NOT FOR PUBLICATION IN WEST'S BANKRUPTCY REPORTER:

Case: Webster v. E.I. Kane Constr., Inc. (In re NETtel Corp., Inc.)

Decision: Decision re Granting Plaintiff's Motion for Summary Judgment in Part, Denying Plaintiff's Motion for Summary Judgment in Part, and Denying Defendant's Motion for Summary Judgment

Decided: November 8, 2004.

Attorneys:

Linda M. Correia for plaintiff

Craig D. Roswell for defendant

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF COLUMBIA

In re	)	
	)	
NETTEL CORPORATION, INC. and NETTEL COMMUNICATIONS, INC.,	)	Case No. 00-01771 (Chapter 7)
	)	
Debtors.	)	(Jointly Administered)
	)	
_____	)	
	)	
WENDELL W. WEBSTER, TRUSTEE,	)	
	)	
Plaintiff,	)	
	)	Adversary Proceeding
v.	)	No. 02-10016
	)	
	)	
E.I. KANE CONSTRUCTION, INC.,	)	
	)	
	)	
Defendant.	)	

DECISION RE GRANTING PLAINTIFF'S MOTION
FOR SUMMARY JUDGMENT IN PART, DENYING
PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT IN PART,
AND DENYING DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

This is a preference action under 11 U.S.C. § 547. Under consideration is a motion for summary judgment by the chapter 7 trustee ("plaintiff"), and a motion for summary judgment by E.I. Kane Construction, Inc. ("defendant"). The defendant does not dispute the plaintiff's allegation that the transfer at issue was made on account of an antecedent debt owed by the debtor before the transfer was made, that the transfer was made while the debtor was insolvent, or that the transfer was made during the 90-day preference period. Consequently, the court will grant the plaintiff's motion as to §§ 547(b)(2),(3), and (4). As to

the remaining two elements of § 547(b) (that is, § 547(b)(1) and § 547(b)(5)), the court determines below that summary judgment in the plaintiff's favor is appropriate as to § 547(b)(1) and that partial summary judgment is appropriate in the plaintiff's favor as to § 547(b)(5). The court also determines below to deny the parties' motions for summary judgment as to the defendant's affirmative defenses under § 547(c)(2) (addressed by both motions) and § 547(c)(6) (addressed by only the defendant's motion).

The defendant is a general contractor specializing in commercial interior construction and building renovation. Commencing in 1998, NETtel, the debtor in these proceedings,[1] entered into several prepetition agreements with the defendant for various tenant improvement and building renovation projects. The payment that is the subject of this dispute was received by the defendant on August 4, 2000 in connection with three applications for payment on two jobs ("August 4 payment"). Each application for payment was over 100 days outstanding. $2,455 of the August 4 payment was applied toward Job 200 (work done at 1023 31st Street), and $108,640 was applied toward Job 213 (work done at 2000 M Street). The plaintiff seeks to avoid the August

[1] There are two debtors in this chapter 7 case: NETtel Corporation, Inc. and NETtel Communications, Inc. For ease of discussion, the court will not distinguish between the two debtors, and its references to 'NETtel' or 'debtor' should be taken as meaning either one or both of the debtors.

4 payment as a preference under § 547(b), and the defendant seeks to invoke the ordinary course of business and statutory lien defenses, under, respectively, § 547(c)(2) and § 547(c)(6).

I

As to § 547(b)(1), the defendant argues first that the August 4 payment was not made “to or for the benefit of” the defendant because the funds were at all times held by the defendant in trust for the benefit of the subcontractors (either by operation of law or by virtue of the defendant’s contractual obligations to the subcontractors). According to the defendant, it would elevate form over substance to suggest that the payments were made “to or for the benefit of” the defendant where the defendant functioned merely as a conduit between the debtor and the real transferees (that is, the subcontractors). Consequently, the defendant argues that the court should not view the transfer as having been made “to or for the benefit of” the defendant within the meaning of § 547(b)(1).

Because § 547(b) is drafted in the disjunctive, the court will consider only the argument that the payment was not made <u>to</u> the defendant: because, as the court finds below, the payments were made to the defendant, the court need not determine whether the transfer was made for the defendant’s benefit.

