacificorp except to the extent the liability was satisfied. Pacificorp was not prejudiced by the settlement. Pacificorp's claim in the chapter 11 cases would increase by the amount Mitchell recovers in this case. Beyond those contractual rights as they are diluted by the bankruptcy filings, Pacificorp does not have a right of indemnity or contribution against HAC as another potential defendant under §§ 547 and 550. See, Edward M. Fox and James Gadsden, Rights of Indemnification and Contribution Among Persons Liable for Fraudulent Conveyances, 23 Seton Hall L.Rev. 1600 (1993). The fact that the § 547 recovery is linked to HAC as the insider does not render HAC primarily liable for the preference recovery under § 550 to Pacificorp's benefit.

The trustee claims that these avoidance actions were preserved by the language of Articles 13 and 14 of the Hanna plan. Those articles reserve to the trustee the right to commence adversary proceedings under the Code, and state that

nothing in the plan shall be construed to be a waiver of the trustee's avoidance powers or his power to recover improper payments. This language eliminates any argument that Pacificorp might be an intended beneficiary of the settlement under third party beneficiary principles.

The record is not adequate to find that Mitchell received a satisfaction of the preferential transfers at issue here. The settlement between the estates did not provide a specific payment from HAC to Mitchell for any particular claim. The cases cited by Pacificorp include some monetary recovery which provided the basis for finding a prior satisfaction for the transfers involved. See, In Re Lendvest Mortgage, Inc. 123 Bankr. 623.

Mitchell argued that the Hanna estate received no value from the settlement with HAC, so the Hanna estate has not recovered a satisfaction of the avoidable transfers at issue here. In effect, the settlement was a substantive consolidation of the assets for Canadian Imperial Bank of Commerce ("CIBC") and administrative claims, but not as to the unsecured creditors.

Pacificorp's position that Mitchell's Disclosure Statement valued the settlement at $2.6 million is not accurate. Pages 37 - 39 and exhibit F of the Trustee's Fourth Amended Disclosure Statement do not establish that the Hanna

estate received $2.6 million from the settlement. Exhibit F is a cash flow analysis which estimates that $2.6 million cash will flow into the Hanna estate from HAC. These funds would be the proceeds of CIBC's collateral. Exhibit F also shows that most of the money from HAC would be paid to CIBC. While there are circumstances where an after-the-fact allocation of a settlement fund would be unfair, exhibit F tends to support the trustee's position that the Hanna estate did not receive any payment from the settlement of the preference claims against HAC.

In a case between two insolvent estates, the parties are trading in bankruptcy dollars in the form of claims rather than real dollars. On the present record, I cannot conclude that the settlement provided the Hanna estate with a satisfaction of the transfers asserted in this lawsuit. Any other benefits suggested by Pacificorp, such as the elimination of attorney fees in litigation, do not constitute a satisfaction under § 550(c) in this case. At best, there remains a material issue of fact for trial of whether the trustee has already received a satisfaction of the transfers at issue.

Before Mitchell and HAC filed their chapter 11 plans, Mitchell caused the Hanna estate to file a proof of claim in the HAC chapter 11 in an unspecified amount. The exhibit

attached to the proof of claim stated that HAC received from Hanna transfers of property and money which may be avoidable as preferences and fraudulent conveyances. HAC filed a claim in the Hanna chapter 11 for $30,578,895.63, as to Daniel Hanna and for $12,777,526.44 as to Rub-A-Dub.

The HAC proof of claim referred to the security interest which it perfected against Hanna's property within 90 days of Hanna's chapter 11. That security interest was avoided as part of the settlement between the estates. Mitchell claimed that the Hanna estate did not receive any value from that part of the settlement because it was so clearly avoidable. The HAC proof of claim contended that HAC provided new value to Daniel Hanna and his related entities after June 15, 1990. The record is not adequate to do anything other than speculate that there may have been offsets or defenses considered in reaching the settlement. Pacificorp may rely on collateral securing HAC's claim or new value provided by HAC to Hanna after the transfers at issue as a defense to this suit.

A separate order will be entered which specifies the issues decided by this memorandum and those remaining for trial.

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DONAL D. SULLIVAN
Bankruptcy Judge

cc: Sarah J. Ryan
Richard C. Josephson
Janet M. Briggs