11 U.S.C. § 544(b)
contract interpretation
ORS 95.230
fraudulent conveyance
reasonably equivalent value

Wilbur-Ellis Company v. Desert Lake, Inc. (In re Western Empires Corporation), Adv. No. 93-3312 (D. Or. Jan. 25, 1993) (Perris, Bankr. J.) unpublished

Three corporate debtors in possession were part of a vertically integrated farming operation along with two nondebtors. All were also related through ownership. Each had agreed to assume various liabilities owed by the others to Wilbur-Ellis Company. The debtors in possession sought to set aside the assumptions of indebtedness and other payments to Wilbur-Ellis as fraudulent conveyances, both under § 544(b) and also solely under state law.

The court held that the claim based solely on state law was released prepetition. As to all the fraudulent conveyance claims, the evidence was insufficient to permit the court to quantify the economic benefits (both direct and indirect) and burdens assumed in connection with the assumption of obligations or payments. Accordingly, the parties seeking to set aside the assumptions of indebtedness and transfers failed to meet their burdens of proving lack of reasonably equivalent value.

A separate claim concerned the scope of a limitation on Wilbur-Ellis' collection rights under a subordination agreement. At the time the contract was formed, the parties had different perceptions concerning the scope of the limitation. The court concluded that Wilbur-Ellis' understanding should be given effect, as the other parties had reason to know of Wilbur-Ellis' belief concerning the scope of the agreement, and Wilbur-Ellis did not have reason to know of the other parties' understanding.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

<table>
<tr><td>In Re:

WESTERN EMPIRES CORPORATION,

Debtor.
____

WILBUR-ELLIS COMPANY, a
California corporation,

Plaintiff,

v.

DESERT LAKE, INC., an Oregon
corporation; DENNIS LOGAN;
LOGAN FARMS, INC., an Oregon
corporation; LOGAN
INTERNATIONAL, LTD., an
Oregon corporation; and
WESTERN EMPIRES CORPORATION,
an Oregon corporation,

Defendants.</td><td>Case Nos. 392-33738-P11;
392-33739-P11; and
392-33740-P11
(Administratively
Consolidated)

Administered Under
Case No. 392-33738-P11

Chapter 11

Adversary Proceeding
No. 92-3312-P

MEMORANDUM OPINION</td></tr>
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In this proceeding, Wilbur-Ellis Company ("Wilbur-Ellis") seeks to establish the amount of its claim against the debtors Western Empires Corporation ("Empires"), Logan Farms, Inc. ("Farms") and Desert Lake, Inc. ("Lake"), and obtain a money judgment against two nondebtors, Dennis Logan ("Logan") and Logan International, Ltd. ("LIL"). I will refer to all of the defendants collectively as the "Logan-related entities" or "related entities." Empires, Lake and Farms have filed counterclaims seeking to avoid alleged fraudulent conveyances. In addition, Empires, Lake and Farms contend that enforcing any judgment entered herein against Logan or LIL is a breach of a subordination agreement, and Empires seeks to enjoin Wilbur-Ellis from enforcing any judgment against those nondebtors.

I have jurisdiction to determine the amount of the claims against the debtors and the fraudulent conveyance counterclaims as core matters under 28 U.S.C. § 1334(b) and 157(b)(2)(B),(C),(H) and (O). To the extent the claims for relief are not core matters, they are related proceedings to which the parties have consented to my entering a final order.

I. BACKGROUND

Prior to 1988, Logan and various corporations in which Logan owned an interest conducted farming operations on property leased from The Prudential Insurance Company of America (Prudential). Wilbur-Ellis furnished some of the chemicals and fertilizer used in the operations.

In 1988, Logan organized Farms to acquire the farmland he and his corporations previously rented from Prudential. Logan owns 100% of the shares of Farms. The transaction closed in February of 1989. Farms made a down-payment to Prudential of $3.2 million, and Prudential took back three notes and three deeds of trust to secure the unpaid balance of the purchase price. The purchase was characteristic of the operations of the Logan-related entities in that the transaction involved assets and liabilities of related entities who were not parties to the agreement. There were two sources of money for the down-payment. The first was Dennis Logan, who loaned $3 million to Farms. Logan had borrowed that money from LIL, who had borrowed the money from the Oregon Public Employees' Retirement Fund. The balance of the down-payment came from money loaned by Empires to Logan. Ex. 20, p. 9.

The purchase price paid by Farms included approximately $1.4 million in rent which Lake and Empires owed Prudential at the time of the purchase. That rent debt was rolled into the purchase price paid by Farms, and Prudential released Dennis Logan, Lake and Empires from the past due rent obligations. Ex. 3, p. 30.

Farms leased a portion of the property to Empires (which is 81% owned by Logan) for $1 million per year[1]. Most of the potatoes grown by Empires on Farms' property are sold to LIL,

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[1] While the lease contemplated that there might be future adjustments of the rent, no such adjustments were made.

which is 100% owned by Logan. LIL uses the potatoes to manufacture french fries, its sole product.

Lake, which is a 100% owned subsidiary of Empires, leased the balance of the property from Farms for $1 million per year initially[2]. Lake owns no tangible assets other than its crops, and contracts with Empires for most of the services needed to grow its apple crop.

Farms acquisition of the property from Prudential marked the beginning of a series of complex agreements between the Logan-related entities and Wilbur-Ellis. Before Prudential would agree to sell the property to Farms, Prudential required that for five years Farms post a $1.6 million letter of credit guaranteeing Farms' annual payment to Prudential. Farms was able to meet this requirement through an agreement with Wilbur-Ellis whereby Wilbur-Ellis promised to guarantee reimbursement of up to $1.6 million paid by the issuer of the letter of credit (the "Prudential Guaranty") in exchange for Farms' agreement to pay Wilbur-Ellis a fee of $33,333.33 per month. Empires paid Wilbur-Ellis a total of $800,000 to satisfy Farms' guaranty fee obligation.

The inability of the Logan-related entities to pay their obligations to Wilbur-Ellis when due led to a 1989 Payment

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[2] As with the Empires lease, no subsequent adjustments were made to the annual lease payments.