The defendant’s argument urges a distinction, for the purposes of § 547(b)(1), between a ‘transferee’ and a mere

'recipient.' If by to the creditor, Congress meant to implicate only transferees and not mere recipients, and if the defendant here were a mere recipient, then the transfer would not have been "to the defendant" as contemplated by § 547(b)(1). The distinction between a transferee and a mere recipient is recognized elsewhere in the Bankruptcy Code. Courts interpreting § 550(a)(1) have held that an individual is not an initial transferee where the individual functions as a mere conduit between the debtor and a third-party. E.g., Lowry v. Security Pac. Business Credit, Inc. (In re Columbia Data Products, Inc.), 892 F.2d 26, 28 (4th Cir. 1989); Bonded Financial Servs., Inc. v. European Am. Bank., 838 F.2d 890, 893 (7th Cir. 1988). Moreover, where an initial recipient or payee has no dominion or control whatever over the funds transferred, the recipient will not be liable under § 550(a)(1) as an initial transferee if the trustee succeeds in a preference action. E.g., Christy v. Alexander & Alexander of New York Inc. (In re Finley, Kumble, Wagner, Heine, Underberg, Manley, Myerson & Casey), 130 F.3d 52 (2d Cir. 1997) (insurance agent not transferee); Luker v. Reeves (In re Reeves), 65 F.3d 670 (8th Cir. 1995) (corporate shell not transferee); Malloy v. Citizens Bank of Sapulpa (In re First Sec. Mortg. Co.), 33 F.3d 42 (10th Cir. 1994) (bank receiving deposit not transferee); Kaiser Steel Resources, Inc. v. Jacobs (In re Kaiser Steel Corp.), 110 B.R. 514 (D. Colo. 1990) (brokerage firm not

transferee); Gropper v. Unitrac, S.A. (In re Fabric Buys of Jericho, Inc.), 33 B.R. 334 (Bankr. S.D.N.Y. 1983) (law firm maintaining escrow account not transferee); 5 Collier on Bankruptcy ¶ 550.02[4][a] (15th ed. rev. 2002). This court, therefore, finds persuasive the defendant's argument that if the defendant were a mere conduit, exercising no dominion or control over the subject funds, the defendant would not be a transferee, and the transfer would not be 'to a creditor,' as contemplated by § 547(b)(1).

Here, however, the defendant admits that some portion of the funds transferred from the debtor to the defendant is typically retained by the defendant as payment for the project manager or as profit. (Def. Motion, at 6, Exh. 2, at 17.) In addition, the defendant exercises dominion over those funds by using the funds to discharge its contractual obligations to its subcontractors. Columbia Data Products, Inc., 892 F.2d at 29 (transferee used funds to reduce debt owing to third party; "[t]he fact that [the transferee] could not have used the funds for other purposes does not affect this critical factor").[2] Finally, the debtor had an

[2] Because the defendant benefitted from the transaction (by earning a profit and using the funds to discharge its contractual obligations), the transfer was also made for the defendant's benefit, thus satisfying the 'for the benefit' prong of § 547(b)(1), notwithstanding the fact that the majority of the funds were transferred to a subsequent transferee. Cf. Bonded Financial Servs., Inc., 838 F.2d at 896 (discussing § 550(a) and holding that "[s]omeone who receives [the transfer] later on is not an 'entity for whose benefit such transfer was made'; only a

independent obligation to the defendant as its prime contractor for performing the construction work (albeit with the assistance of subcontractors).

Had the defendant paid the subcontractors early on, and then received payment from the debtor, that later payment would have obviously been a payment to the defendant as compensation for work performed by the defendant as the prime contractor (and not merely as a subrogee of the subcontractors) covering its costs, compensation as project manager, and profit. That the payment accrued prior to the subcontractors being paid does not alter the payment as compensation to the defendant for work performed by the defendant (albeit through the use of subcontractors). In either event, the defendant would not be acting as a mere conduit.

Pursuant to § 550(a), the defendant is, therefore, an 'initial transferee,' and it follows therefrom that the payment was made 'to the defendant,' as contemplated by § 547(b).

