UNITED STATES BANKRUPTCY COURT
DISTRICT OF MINNESOTA
THIRD DIVISION

In Re:

American Coal Corporation, Debtor.

CHAPTER 7

Bky. Case No. 94-34865

Molly T. Shields, Trustee of the Bankruptcy Estate of American Coal Corporation, Plaintiff,

Adv. No. 95-3242

vs.

ORDER FOR PARTIAL SUMMARY JUDGMENT

Cumberland Surety Insurance Company, Inc., Defendant.

This matter is before the Court on motion of Plaintiff American Coal Corporation for partial summary judgment in this post-petition transfer action brought by Molly T. Shields, as Trustee of the Bankruptcy Estate of American Coal Corporation. The motion was heard on August 8, 1996; appearances are as noted in the record at the hearing; and, the Court now makes this ORDER pursuant to the Federal and Local Rules of Bankruptcy Procedure.

I.

UNDISPUTED FACTS

American Coal Corporation ("Debtor") is a Minnesota corporation whose principal office was located in Minneapolis, Minnesota. It was founded in 1993 when investors purchased the mining division of Centran, which was in bankruptcy when its assets were purchased by the Debtor. The Debtor was engaged in the mining, sale, and distribution of coal. The Debtor hired contract miners to perform the actual mining at its sites.

The Debtor conducted its mining operations in Kentucky. Because surface coal mining is a highly regulated industry, Kentucky requires an operator of a mine to obtain a permit from the state before it begins to mine. As a condition of receiving the permit, Kentucky requires that assurances be given that the land mined be reclaimed according to state specifications. In order to ensure that such reclamation is done, Kentucky requires a permit holder post a performance bond with the state.

Cumberland is a surety company which is in the business of issuing performance bonds for mining operators. On April 21, 1994, the Debtor entered into an agreement with Cumberland in which Cumberland would issue a reclamation bond on behalf of the Debtor in connection with its West Beulah III mine. The bond agreement provided that the Debtor was to conduct its mining

operations in accordance with all regulatory requirements and perform reclamation at the mining site. The bond agreement also required the Debtor to pay Cumberland monthly premiums based on a rate per ton as the coal was mined. Cumberland required the Debtor to fund an escrow for the bond and also set the price for the funding of the escrow based on the amount of coal mined. Cumberland also required the Debtor to provide a $50,000 letter of credit to be issued in favor of Cumberland. The Debtor never provided any letter of credit naming Cumberland as the beneficiary.

At the West Beulah III mine, the Debtor hired Vision Mining Company, Inc. ("Vision") to perform the actual mining. Vision was to mine the site, using its own equipment and resources, and deliver specified minimum quantities of coal to the Debtor. Vision was also to perform reclamation at the West Beulah III mine. Pursuant to the agreement, Vision was to issue a letter of credit in the amount of $50,000 in favor of the Debtor. The letter of credit was issued and the Debtor was named as the sole beneficiary.

The business relationship between Vision and the Debtor was strained from the very beginning of the mining operation. Disputes arose as to the quantity and quality of coal Vision delivered, and the timing of the Debtor's payments to Vision. Vision pulled off the mine and failed to reclaim the mine.

On October 24, 1994, American Coal filed for Chapter 11 bankruptcy protection. In November and December of 1994, the Debtor received notices from Kentucky of its failure to perform reclamation at the mine. Because of these notices, the Debtor decided to draw on its letter of credit from Vision. On December 27, 1994, James Pappas, the Debtor's president, flew to Kentucky in order to draw on the letter of credit. The bank refused to honor the letter of credit and obtained a restraining order in Kentucky state court against the Debtor. This Bankruptcy Court held hearings on this matter on January 23, 1995 and March 8, 1995. In the January 23 hearing, this Court held that the letter of credit was property of the bankruptcy estate. On February 7, 1995 the proceeds of the letter of credit were turned over to the Debtor which deposited the proceeds in a separate checking account. On March 13, 1995, following the March 8 evidentiary hearing, this Court awarded $14,500 in compensatory and punitive damages to the Debtor. The Debtor accepted $13,500 in settlement of the award and deposited the money in the same separate checking account designated by the Debtor as the reclamation account.

American Coal used the funds in this reclamation/checking account without restriction during February, March, and April of 1995. On March 31, 1995, American Coal transferred $56,000 from this account to Cumberland by wire transfer. No other transfer out of this account was by wire. On April 6, 1995, American Coal's Chapter 11 case was converted to Chapter 7.