Agreement, a 1990 Payment Agreement, a 1991 Payment Agreement and an amendment to the 1991 payment agreement which was executed in 1992. In addition, in 1990 Wilbur-Ellis agreed to provide a letter of credit guaranteeing payment of $1.5 million of LIL's debt to Stanchart Business Credit (Stanchart) and in 1991 Wilbur-Ellis agreed to subordinate its interest in crops and proceeds for the crop years 1991 and 1992 (the "Subordination Agreement") so that Empires could obtain additional operating credit from Pendleton Grain Growers ("PGG") and from Inland Empire Bank ("Inland"). These agreements will be discussed in greater detail in the analysis of the fraudulent conveyance claims.

On June 3, 1992, Empires, Lake and Farms each filed Chapter 11 petitions.

II. ISSUES

Based upon the December 7, 1992 stipulation of the parties, as modified by my order granting a Motion to Deem Amended Defendants' Counterclaims Alleging Fraudulent Transfer (entered contemporaneously with this ruling), the following issues remain in this adversary proceeding:

(1) Whether the enforcement of a judgment by Wilbur-Ellis against Logan or LIL constitutes a breach of the Subordination Agreement, and, if so, whether such enforcement should be enjoined.

(2) Whether the obligations of the Logan-related

entities assumed, guaranteed or secured by LIL under the various Payment Agreements (and Amendment thereto) are fraudulent conveyances which can be set aside under state law by Empires as a creditor of LIL.

(3) Whether the obligations of the Logan-related entities assumed, guaranteed or secured by Farms or Lake under the various Payment Agreements (and Amendment thereto) are fraudulent conveyances avoidable by Farms or Lake under § 544(b).

(4) Whether the payment of the Prudential Guaranty fees by Empires constituted a fraudulent conveyance avoidable by Empires under § 544(b).

I note that in its Trial Memo, Lake contends that it is entitled to attorney fees if it prevails. However, since that was neither designated as an issue in the Stipulation, nor covered by my order granting the Motion to Deem Amended Defendants' Counterclaims, I will consider any claims for attorney fees waived.

III. DISCUSSION

(A) Whether the enforcement of a judgment against Logan or LIL constitutes a breach of the Subordination Agreement, and, if so, whether such enforcement should be enjoined.

By April of 1991, Empires wanted to obtain additional credit from PGG and from Inland. To facilitate those loans, Wilbur-Ellis, PGG, Inland and Empires entered into an April 10, 1991 Subordination Agreement under which Wilbur-Ellis agreed to subordinate its interest in crops and proceeds for the crop years 1991 and 1992. In addition, Wilbur-Ellis agreed not to exercise its security interest in $750,000 of proceeds from Empire's 1990 potato crop and agreed to permit Empires to use those proceeds for producing its 1991 crop. Most importantly for the purposes of this litigation, Wilbur-Ellis agreed "to take no action against Western [Empires] which could in any way adversely affect Inland's [or PGG's] ability to recover" the extensions of credit. Ex. 12, p. 2 and 3.

Empires, Lake and Farms contend that enforcement of a judgment against either Dennis Logan or LIL falls within the contractual prohibition because of the management and marketing expertise of Dennis Logan and the interconnected business relationship between LIL and Empires, including a large account payable from LIL to Empires. In essence, they argue that for the purposes of the Subordination Agreement, the fates of LIL, Dennis Logan and Empires are inextricably bound, and therefore action against LIL or Logan is the type of action which would "<u>in any way"</u> adversely affect Inland's and PGG's ability to recover on their loans within the meaning of the Subordination Agreement.

The flaw with that argument is that it focuses on the wrong phrase. The key phrase describing the prohibited action refers to "actions <u>against Western [Empires]</u>." If the parties intended to prohibit actions against all the Logan-related entities, the Subordination Agreement could have so provided. For example, the 1991 Payment Agreement, Ex. 10, which was signed by Empires and Wilbur-Ellis the same month they signed the Subordination Agreement, carefully distinguishes between all members of the Logan-related entities collectively (which it refers to as the "Logan Group") and the individual members.

Empires argues that interpreting the contract as permitting actions against LIL and Logan would be unreasonable or would make the contract illusory because such actions would "financially cripple" Empires, thereby rendering the Subordination Agreement meaningless. Mr. Wright, who negotiated the Subordination Agreement on behalf of Inland, stated that he interpreted the agreement as prohibiting Wilbur-Ellis from doing anything that would interrupt the flow of funds to Empires. Richard Caplinger, who was involved in the negotiations on behalf of PGG, stated that PGG would not have provided financing to Empires if it knew the Wilbur-Ellis could proceed against LIL in the event of a default by a Logan-related entity.

Wilbur-Ellis' understanding of the scope of the prohibition is diametrically opposed to that of PGG and Inland. Wilbur-Ellis contends that the agreement should be interpreted as applying solely to actions against Empires. It argues that interpreting the agreement broadly would hamstring Wilbur-Ellis' ability to collect on the obligations owed by the other Logan-related entities. Mr. Thompson, who participated in the negotiations on behalf of Wilbur-Ellis, believed the language at issue only prohibited actions directed at Empires. He stated that Wilbur-Ellis would not have agreed to language which prohibited collection efforts against Logan and LIL.

Though the Subordination Agreement went through several drafts, each of which contained different versions of the prohibition at issue, all of the versions referred only to actions by Wilbur-Ellis against Empires. None of the versions referred to actions against related entities. During the negotiations, none of the parties suggested that the scope of the prohibition extended to actions against entities other than Empires. It therefore appears that the parties had materially different understandings as to the meaning of the language used. Empires, PGG and Inland had reason to know of the meaning attached by Wilbur-Ellis to the provision at issue because of the relevant provision's specific reference to only one Logan-related entity, Empires, rather than a reference to all the Logan-related entities. Wilbur-Ellis was innocent in this misunderstanding, reasonably believing that it was limiting its collection rights only as to the named entity.

The effect of such a mistake under these circumstances is covered by <u>Restatement (Second) of Contracts</u> § 20 (1981), which provides that

> (2) The manifestations of the parties are operative in accordance with the meaning attached to them by one of the parties if
>
> * * * *
>
> (b) that party has no reason to know of any different meaning attached by the other, and the other has reason to know the meaning attached by the first party.

Accordingly, Wilbur-Ellis' understanding of the provision at issue will be given effect. Collection activities directed against LIL and Logan are not prohibited by the Subordination Agreement.