II

The defendant next argues that allowing § 547(c)(6) to apply only to the "fixing of statutory liens" and not to payments made in satisfaction of a statutory lien results in an absurdity. After all, if, but for the payment, the creditor would have

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person who receives a benefit from the initial transfer [a guarantor being the paradigmatic example] is within this language.").

perfected its statutory lien (which lien would be unavoidable under the statute), it would seem to follow that the payment itself ought be unavoidable as well. The court is reluctant to rewrite the plain language of the statute, which on its face applies only to the fixing of liens – especially in light of legislative history that would seem to express an intent not to exempt from the trustee's avoidance powers transfers in satisfaction of statutory liens. See 124 Cong. Rec. H11097 (daily ed. Sept. 28, 1978), S17414 (daily ed. Oct. 6, 1978) (remarks of Rep. Edwards and Sen. DeConcini) (final bill deleting language that would have exempted from avoidance powers payments made in satisfaction of a statutory lien).

At least one court has resolved the problem by assuming for the purposes of the § 547(b)(5) hypothetical liquidation analysis, that the creditor would have acted in a commercially reasonable manner and would therefore have timely perfected its statutory lien. E.g., Rand Energy Co. v. Strata Directional Tech., Inc. (In re Rand Energy Co.), 259 B.R. 274, 277-78 (Bankr. N.D. Tex. 2001) (in liquidation analysis, "the court must assume that the lienor would have acted in a commercially reasonable manner [and that t]he lienor would have presumably perfected the statutory lien."). Under such an analysis, the payment would be insulated from avoidance to the extent that the payment did not leave the creditor with more than

it would have had in the hypothetical liquidation (assuming the creditor would have been fully or partially secured by taking the step of filing a statutory lien immune from avoidance under § 547(c)(6)).

The Rand assumption, however, that all creditors would have perfected their statutory lien, improperly shifts the burden of proof. In order to take advantage of the § 547(c)(6) *affirmative defense* that hypothetically would have arisen by way of filing a mechanic's lien had the payment in question not been made as hypothesized by § 547(b)(5), the defendant carries the burden of proving that its failure to perfect before payment was commercially reasonable (in order to justify the Rand assumption that as a commercially reasonable entity, it would have perfected had payment not been made). 11 U.S.C. § 547(g) (burden on the defendant to prove nonavoidability under subsection (c)). In other words, if the defendant unreasonably slept on its statutory lien rights, and the debtor made payment during the preference period, it makes little sense to assume that absent payment, the defendant would have timely perfected its lien. Commercial reasonableness, and thus the viability of the Rand assumption, must be proved by the defendant. Were the defendant to show that it was acting reasonably in not perfecting and that it would have perfected but for the payment, and the court otherwise follows Rand, the court would assume the existence of the lien in the

section (b) analysis.

The defendant has not on this record persuaded the court that it acted in a commercially reasonable manner in failing to perfect its mechanic's lien. Consequently, for the purposes of summary judgment, the court need not consider the lien in its hypothetical liquidation analysis. Moreover, the defendant does not dispute the plaintiff’s allegation that the debtor’s assets are insufficient to make 100% payment on unsecured claims. It is clear, therefore, that the defendant received more by virtue of the payment than it would have received (as an unsecured creditor) in a hypothetical liquidation (absent the Rand assumption). Unless the defendant is able at trial to persuade the court that the Rand assumption applies, based on the plaintiff’s undisputed allegation of insolvency, the plaintiff will prevail on § 547(b)(5). Summary judgment as to § 547(b)(5) is, therefore, partially granted in the plaintiff’s favor, as to the debtor’s inability to pay unsecured claims at 100%.

Although the court is not without doubts regarding Rand's general approach of asking what the creditor hypothetically would have done had no payment been made, the trustee has not marshaled arguments at this juncture that persuade the court that, as a matter of law, Rand was erroneously decided in this regard. Nevertheless, because no final judgment is being entered at this juncture, the trustee may still brief that likely critical issue

anew.

III

Both the plaintiff and the defendant move for summary judgment as to the defendant's § 547(c)(2) defense. The plaintiff concedes that the transfer was made in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee. Consequently, the court need consider only whether summary judgment is appropriate as to §§ 547(c)(2)(B) and (C).

