UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF GEORGIA
COLUMBUS DIVISION

IN RE:	)	CHAPTER 11
	)	CASE NOS. 03-40293 through
JOHNSTON INDUSTRIES, INC.,	)	03-40298
	)	Procedurally Consolidated Under
DEBTOR.	)	Case No. 03-40293
	)	
JOHNSTON INDUSTRIES, INC.,	)	ADVERSARY PROCEEDING
	)	NO. 04-4089
PLAINTIFF,	)	
	)	
VS.	)	
	)	
CB&T BANK OF RUSSELL COUNTY n/k/a CB&T BANK OF EAST ALABAMA,	)	
	)	
DEFENDANTS.	)	

BEFORE

JAMES D. WALKER, JR.

UNITED STATES BANKRUPTCY JUDGE

COUNSEL

For Plaintiff: Stuart F. Clayton, Jr.
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For Defendant: David B. Anderson
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MEMORANDUM OPINION

This matter comes before the Court on Debtor-Plaintiff's complaint to recover preferences. This is a core matter within the meaning of 28 U.S.C. § 157(b)(2)(F). After considering the pleadings, the evidence, and the applicable authorities, the Court enters the following findings of fact and conclusions of law in conformance with Federal Rule of Bankruptcy Procedure 7052.

Findings of Fact

Debtor-Plaintiff Johnston Industries filed a Chapter 11 petition on January 31, 2003. On September 24, 2004, Debtor filed this adversary proceeding to recover as preferences certain transfers it made to Defendant CB&T Bank in connection with an employee stock purchase plan. Debtor initially sued both CB&T and former employee Donald Massey. However, Debtor has dismissed Massey as a defendant.

By order of June 6, 2006, the Court granted summary judgment to CB&T on two of the preference claims and granted summary judgment to Debtor on one preference claim. The Court left open the question of whether a transfer relating to repayment of a loan owed by Massey to CB&T was a preference. The Court held a trial on the Massey transfer on October 18, 2006. Based on the evidence presented at trial and the stipulation of the parties, the Court makes the following findings of fact:

On or about October 15, 1990, Debtor adopted an employee stock purchase plan (the "Plan") for the purpose of providing incentives to key employees and directors. Pursuant to the Plan, Debtor assisted employees in purchasing stock in Debtor by guaranteeing payment of bank loans arranged by Debtor. Debtor arranged the loans with Defendant CB&T Bank.

Under the Plan, Debtor executed a guarantee on June 11, 1996, of up to $5,582,768.05 in loans maturing from 1998 through 2000, including a loan made to Donald Massey with a principal balance of $171,553.14. On October 6, 1998, Debtor requested CB&T extend the maturities of loans maturing on December 31, 1998, in connection with ongoing turnaround efforts. CB&T agreed to the extension and on January 31, 1999, Debtor executed an "Affirmation and Clarification of Guaranty." In December 1999, Debtor requested another extension, and Debtor and CB&T negotiated the terms of an extension and renewal. In February of 2000, CB&T issued a commitment to renew the loans for five years with payment required upon the occurrence of certain events, including termination of employment.

The loan to Massey was renewed by promissory note dated April 3, 2000, in the principal amount of $171,653.14. The note was payable in full on March 30, 2005, with interest due quarterly.

In the first quarter of 2002, Debtor decided to attempt to find a buyer for one of its wholly-owned subsidiaries, Johnston Industries Composite Reinforcements, Inc. At the time, Massey was president of the subsidiary. In connection with the potential sale of the subsidiary, Debtor and Massey entered into an Employment and Confidentiality Agreement. Pursuant to that agreement, Massey was to receive a percentage of the sale price as a bonus. If the bonus became due while any amount on Massey's loan remained outstanding, the agreement provided, "the Company [Debtor] shall pay the Sale Bonus (or so much thereof as shall equal such then outstanding principal amount of the Note) to the Bank [CB&T] for and on behalf of Executive [Massey] . . . . Any payment to the Bank of all or a portion of the Sale Bonus as herein authorized shall for, all purposes hereof be deemed, a payment to Executive hereunder." (Ex.