Empires' request for an injunction prohibiting Wilbur-Ellis from enforcing any judgment against Logan or LIL was based upon the contention that enforcing the judgment would be a breach of the Subordination Agreement. Because the Subordination Agreement does not preclude enforcement by Wilbur-Ellis of its claims against Logan and LIL, Empires' request for an injunction barring enforcement of the judgment must be denied[3].

(B). <u>Whether the obligations of related entities assumed, guaranteed or secured by LIL are fraudulent conveyances which can be set aside under state law by Empires as a creditor of LIL.</u>

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[3] Neither PGG nor Inland were parties to this proceeding. That fact must be considered in evaluating whether this ruling has any preclusive effect as to them.

Had this counterclaim been raised by the pleadings at the time the Motion for Summary Judgment was filed by Wilbur-Ellis, I would have granted summary judgment against Empires on this issue. This counterclaim is covered by the releases of the 1991 Payment Agreement. In paragraph 5 of that agreement, the plaintiff and all defendants each "unconditionally" released each other from "any and all claims and causes of action of every kind, nature or description whatsoever for events occurring prior to the date hereof."

Empires argues that LIL's assumption, guaranty or securing of related entities' liability occurred contemporaneously with execution of the 1991 Payment Agreement, and therefore is not within the ambit of the release because it is not based upon events "occurring prior to the date" of the release. That argument fails because the release is restated in a subsequent document, the January 21, 1992 Amendment to 1991 Payment Agreement. In paragraph 8 (a), Empires reaffirmed all the terms, covenants, conditions and obligations contained in the 1991 Payment Agreement. The releases were one of the terms, covenants and conditions so reaffirmed. Further, in ¶8 (b) Empires

> irrevocably and unconditionally release[d] WILBUR-ELLIS and each of its present and former officers, directors, agents, employees and affiliates, from any and all claims and causes of action of any kind, nature or description whatsoever (whether direct or

> derivative ...) for events occurring prior to the date of this Amendment.

I therefore conclude that any fraudulent conveyance claim arising from LIL's assumption, guaranty or securing of a related entities' debt occurred prior to Empires' release of claims against Wilbur-Ellis, and therefore the release is a valid defense to Empires' fraudulent conveyance claim against Wilbur-Ellis.

(C). <u>Whether the obligations of Logan-related entities assumed, guaranteed or secured by Farms or Lake under the various Payment Agreements are fraudulent conveyances avoidable by them under § 544(b).</u>

Section 544(b) provides:

> The trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

In its opening argument, the plaintiff contended that my November 3, 1992 Findings and Conclusions determined that this claim was within the scope of the releases described above. That is incorrect. In finding of fact number 24, I held that "[t]he releases, however, do not limit in any way the rights of Desert Lake, Logan Farms or Western Empires, in their capacity as debtors in possession, or of a trustee for such defendants, to assert claims, if any, against plaintiff pursuant to 11 USC § 544(b), 548(a) or 550." That is because the trustee or debtor in possession is considered an entity distinct from the debtor, and is given the power to pursue such claims under title 11 of the United States Code. I am aware of no authority which would permit a prepetition debtor to waive or release future causes of action which might arise under title 11, as such causes of action do not belong to the prepetition debtor, but are vested in the debtor in possession or trustee.

The state law provision relied upon by Lake and Farms to avoid their own obligations for debts of other Logan-related entities is ORS 95.230, which provides:

> (1) A transfer made or obligation incurred by a debtor is fraudulent as to a creditor, whether the creditor's claim arose before or after the transfer was made or the obligation was incurred, if the debtor made the transfer or incurred the obligation:
>
> . . .
>
> (b) Without receiving a reasonably equivalent value in exchange for the transfer or obligation, and the debtor:
>
> (A) Was engaged or was about to engage in a business or a transaction for which the remaining assets of the debtor were unreasonably small in relation to the business or transaction; or
>
> (B) Intended to incur, or believed or reasonably should have believed that

the debtor would incur,
debts beyond the debtor's
ability to pay as they
become due.

(1) Did Farms Have Unreasonably Small Assets or Intend to Incur Debts Beyond Its Ability to Pay?

Farms has failed to meet its burden of proving the elements of ORS 95.230 (1)(b)(A) and (B) which require that at the time of the Payment Agreements, Farms: (1) was engaged or was about to engage in a business or a transaction for which its assets were unreasonably small in relation to the business or transaction; or (2) intended, believed or should have believed that it would incur debts beyond its ability to pay as they became due.

Farms' sole reason for existence consisted of acquiring the real property at issue and leasing it to Empires and Lake. There is no evidence that its assets were unreasonably small in relation to those transactions. Upon consummation of the land purchase in February of 1989, Farms had an asset valued at $28 million, and had incurred an obligation of approximately $16 million, resulting in approximately $12 million equity. At the time of the petition, according to Farms' schedules (Ex. 17) its assets exceeded it liabilities by over $11 million. I cannot find that its assets were unreasonably small in relation to its business or transactions.

Nor can I find that Farms intended to incur debts beyond its ability to pay. The leases with Empires and Lake were set up to cover the debt service on the land. Ex. 20 at p. 10. Farms has not established that it knew or should have known its lessees would be unable to timely make the rent payments. Though Farms incurred additional debt in becoming jointly liable for the debt of related entities, the evidence is insufficient to find that Farms had cause to believe that it would be called upon to satisfy any of that debt. That is because the ability of the related entities to pay their obligations was dependent upon variables requiring a crystal ball to predict, such as the weather and fluctuations in the market price of apples and french fries.

Accordingly, I cannot find that at the time the various Payment Agreements were entered into, Farms intended to incur, believed or reasonably should have believed that it would incur, debts beyond its ability to pay as they become due. Having failed to meet its burden of proving those elements, Farms claim seeking to set aside its assumption of the related entities debt must be dismissed.

(2) Did Lake, Farms and LIL Receive Reasonably Equivalent Value?

The following discussion attempts to dissect the value given and received by Lake under the various agreements to determine whether reasonably equivalent value was received by

Lake. The discussion is intended to illustrate the difficulty in quantifying many of the benefits and burdens received or surrendered by all Logan-related entities under the agreements. Although the discussion focuses on Lake, the observations are equally applicable to the question of whether LIL or Farms received reasonably equivalent value, and provide an alternative basis for my conclusion that their agreements to assume joint liability on related entities' obligations are not fraudulent conveyances.