A. Section 547(c)(2)(B)

The court will deny both the plaintiff's and the defendant's motions for summary judgment as to § 547(c)(2)(B) because there remain unresolved issues of fact concerning whether the August 4 payment was made in the ordinary course of business between the debtor and the defendant. The plaintiff maintains that the August 4 payment was made much later than any of the payments made before the preference period, and that the payment was therefore not made in the ordinary course of the debtor's and the defendant's business relationship. The defendant, on the other hand, alleges that the August 4 payment, though late, was no later than typical pre-preference period transfers. Central to the parties' disagreement over whether the timing of the August 4 payment is consistent with the defendant's and the debtor's prior dealings, is a factual dispute as to whether one of the debtor's

prior payments (Job 165) was paid in 26 or 182 days.

There is also a factual dispute as to whether the defendant engaged in unusual collection practices by exerting pressure over the debtor to procure the August 4 payment. Referring to the deposition of the defendant's Chief Executive Officer, Dennis O. Kane, the defendant maintains that Mr. Kane did not have any conversations with the debtor urging payment. The plaintiff, on the other hand, points to a July 24, 2000 email message from Mr. Kane to Robert Klancher of Interplan, Inc., in which Mr. Kane remarks: "[s]till no dough form [sic] NET-tel. We are calling every day or two." Because there remains a question of fact as to the timing of pre-preference period payments and as to whether the defendant was engaging in any unusual collection activity, both the plaintiff's and the defendant's motions for summary judgment will be denied as to § 547(c)(2)(B).

B. Section 547(c)(2)(C)

Because there remain genuine issues of fact as to whether the collection practices of the defendant are within the range of typical business practices of the construction industry, the court will deny both the plaintiff's and the defendant's motion for summary judgment as to § 547(c)(2)(C). The defendant has made a sufficient showing to survive the plaintiff's motion for summary judgment under Celotex Corp. v. Catrett, 477 U.S. 317, 323 (1986) ("The moving party is entitled to a judgment as a

matter of law [where] the nonmoving party has failed to make a sufficient showing on an essential element of her case with respect to which she has the burden of proof.") (quotation omitted), but has not persuaded this court that there is no genuine issue of material fact as to the ordinary business terms in the construction industry.

In order to satisfy the third prong of a § 547(c)(2) defense, a creditor must show by a preponderance of the evidence that the preferential transfer was consistent with the "ordinary business terms" of the creditor's industry. § 547(c)(2)(C). "Ordinary business terms" refers to the "*range* of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage." In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1033 (7th Cir. 1993) (emphasis in original). Furthermore, "only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of [§ 547(c)(2)(C)]." Id.; accord In re Molded Acoustical Products, Inc. v. Maxway Corp., 18 F.3d 217, 224 (3d Cir. 1994) (substituting "unusual" for "idiosyncratic"). The creditor need not prove "some single, uniform set of business terms," id., but rather need only establish that its own dealings with the debtor are situated "within the outer limits of normal industry practice." Id.; see also Appeal of Jensen Cabinet, Inc. (In re Midway Airlines, Inc.), 69 F.3d 792, 797 (7th Cir. 1995).

The court finds that the defendant has satisfied its burden under Celotex to survive the plaintiff's motion for summary judgment. The plaintiff's motion for summary judgment as to the ordinary course of business defense should be granted only if the defendant provides no legally sufficient evidentiary basis for a factfinder to find for the defendant. Celotex, 477 U.S. at 323 (the standard for granting summary judgment mirrors the standard for directed verdict). Here, the defendant's expert, Larry M. Epstein, testified in his deposition about ordinary business practices in the construction industry and about payments more than 120 days after invoicing:

> Q: [A]re you also intending to say that that is the ordinary course of business in the construction industry . . . [f]or contractors to not be paid as long as 120 days or whatever it might be?
>
> . . .
>
> A: I'm saying it's not unusual. There are some owners that will pay in 30 days. There's some that will pay in ten days after you send them a requisition. There's some that will string you out for six months. And, it's your decision as a business person as to whether you want to continue to do work for those people that string you out like that. But, a lot of owners do that. A lot of developers do that.
>
> Q. So then, to answer my question are you saying that it's not the ordinary course of business for contractors to not receive payment until more than 120 days have passed beyond the date of the invoice?
>
> A: I can't answer it that way because of the fact that it's not unusual for contractors to receive money like that. As a contractor they'd like to receive their money the day after you send them a bill. As I said, it's all over the board as to how people pay and I

> can't answer is it ordinary or not. It's not unusual. Do you want me to say 50% of the time? I can't tell you that.
>
> Q: I'm interested in whether you can testify based on your area of expertise whether the payment practices that have been described for the construction industry are the ordinary course of business for the construction industry.
>
> A: Again, is it ordinary? Yes, it's ordinary in that it happens in a lot of contracts. Every contract? No. There's some owners that are better than other owners that pay just like any other business.