17, Employment and Confidentiality Agreement ¶ 3(d).)

A sale of the subsidiary was completed on November 4, 2002, and Massey became entitled to a bonus of approximately $221,000. Pursuant to the agreement with Massey, Debtor gave CB&T a check dated October 31, 2002, in the amount of $171,653.14 in satisfaction of the balance due on the Massey loan. The check cleared on November 4, 2002–the same day that the sale closed. The payment was treated as compensation to Massey for income tax purposes. In fact, the balance of the bonus after payment to CB&T was submitted to the government to cover withholding taxes due on the bonus.

The liquidating agent in this case, Ronald L. Glass, stated by affidavit his opinion, based on his review of the proofs of claim filed in this case and the estate assets available for distribution to unsecured creditors, there is no reasonable prospect for a 100% distribution to unsecured creditors.

Conclusions of Law

At issue in this case is whether a transfer made by Debtor to CB&T may be avoided as a preference. Section 547(b)[1] provides as follows:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property–
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between ninety days and one year before the

[1] The applicable law in this case is the law as it existed prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

> date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if–
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). Even if all the elements of a preference are proven, the transfer may fall within one of the safe harbors set forth in § 547(c).

The transfer at issue is a check issued by Debtor to CB&T to pay the full principal due under the Massey note. In the June 6, 2006, ruling on the cross motions for summary judgment, the Court determined as a threshold matter that Debtor had an interest in the funds transferred because they were held in Debtor's general operating account and were not subject to a trust in favor of Massey. Thus, the Court must consider whether the transfer of Debtor's interest in those funds constitutes a preference.

With regard to the first element of a preference, the Court must decide whether the transfer was to or for the benefit of a creditor. Debtor has argued that the Eleventh Circuit Court of Appeals decision in Nordberg v. Arab Banking Corp. (In re Chase & Sanborn Corp.), 904 F.2d 588 (11th Cir. 1990), is dispositive of this question. In Chase & Sanborn, the borrower, who was the owner of the debtor, obtained a $22 million loan from the lender. The debtor guaranteed the loan. Id. at 591. The borrower failed to make the first loan payment. Consequently, the debtor made four payments on the loan. The debtor then filed a Chapter 11 petition. The trustee sought to recover two of the loan payments as preferences. Id. at 592. The bankruptcy court held that the transfers satisfied all the elements of a preference, but

nevertheless ruled against the trustee because the payments had been contemporaneous exchanges for new value and, thus, fell under one of the safe harbors to a preference action. The district court affirmed. Id. at 592-93.

The court of appeals reversed. Id. at 595. The lender had argued that the transfer was not on account of antecedent debt because the borrower had not defaulted so as to cause the debtor's guarantee obligation to mature. Id. The court rejected that argument, stating that even contingent obligations are still debts within the meaning of the Bankruptcy Code. Id. Just because the payments were made by the debtor "in anticipatory satisfaction of its contingent obligation" does not make the payments "any less 'for or on account of' that debt." Id.

The holding in Chase & Sanborn might control the outcome of this case if not for one fact that renders it not analogous to the circumstances here. The debtor in Chase & Sanborn had no independent obligation to the borrower, so the court of appeals never had to address the question of which debt the debtor was satisfying with the payment–a primary obligation or a guarantee obligation. Here, Debtor owed a bonus to Massey. All the evidence, including the written agreement between Debtor and Massey, indicates the parties intended the transfer to satisfy Debtor's compensation obligations to Massey, not to satisfy any obligations Debtor may have had to CB&T under the guarantee. Debtor had a contractual obligation to Massey to pay a bonus as a result of the sale of a subsidiary. Debtor transferred the money to CB&T for Massey's benefit–in accordance with terms of the agreement–to pay off the balance of his loan. This case does not sound a claim against Massey to recover this payment. Debtor has previously dismissed its claim against Massey. The Court is left to decide if this disbursement was a payment to or for the benefit of Massey or CB&T–the former irrelevant to this case, the latter

alleged for recovery in this case.