Lake asserts that it may avoid as fraudulent conveyances its liability for the obligations of its parent corporation (Empires), the sister corporations of its parent (LIL and Farms), and Logan because Lake did not receive reasonably equivalent value for the obligations assumed, guaranteed or secured.

It is well established that a transaction's benefit to the debtor "need not be direct; it may come indirectly through benefit to a third person." Rubin v. Manufacturers Hanover Trust Co., 661 F. 2d 979, 991 (2nd Cir. 1981). Courts have taken divergent approaches in analyzing reasonably equivalent value questions when the benefit flowed, not to the debtor, but to an entity so financially related to the debtor that an "identity of interests" exists.

One approach is that if an "identity of interests" exists between the debtor and the entity which received the benefit, then the debtor received reasonably equivalent value.

> 'If an alter ego situation presents sufficient consideration, then so should the guaranty of a loan to a third party that is not the alter ego of the guarantor but whose continued health and existence is vitally important to the guarantor - a vital supplier or customer, for example. Under this approach, fair consideration to the guarantor could be found without much difficulty when the loan to the affiliated corporation strengthens its operation sufficiently so that the health of the guarantor is maintained or improved, even though bankruptcy was not imminent.' Rosenberg, supra. at 245-246 (footnotes omitted). . . . . Contemporary corporate practices of vertically and horizontally dividing the integrated operations of what is essentially one enterprise among a number of legally distinct entities, making it necessary for financial institutions to frequently obtain 'upstream' and 'cross-stream' collateralizations, demand that a broad view of 'fair consideration' be taken.

Telefest, Inc. v. Vu-TV, Inc., 591 F. Supp. 1368, 1379-80 (D. N.J. 1984).

The Logan-related entities which are parties to this proceeding had an "identity of interests" at the time of the transactions at issue. There was a high degree of economic interdependence among the various related entities. Their individual success depended upon their collective success. Indeed, the whole theory and practice behind the structure of the Logan-related entities was that of vertical integration. Each entity was intended to serve, to one extent or another, as a buffer which would protect the other entities from what would otherwise be external, uncontrollable variables.

For example, Empires was a captive producer of LIL's raw material, potatoes. The price LIL paid (and Empires received) for potatoes was not necessarily tied to the market. When LIL made too much money one year, thereby placing it in a precarious tax position, it retroactively <u>increased</u> the price it paid to its potato supplier, Empires.

Logan Farms did not have to worry about tenants because it could count on Empires and Lake to rent the property. And Empires and Lake similarly did not need to worry about the availability of land to rent. Empires appeared to receive an additional benefit of below-market rental rate. <u>See</u> ex. 20, p.10. Its rent was structured to cover Farms' debt service to Prudential. <u>Id.</u>

Lake depended on Empires for labor and other essential services. Indeed, the Disclosure Statement filed in this case recites that "Desert Lake and Empires are interdependent in their operations and financial affairs." Ex. 21, p. 15.

The practice was that whichever Logan entity had the money at the time paid for the expenses of the related entities, and there did not appear to be much concern for settling up on accounts. Though the various intercorporate advances were usually booked, they were not always. For example, when Empires paid letter of credit fees on behalf of Farms, it was treated as an interest expense of Empires rather than an intercompany obligation. It was this type of activity which caused the court-appointed examiner to conclude that "[i]n a financial sense, the end result of this activity was to disregard corporate separateness ...." Ex. 20, p.3.

While it was and is theoretically possible for each Logan-related entity to survive without the others, they were not designed to operate that way, and the symbiotic relationship between the various entities cannot be ignored in determining whether reasonably equivalent value was received. I therefore find, as a result of the economic interdependency of the Logan-related entities, benefit to one necessarily benefitted the other to some degree, thereby resulting in an "identity of interests" between the Logan-related entities. If I took the Telefest approach to analyzing whether reasonably equivalent value was received, I would have to find that it was.

A stricter approach to analyzing indirect benefit in the context of a fraudulent conveyance action requires quantification of the effect of the indirect benefit to determine whether the debtor's net worth has been preserved.

> Thus, although these 'indirect benefit' cases frequently speak as though an 'identity of [economic] interest' between the debtor and the third person sufficed to establish fair

> consideration, see e.g. McNellis v. Raymond, supra, 287 F. Supp. at 238; In re Winslow Plumbing, Heating & Contracting Co., 424 F. Supp. 910, 914-15 (D. Conn. 1976), the decisions in fact turn on the statutory purpose of conserving the debtor's estate for the benefit of creditors.
> . . . .
> Accordingly, the court must attempt to measure the economic benefit, if any, that accrued to each bankrupt as a result of the third person's indebtedness, and it must then determine whether that benefit was "disproportionately small" when compared to the size of the security that the bankrupt gave and the obligations that it incurred.

Rubin, 661 F.2d at 992-93; see also In re Alexander Dispos-Haul Systems, 36 B.R. 612, 616 (Bankr. D. Or. 1983).

I believe that Rubin approach is more consistent than that of Telefest with the policy behind fraudulent conveyance law - an insolvent debtor cannot incur obligations or convey away its assets without receiving reasonably equivalent value. The quantification required by Rubin assures that a transfer or obligation which increases the extent of a debtor's insolvency will be an avoidable fraudulent transfer to the extent that the creditors are harmed. In cases involving financially interrelated entities the "identity of interests" test will often be met. Such "identity of interests" should not provide a basis on which one or more of the related entities can assume the obligations of and/or transfer assets to a related entity which has the effect of diminishing the potential recovery by the transferor's/obligor's creditors to less than payment in full. To allow such transfers/obligations on the mere basis of "identity of interests" would in essence allow related entities to freely pierce each others' corporate veils and substantively consolidate their finances even though such actions prejudice creditors who have relied upon the existence of separate entities.

No party attempted to quantify the benefits and burdens to each debtor of the various agreements, although that is what is required by the Rubin approach. Instead of providing the necessary evidence of value, the parties painted with a broad brush. Wilbur-Ellis relied primarily upon the fact that the Logan-related entities had an "identity of interest," and therefore could be presumed to have received reasonably equivalent value for the assumptions of liability of related entities. According to Wilbur-Ellis, the debtors bore the burden of proving that the value was not reasonably equivalent.

Lake, Farms and Empires took the opposite approach, arguing that if no direct value was provided in exchange for the assumption of a related entity's debt, the burden was on Wilbur-Ellis to show that any indirect value was reasonably equivalent to the obligation assumed.