(Pl. Opp., Exh. 3, at 51-53.) Because Mr. Epstein characterized payments 120 days after invoice as "not unusual," the defendant has provided sufficient evidence for a reasonable factfinder to conclude that such payments are not "so idiosyncratic [or unusual] as to fall outside that broad range of terms" encompassing the general practices of the construction industry. In re Molded Acoustical Products, Inc., 18 F.3d at 224; In re Tolona Pizza Prods. Corp., 3 F.3d at 1033. Consequently, the plaintiff's motion will be denied.

The court does not, however, find the defendant's evidence so persuasive as to conclude that there remain no genuine issues of material fact. Mr. Epstein was unable to offer an opinion as to the frequency with which firms in the construction industry accept payment 120 days after invoicing; nor has the defendant offered any evidence as to the outer limits of how long after invoicing a payment can be made and still be within the range of acceptable business practices for the construction industry. See

Galesburg v. G & H Custom Craft, Inc. (In re H.L. Hansen Lumber Co. of Galesburg, Inc.), 270 B.R. 273, 280-81 (Bankr. C.D. Ill. 2001) (evidence insufficient where, among other things, defendant failed to offer evidence as to the outer limit of how late invoices are ordinarily paid in the industry). Moreover, as Molded Acoustical, 18 F.3d at 227, indicates, ordinary terms are those that prevail in a healthy creditor-debtor relationship, not the terms that prevail in unusual circumstances. See also Clark v. Balcor Real Estate Fin., Inc. (In re Meridith Hoffman Partners), 12 F.3d 1549, 1553 (10th Cir. 1993), cert. denied, 512 U.S. 1206 (1994). Epstein failed to address whether the range he used included payors who were themselves in unhealthy relationships such as to make reliance on them inappropriate. See Molded Acoustical, 18 F.3d at 227 ("Fiber Lite admitted that both Renaissance and VanDresser were delinquent in their payments during the critical period when Fiber Lite compared their credit terms to the debtor's, and additionally that both those firms eventually filed for bankruptcy. These facts standing alone undermine any claim that Fiber Lite's credit terms with Renaissance and VanDresser were 'ordinary.'").

The court notes as well that Mr. Epstein's opinion as to the industry standard is based in large part on an analysis of the defendant's history with its other customers (in addition to his apparent general expertise in the construction industry). The

plaintiff correctly notes, however, that while probative of industry standard, a creditor's relationship with its own customers is not alone sufficient to establish ordinary business practices under § 547(c)(2)(C). Logan v. Basic Distribution Corp. (In re Fred Hawes Org., Inc.), 957 F.2d 239, 246 (6th Cir. 1992) ("[C]ourts do not look only at the manner in which one particular creditor interacted with other similarly situated debtors, but rather analyze whether the particular transaction in question comports with the standard conduct of business within the industry.").

Because the defendant has not persuaded the court that there is not a genuine issue of material fact as to whether payments over 100 days outstanding are within the outer limits of ordinary practice in the construction industry, and because the plaintiff has raised a legitimate concern that Mr. Epstein's opinion may be improperly based on the defendant's business practices rather than on his general knowledge of the industry, the court will deny the defendant's motion as to § 547(c)(2)(C).

IV

For the foregoing reasons, the court will grant the plaintiff's motion as to § 547(b)(1)-(4) and will partially grant the plaintiff's motion as to § 547(b)(5). The court will deny the defendant's motion as to § 547(c)(6), and will deny both the plaintiff's and the defendant's motions as to § 547(c)(2). The

court’s order follows.

Dated: November 8, 2004.

S. Martin Teel, Jr.
United States Bankruptcy Judge

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