The first element is satisfied in that Debtor made a transfer to benefit a creditor. As for the second element, the question remains, "which creditor"? The answer to this question determines whether the second element of the test–that the transfer was made on account of antecedent debt owed by Debtor–is satisfied. Debtor's guarantee to CB&T of Massey's loan was an antecedent debt, a fact confirmed by Chase & Sanborn. Another debt, the obligation to pay Massey, also arose before the filing of this case. While the Court did not have the facts necessary on summary judgment to determine when the Massey debt arose, the parties produced evidence at trial showing that the Massey debt arose the day the sale of the subsidiary closed, which was the same date the check at issue cleared–November 4, 2002. Thus, the debt to Massey accrued contemporaneous with the transfer.

To satisfy the second element of a preference the transfer must have been "on account of" an antecedent debt owed by Debtor. The Supreme Court has interpreted this language in two other sections of the Bankruptcy Code. Rousey v. Jacoway, 544 U.S. 320, 125 S. Ct. 1561 (2005); Bank of Amer. Nat'l Trust & Sav. Ass'n v. 203 N. La Salle St. P'ship, 526 U.S. 434, 119 S. Ct. 1411 (1999). In Rousey, the Court held the language "on account of" in § 522(d)(10)(E) retained its ordinary meaning: "because of." 544 U.S. at 326-27, 125 S. Ct. at 1566. This meaning requires "a causal connection between the term that the phrase 'on account of' modifies and the factor specified in the statute at issue." Id. at 326, 125 S. Ct. at 1566. In 203 North La Salle Street Partnership, the Court discussed, without deciding, the meaning of "on account of" in § 1129(b)(2)(B)(ii). 526 U.S. at 449-54, 119 S. Ct. at 1419-22. In doing so, it noted that "because of" is "certainly the usage meant for the phrase at other places in the statute." Id. at

450-51, 119 S. Ct. at 1420. It then expressly listed § 547(b)(2)–the subsection at issue in this case–as an example. Id. at 451, 119 S. Ct. at 1420. Based on these cases, the Court concludes the phrase "on account of" in § 547(b)(2) means "because of."

In this case, the facts show the transfer was made "because of" the debt owing to Massey. That it also relieved Debtor of a contingent guarantee obligation to CB&T is incidental. The transaction cannot be transformed into an actionable transfer because of Debtor's compliance with a payment designation contained in the agreement with Massey. In other words, if the purpose of the payment was to satisfy the Massey debt, then it must be actionable against Massey in order to be actionable at all.

With respect to the third and fourth elements–insolvency of the debtor and the preference period–the debtor is presumed insolvent during the 90 days prior to bankruptcy. 11 U.S.C. § 547(f). The transfer took place on October 31, 2002, which was both within the 90-day preference period and during the time Debtor was presumed insolvent. These elements were not contested.

With respect to the fifth element, Debtor submitted an affidavit from the liquidating agent stating his opinion that there is no prospect for full payment of unsecured creditors. However, CB&T has argued that because the transfer was actually Massey's payment of his obligation to CB&T rather than Debtor's payment of its guarantee, there was no diminution of the bankruptcy estate. That argument only works if Massey's interest in the funds was protected in some way, such as with a security interest. No such facts exist in this case. Thus, the transfer enabled either CB&T or Massey to receive more than either one would have in a liquidation had the transfer not taken place.

Based on the foregoing, Debtor has failed to prove that the transfer was made on account of antecedent debt. Thus, the transfer is not a preference, and the Court will enter judgment for CB&T.

An Order in accordance with this Opinion will be entered on this date.

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