The problem is that the various agreements provided the related entities with both direct and indirect benefits. I agree that this case must ultimately be decided on the basis of a lack of evidence of value of those benefits, which means that it comes down to which party bears the burden of quantifying both the direct and indirect benefits which flowed to each debtor under the agreement. I will first discuss the various agreements under which burdens were assumed, and explain my inability to evaluate the economic benefits and burdens conferred by those various agreements. I will then address the allocation of the burden of proof.

(a) The 1990 Payment Agreement

In the summer of 1990, LIL sought operating funds from Stanchart, which agreed to furnish LIL with a revolving credit facility of $2,500,000. However, Stanchart was unwilling to extend credit unless the obligation was guaranteed by a letter of credit supplied by Wilbur-Ellis. By agreement dated June 29, 1990, Wilbur-Ellis agreed to guarantee $1,500,000 of LIL's debt to Stanchart (the "Stanchart Guaranty"). Ex. 3, p. 17. At this point, Logan, Farms, Lake and Empires were in default under a 1989 Payment Agreement, Ex. 3, p. 2, and that debt needed to be restructured.

On July 1, 1990, the parties entered into a new payment agreement (the 1990 Payment Agreement). Unlike the 1989 Payment Agreement, which just covered the trade debt incurred by Empires and Lake, the 1990 Payment Agreement dealt with all the outstanding obligations to Wilbur-Ellis. In connection with the Stanchart Guaranty, LIL agreed to pay Wilbur-Ellis an annual fee of $15,000. In addition, LIL agreed to immediately draw $1,300,000 from Stanchart and pay that money to Empires on an outstanding debt. Empires, in turn, agreed to pay Wilbur-Ellis $1,100,000 on Empire's outstanding debt to Wilbur-Ellis.

The 1990 Payment Agreement restructured the existing payment schedule for the trade debt, thereby superseding the 1989 Trade Debt Payment Agreement. Ex. 3, p. 2. The 1990 Payment Agreement also provided that Wilbur-Ellis would continue to guarantee the Prudential letter of credit under the previously-agreed terms. However, the monthly fee of $33,333.33, which previously was payable only so long as Wilbur-Ellis was obligated on the Prudential Guarantee, now applied as long as either (1) the Stanchart Guaranty was in effect; (2) the Prudential Guaranty was in effect; or (3) the new trade debt payment schedule was not met. Ex. 3, p. 5 ¶ 4(d).

The 1990 Payment Agreement contains the following statement:

> (a) In order to induce Wilbur-Ellis to accept this Agreement, LIL, Empires, Farms, Lake and Logans ("Obligors"), represent and warrant to Wilbur-Ellis that :
> (1) Obligors' agreement hereunder reasonably may be expected to benefit Obligors either directly or indirectly.

Ex. 3, p. 12, ¶ 8.

The 1990 Payment Agreement was the first one which expressly provided that the LIL, Farms and Lake agreed to be jointly liable for their related entities' debts to Wilbur-Ellis. Under the 1990 Payment Agreement, LIL, Farms and Lake agreed to grant Wilbur-Ellis a security interest in all their assets to secure payment of the trade debt and debts arising out of the Stanchart Guaranty or the Prudential Guaranty. Logan granted Wilbur-Ellis a security interest in selected assets, but Wilbur-Ellis' right to proceed against Logan's assets was conditional. Ex. 3, p. 10. My attempt to quantify the burdens and benefits to Lake under the 1990 Payment Agreement yielded the following.

(i) <u>Value Surrendered by Lake</u>

Lake agreed to be jointly liable for the $15,000 annual Stanchart Guaranty fee.

Lake obligated itself for the $2.9 million in existing trade debt owed by Empires. However, that debt was to be immediately reduced by $1.1 million under ¶ 3(f) of 1990 Payment Agreement, so it appears that Lake actually assumed only $1.8 million in Empires trade debt. Lake also obligated itself for any future trade debt incurred by Empires pursuant to Wilbur-Ellis' agreement to extend credit to Empires. <u>See</u> ex. 3, p.9, ¶7.

Lake agreed to be jointly liable on the $33,333 monthly Prudential Guaranty fee for as long as Wilbur-Ellis guaranteed the letter of credit securing Farms' annual payment to Prudential. It is not clear how I should quantify this obligation's effect on Lake's net worth. Lake was never called on to pay this fee, and the actual risk to Lake's net worth was not explored.

Lake assumed joint liability for the $1.6 million contingent liability on the Prudential Guaranty and the $1.5 million contingent liability on the Stanchart Guaranty. Here, also, the actual impact to the debtor of such contingent obligations is difficult to quantify. "[T]o find the value of a contingent liability a court must determine the likelihood that the contingency will occur." Covey v. Commercial Nat. Bank of Peoria, 960 F.2d 657, 659 (7th Cir. 1992), petition for cert. filed, ___ U.S.L.W. ___. Where, as here, the debtor agrees to be liable for a contingent debt of another, the valuation should also take into account the likelihood that, even if the contingency occurs, the debtor will either not be called upon to honor the obligation[4], or, if called upon, will thereby obtain valuable contribution or indemnity rights.

While Wilbur-Ellis was ultimately called upon to honor both the Stanchart Guaranty and the Prudential Guaranty, those facts are not determinative of the value of the contingent

[4] It appears that LIL repaid Wilbur-Ellis for its loss on the Stanchart Guaranty, and therefore Lake suffered no loss even though the contingency occurred.

liability. That is because the determination of value (in this case, the likelihood of the contingency occurring) should be made as of the time of the transfer, rather than retrospectively. For example, if the debtor agreed to pay $1,000 and received in exchange gold bars with an equal value at the time, I do not believe that a subsequent drop in the price of gold would be relevant in determining whether the debtor received reasonably equivalent value.

The record provides me with an inadequate basis for evaluating, as of the date the contingent liability was assumed by Lake (1) the likelihood that the contingency would occur; (2) the likelihood that, if the contingency occurred, Lake would be called upon to meet the obligation; and (3) if Lake was called upon to meet the obligation, whether by doing so it would have acquired valuable rights of contribution or indemnity. Accordingly, the impact of the contingent liabilities on Lake's net worth cannot be determined.

Lake granted Wilbur-Ellis a security interest in all its assets. I do not know what Lake's assets were worth on the date of the 1990 Payment Agreement and the amount of prior secured claims, if any.

(ii) <u>Value Received by Lake</u>

In exchange for the above burdens, Lake obtained a new payment schedule and forbearance by Wilbur-Ellis in collecting its debt from Lake. While this portion of the agreement clearly had direct benefit to Lake, there is no evidence of the value, if any, of the benefit. The forbearance agreement permitted Lake to avoid litigation and continue operating, thereby saving litigation costs and preserving the going concern value of Lake. On the other hand, given Lake's ability to file a Chapter 11 bankruptcy, the benefit may have been minimal. However, filing a chapter 11 is no guarantee that high litigation costs will still not be necessary, as this case proves. In light of the above, the evidence is insufficient to permit quantification of the direct benefits of the forbearance.

Wilbur-Ellis agreed to extend credit to Lake "in such sums as shall be reasonably necessary and required to facilitate the growing of their crops." The time frame and maximum credit amounts are not specified, except that payment was to be made in accordance with set payment schedule which called for payment in full by November 30, 1992. This obligation to provide credit to Lake was a direct benefit which had some value, which was not quantified.

Lake obtained the direct benefit of having the other related entities assume its trade debt to Wilbur-Ellis. Here, too, the evidence is insufficient to permit quantification of the benefits.

Wilbur-Ellis' agreement to a new payment schedule for

Empires and to extend credit to Empires was of no direct economic benefit to Lake, but likely had indirect economic value to the extent it permitted Empires to continue providing Lake with goods and services on credit. These goods and services were essential to Lake, and came at a time when traditional lenders would not advance it funds because the apple crop had not reached sufficient maturity. I cannot evaluate the actual monetary value to Lake of this arrangement, but it appears to have been significant. Lake's need for credit was great in 1989 and 1990 because it was experiencing cash flow problems due to the Alar scare. The credit provided by Empires was interest-free, a real benefit.

For the same reason, facilitating the Stanchart loan to LIL was of no direct benefit to Lake, but may have indirectly benefitted Lake by keeping Empires healthy. The Stanchart Loan permitted LIL to pay Empires, which may have indirectly benefitted Lake.

Wilbur-Ellis' agreement to continue to guarantee payment on the Prudential letter of credit may have been of no value if Wilbur-Ellis was already obligated to continue the guaranty. That appears to be the case. See ex. 3, p. 35. However, the parties do not agree on whether Wilbur-Ellis could refuse to renew its guaranty of the Prudential letter of credit. If Wilbur-Ellis was not under a preexisting duty to renew the letter of credit, then its agreement to do so could have bestowed some indirect economic benefit to Lake. That is because the guaranty was necessary to assure that Lake's landlord, Farms, was not in default in its agreement with Prudential. If Farms went into default and Prudential foreclosed, it is possible that Lake's lease could have been terminated or continued on less favorable terms. Having Farms as a landlord was beneficial to Lake. Farms was a particularly indulgent landlord who never threatened to terminate the lease or invoke other remedies, even though Lake failed to pay its rent when due. I have no basis for quantifying this economic benefit.

Lake obtained rights to contribution or indemnity from the other joint obligors. Those rights were of direct benefit to Lake, and their importance in determining reasonably equivalent value cannot be understated. See In re Alexander Dispos-Haul Systems, 36 B.R. 612, 616 (Bankr. D. Or. 1983). The value of contribution or indemnity rights depends upon the financial ability of the codebtors to respond to a demand for contribution or indemnity. Id. at 616. The value against Farms was substantial because of the large amount of equity in the Farms property. The value of such rights against the other Logan-related entities is not so clear. While the value of those rights must be taken into account in determining whether Lake received reasonably equivalent value, the record provides me with no concrete basis for quantifying the value of those rights.

In light of the above, did Lake receive reasonably equivalent value for the obligations it assumed under the 1990 Payment Agreement? Answering that question with any degree of confidence is impossible under the present record, given the numerous benefits and burdens which flowed from the agreement, and their varied nature: immediate and remote, fixed and contingent, speculative and probable, real and illusory, concrete and intangible, direct and indirect, and, most importantly, quantified and unquantified.

(b) The 1991 Payment Agreement

By the time of the 1991 Payment Agreement, the outstanding trade debt attributable to goods and services provided by Wilbur-Ellis to Lake totalled $454,282.43. The amount of Empires trade debt to Wilbur-Ellis was $3,045,717.57, for a total trade debt of $3.5 million. The parties to the 1990 Payment Agreement wanted to set up a new payment schedule for the trade debt and to make other modifications to the 1990 Payment Agreement. On April 23, 1991, they entered in the 1991 Payment Agreement (ex. 10), which required Lake and Empires to deliver promissory notes to Wilbur-Ellis to be applied by Wilbur-Ellis against the outstanding trade debt. LIL was to cause Wilbur-Ellis to be relieved of its obligation under the Stanchart Guaranty on or before December 31, 1991. Farms was to relieve

Wilbur-Ellis of its obligations under the Prudential Guaranty on or before March 15, 1992.

The Recitals to the 1991 Payment Agreement include the following acknowledgements concerning the debt owed Wilbur-Ellis:

> 1.1 The Trade Debt is validly due, owing and immediately payable;
> 1.2 The Existing Security Documents are enforceable according to their terms.
> 1.3 No defenses, offsets or counterclaims exist with respect to the Obligations.

In paragraph 5 of the 1991 Payment Agreement, all parties to the agreement each unconditionally released each other from "any and all claims and causes of action of every kind, nature or description whatsoever for events occurring prior to the date hereof."

Paragraph 6 of the 1991 Payment Agreement, captioned "Unconditional Guaranty," provided as follows:

> 6.1 The Logan Group [defined as Dennis Logan, Empires, Lake, Farms, and LIL] unconditionally guarantees and promises to pay to [Wilbur-Ellis] when due and immediately upon demand all indebtedness, obligations and liabilities of every kind or character now or hereafter at any time owing by any member of the Logan Group to [Wilbur-Ellis] . . . .
>
> 6.2 The Logan Group acknowledges that each member's liability under this Agreement is (i) joint and several, (ii) absolute, continuing, unconditional and irrevocable and (iii) not contingent upon advance notice (except as expressly provided in Subsection 13.1) of or the enforceability of any Guaranteed Obligation.

The same difficulties discussed in connection with the 1990 Payment Agreement apply to evaluating the benefits and burdens of the 1991 Payment Agreement.

(i) Value Surrendered by Lake

On the burden side of the equation, Lake again assumed liability for Empire's trade debt to Wilbur-Ellis, which had grown to $3,045,717. It is questionable whether this actually affected Lake's net worth, as Lake may have been liable for Empire's future trade debt under the 1990 Payment Agreement.

The 1991 Payment Agreement contained a deferral of rights of contribution, indemnity or reimbursement until such time as all obligations to Wilbur-Ellis were paid. Again, no one tried to quantify the value of the rights which were deferred, and the fact that the rights were deferred, not unconditionally waived, makes it even more difficult to evaluate the loss of value to Lake.

Lake agreed to subordinate its intercorporate receivables and collection rights to the obligations owed Wilbur-Ellis. The financial impact to Lake from this provision is unknown.

Lake acknowledged that Wilbur-Ellis would not renew its guaranty of the Prudential letter of credit or the Stanchart letter of credit. To the extent this relieved Wilbur-Ellis of a preexisting contractual obligation to Lake, Lake gave up value. The parties disagree on whether Wilbur-Ellis had an obligation to continue renewing the letter of credit. My review of the documentation suggests that Wilbur-Ellis was contractually obligated to do so. See ex. 3, p. 35.

The 1991 Payment Agreement contained a release by Lake of claims against Wilbur-Ellis. Any attempt to value this would be sheer speculation on my part. The record provides no basis for making the determination.

Lake unconditionally guaranteed all obligations owed by related entities to Wilbur-Ellis. Considering the fact that Lake's obligations were already joint and several under the 1990 Payment Agreement, this assumption of obligations would not appear to affect Lake's net worth unless the earlier assumption of the related-entities' debt was somehow unenforceable. The provision whereby Lake waives notice of any amendment, modification or renegotiation of any terms or conditions or impairment of collateral may have some detriment, but I cannot quantify it.

(ii) Value Received by Lake

In exchange for the above, Lake received direct value in the form of Wilbur-Ellis' forbearance (Lake was in default) and a new payment schedule. That was of direct value to Lake, but I cannot quantify the value. To the extent it permitted Lake to avoid litigation expense, continue operating and preserve its going-concern value, the benefit may have been substantial. On the other hand, as noted in connection with the 1990 Payment Agreement, given Lake's ability to file a chapter 11 bankruptcy, as it ultimately did, the forbearance agreement may have been of minimal value.

Lake received an indirect benefit from Wilbur-Ellis' forbearance on collecting Empires trade debt, as Lake was jointly obligated on the Empires debt under the 1990 agreement. Also, as noted above, Empires provided Lake with goods and services on credit, so a benefit to Empires was an indirect benefit to Lake.

Wilbur-Ellis again agreed to guarantee the Prudential letter of credit, but only through March 15, 1992. This was a valueless promise if Wilbur-Ellis was already obligated to continue guaranteeing the letter of credit, a point concerning which the parties disagree.

Wilbur-Ellis agreed to release its agricultural services lien and to subordinate up to $850,000 of its existing consensual security interests to enable Empires to obtain financing for its '91-'92 crops. There is nothing in the record which indicates whether Wilbur-Ellis had any agricultural services liens on Lake's crops, and consequently, there is no basis for determining whether this provision benefitted Lake.

Wilbur-Ellis relinquished its right to receive the

$33,333 monthly Prudential letter of credit fee. Since Lake was obligated to pay this fee under the 1990 agreement, that provision was of direct benefit to Lake.

Wilbur-Ellis released Lake and the other Logan-related entities from any and all claims, except those obligations specifically contemplated by the agreement. This, too, appears to have had some value, although there is nothing in the record which would enable me to quantify that value.

Lake also obtained rights of indemnity and contribution to the extent such rights arose from new obligations created by the 1991 Payment Agreement. The value of those rights is unknown.

Just as I was unable to evaluate whether Lake received reasonably equivalent value for the obligations undertaken in the 1990 Payment Agreement, I am unable to evaluate the net effect of the 1991 Payment Agreement.

(c) The 1992 Amendment to the 1991 Payment Agreement

The 1991 Payment Agreement was amended on January 21, 1992 (the Amendment) to provide for the cure of certain defaults by LIL, Lake and Empires which occurred subsequent to the execution of the 1991 Payment Agreement. Paragraph 8 of the Amendment provided that

> Lake, Farms, LIL, Empires and Logan each:
>
> a. reaffirm all terms, covenants, conditions and obligations

> contained in the [1991 Payment] Agreement including the security interest created by the Existing Security Documents and each of the Security Documents, except as expressly modified by this Amendment.
>
> b. irrevocably and unconditionally release WILBUR-ELLIS ... from any and all claims and causes of action of any kind, nature or description whatsoever ... for events occurring prior to the date of this Amendment

(i) Value Surrendered by Lake

In this Amendment, Lake agreed to immediately pay Wilbur-Ellis the outstanding balance on a loan made by Wilbur-Ellis to Lake in late 1991. Since I do not know the terms of the referenced loan, I cannot tell whether this promise actually gave away any value or was simply an acknowledgement of a preexisting obligation.

Lake also agreed to pay Wilbur-Ellis $4,655.70 to cure Lake's default under the 1991 Payment Agreement. Since that was a preexisting obligation, I cannot find that Lake gave value by such an agreement.

Lake reaffirmed all terms of the 1991 Payment Agreement. This has no value, unless the earlier assumptions of liability in the 1991 Payment Agreement were not otherwise independently enforceable. Since I have not found a basis to invalidate the assumptions of liability in the 1991 Payment

Agreement, this provision does not appear to have an impact on Lake's net worth.

I note that at the time of the 1992 Amendment, the contingent liability on the Stanchart letter of credit had become fixed because Stanchart drew upon the letter of credit, which required Wilbur-Ellis to advance funds. However, LIL was required to reimburse Wilbur-Ellis for those losses immediately upon execution of the Amendment.

Lake unconditionally released Wilbur-Ellis from any claims for events occurring prior to the Agreement. I have no basis for quantifying whether this affected Lake's net worth.

(ii) Value Received by Lake

In exchange for the above, Wilbur-Ellis agreed to release the security assigned to it by Stanchart. There was no apparent value to Lake from this.

Wilbur-Ellis acknowledged that after the payments contemplated by the Amendment, no defaults would exist under the 1991 Payment Agreement. Since it is unclear whether such defaults existed, I cannot find, let alone quantify, value to Lake.

To the extent Lake did undertake any liabilities of related entities for which it was not previously obligated, Lake would have received contribution or indemnity rights with an unknown value.

The net effect on Lake's net worth of the 1992 Amendment, either individually or in conjunction with the 1990 and 1991 Payment Agreements, can only be described as inconclusive. Which leads me to the question of who failed to meet their burden of proof.

(d) Burden of Proof

The trustee or debtor in possession ordinarily bears the burden of proving a fraudulent conveyance by a preponderance of the evidence. Western Wire Works v. Lawler (In re Lawler), 141 B.R. 425, 429 (9th Cir. BAP 1992). In this case, Lake, LIL and Farms received direct benefits of real and significant economic value as a result of the various Payment Agreements. The burden of quantifying that value falls on the parties seeking to set aside the conveyances. They have failed to meet that burden.

In addition, there are the various indirect benefits that flowed to LIL, Lake and Farms under the various payment agreements as a result of benefits received directly by the related entities. Where the direct consideration for a transfer flows to a third party, at least one court, in dicta, considered shifting to the creditor the burden of going forward with evidence of the value of any indirect value received by the debtor. In re Royal Crown Bottlers of North Alabama, 23 B.R. 28, 31 (Bankr. N.D. Ala. 1982). However, those courts which have squarely addressed the issue have taken the approach that once the existence of indirect value has been established, the burden is on the party asserting that the conveyance was fraudulent to quantify the consideration. In re Lawrence Paperboard Corp., 76 B.R. 866, 876 (Bankr. D. Mass. 1987); see also In re Minnesota Utility Contracting, Inc., 110 B.R. 414, 419 (D. Minn. 1990). That burden is necessarily a difficult one to meet, as "it usually will be the task of establishing the value or lack of value of an intangible benefit - a difficult assignment." In re Royal Crown Bottlers of North Alabama, 23 B.R. 28 (1982).

In this case, Wilbur-Ellis has established that LIL, Farms and Lake received indirect benefits of real and significant economic value under the various Payment Agreements. Accordingly, the burden of proving that those benefits were not reasonably equivalent to the obligations incurred falls on the party seeking to set aside the assumption of obligations.

Lake argues at page 10 of its Trial Memorandum that "[i]t is not reasonable ... to impute a value of $4.65 million ($3.05 million of Western Empires' trade debt plus $1.6 million in guaranty liability in connection with the letter of credit) to Desert Lake's interest in continuing to deal with Western Empires, Logan Farms and Dennis Logan." As noted above, the actual impact upon Lake's net worth of the contingent obligations and the various benefits has not been established, and I cannot tell whether it is reasonable or not to impute reasonably equivalent value.

Lake next argues that its guaranty of Empire's debts was necessarily a fraudulent conveyance because under Rubin v. Manufacturers Hanover Co., supra., all upstream financial accommodations are necessarily for less than reasonably equivalent value. I do not read Rubin as establishing any conclusive presumptions or per se rules regarding value in three-sided transactions. Instead, Rubin stresses the importance of attempting to quantify the benefit conferred. Rubin, 661 F.2d at 993.

Lake next argues that the 1991 Payment Agreement was, on its face, "conspicuously lopsided." Lake Trial Memo at 11. However, in the same paragraph Lake bemoans the fact that "the Agreement provides no formula or method for determining consideration on a bilateral basis between Desert Lake and Wilbur-Ellis." Unfortunately for Lake, it bore the burden of providing a formula or method for quantifying the value of that consideration, and failed to do so.

Because the record provides an insufficient basis for quantifying both the direct and indirect economic benefits accruing to LIL, Lake and Farms under the various Payment Agreements and the Amendment, I must rule against the parties bearing the burden of establishing the absence of reasonably equivalent value. Those parties are Empires, Lake and Farms.

(4) <u>Whether the payment of guaranty fees by Empires constituted a fraudulent conveyance avoidable by Empires under § 544(b).</u>

Empires contends that it may avoid $800,000 in guaranty fees paid by it to Wilbur-Ellis under the Prudential Guaranty. Empires claims that it received no direct benefit in exchange for the transfers, which it contends were solely for the benefit of Farms. As I discussed earlier, I have found that indirect benefit flowed to Empires as a result of the benefits conferred to its related entities. Empires bore the burden of quantifying that benefit and showing it was not reasonably equivalent to the $800,000 it paid. Further, though not booked as an intercompany receivable, the payment gave rise to a right of offset by Empires on its rent obligations to Lake, and therefore reasonably equivalent value could be found.

Empires next contends that the amount of the fee was excessive. While the nominal rate charged was 25%, the actual rate was 16.67% because during the third year, Wilbur-Ellis waived the guaranty fee. Based upon the expert testimony of Arthur Eby, a consultant with 41 years experience in the surety field, which included the setting of rates, I conclude that the actual rate of 16.67% was reasonably equivalent to the prevailing rates.

CONCLUSION

Under the express language of the Subordination Agreement, Wilbur-Ellis was precluded from taking action "against Western [Empires]." It was not precluded from taking action against LIL or Logan. Therefore, Wilbur-Ellis may seek to collect from Logan or LIL without breaching the Subordination Agreement, and will not be enjoined from doing so.

Empires has released any state law fraudulent conveyance claim it had against Wilbur-Ellis arising from LIL's assumption, guaranty or securing of any Logan-related entities' obligations.

Lake, Farms and Empires have failed to meet their burdens of establishing less than reasonably equivalent value was received in exchange for the assumptions of indebtedness under the various Payment Agreements and Amendment. Meeting that burden requires quantification of the value surrendered and received, and the record is insufficient for such quantification. In addition, Farms has failed to establish that it was engaged or was about to engage in a business or a transaction for which its assets were unreasonably small in relation to the business or transaction; or that it intended, believed or should have believed that it would incur debts beyond its ability to pay as they became due.

Finally, Empires has failed to meet its burden of proving that the guaranty fees were excessive or that the indirect benefits it received under the various Payment Agreements were not reasonably equivalent to the guaranty fees it paid on behalf of Farms.

ELIZABETH L. PERRIS
Bankruptcy Judge

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