II.
DISCUSSION

Federal Rules of Bankruptcy Procedure Rule 7056 provides that Rule 56 of the Federal Rules of Civil Procedure applies to adversary proceedings. Rule 56(c) provides that summary judgment shall be entered if:

> the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

The moving party has the burden of demonstrating that there is an absence of a genuine issue of material fact. In re Calstar, 159 B.R. 247, 251 (Bankr. D. Minn. 1993). However, the non-moving party must "do more than simply show that there is some metaphysical doubt as to the material facts." Matsushita Electric Industrial Co., Inc. v. Zenith Radio Corp., 475 U.S. 574, 586, 106 Sup. Ct. 1348, 1355, 89 L.Ed.2d 538, 552 (1986). For the reasons discussed below, summary judgment is appropriate in this case.

A) The trustee is entitled to avoid the post-petition transfer

The trustee seeks to avoid a post-petition wire transfer of $56,000 to Cumberland pursuant to Section 549. A trustee may avoid a transfer of property of the estate under Section 549(a):

> (1) that occurs after the commencement of the case; and
> (2) that is not authorized under this title or by the court

In re Calstar, sets out 3 elements which must be established in order for the trustee to avoid a transfer under Section 549. The trustee must prove:

> (1) that property of the estate was transferred;
> (2) after the filing of a petition;
> (3) which was not authorized by the Code or by the court

Calstar, 159 B.R. at 252.

1) Property of the Estate was Transferred.

The Trustee argues that this Court previously decided the issue of ownership of the letter of credit in previous hearings. Those hearings did not involve Cumberland, nor were the issues the same as this Court faces in this matter. At issue in the hearings the Trustee refers to, was whether the bank, which never claimed to have any interest in this irrevocable letter of credit, could withhold the letter of credit proceeds from the Debtor in whose favor the letter of credit was issued. The interest of third parties in that letter of credit was not considered. Therefore, the holding of this Court in those

previous hearings is not the law of the case and is not binding on Cumberland in this proceeding.

At issue is property which was received from the $50,000 letter of credit and the $13,500 American Coal received in settlement of the compensatory and punitive damage award which this Court awarded. The total amount being $63,500, $56,000 of which was transferred by the Debtor to Cumberland. Cumberland argues that there is a genuine issue of material fact as to whether property of the estate was transferred. It argues that there are facts which indicate that American Coal only had a bare legal title in the letter of credit and that Cumberland at all times had the beneficial interest. In fact, in its brief Cumberland states, "[t]he facts indicate that American Coal only had bare legal title in the Letter of Credit proceeds and that Cumberland held the beneficial interest." Defendant's Memorandum in Opposition to Plaintiff's Motion for Partial Summary Judgment, June 25, 1996, at 12. Section 541(a)(1) defines property of the estate to include, "all legal or equitable interests of the debtor in property as of the commencement of the case." Bare legal title would therefore qualify as property of the estate. Cumberland does not dispute that, at a minimum, American Coal had bare legal title to the letter of credit. The actual letter of credit shows the Debtor had an interest in the letter by the listing of the Debtor as the entity in whose favor the letter of credit was issued. This Court finds that the Debtor did have an interest in the letter of credit, and, at a minimum, that interest was bare legal title which qualifies as property of the estate.

The next issue is whether the $13,500 received by American Coal as compensatory and punitive damages is property of the bankruptcy estate. Section 541(a)(7) defines property of the estate as: "[a]ny interest in property that the estate acquires after the commencement of the case." This money was received after the commencement of the case in settlement of a Court award to American Coal for both damages it incurred in claiming the proceeds from the letter of credit and punitive damages. Therefore, the $13,500 qualifies as property of the bankruptcy estate.

a) Beneficial interest

Cumberland argues that it at all times had the beneficial interest in the letter of credit and cites Cretex Companies, Inc., v. Construction Leaders, Inc., 342 N.W. 2d 135 (Minn. 1984), in support of its position. The issue in Cretex was whether unpaid materialmen could be considered third party beneficiaries under the defaulting general contractor's performance bond; the Minnesota Supreme Court held they were not beneficiaries. There are two tests used to determine if a party is a third party contract beneficiary, and only one test must be met. Cretex at 138.

The first test is the "intent to benefit" test which means the contract must express some intent by the partes to benefit the third party. Cretex at 137. Examination of the face of the letter of credit shows it was issued in

favor of American Coal by Vision, and no other parties or obligations of other parties are mentioned. Nothing in the record indicates that American Coal intended Cumberland to be the beneficiary, nor is there anything in the record from which an inference of such an intention can be drawn. Therefore, it cannot be said that American Coal intended the letter of credit to benefit Cumberland.

The second test is the "duty owed" test which means that the promisor's performance under the contract must discharge a duty otherwise owed the third party by the promisee. At issue in Cretex was a situation where subcontractors did not get paid for materials they supplied. The owner of the property hired a general contractor who hired these contractors, but the general contractor became insolvent and did not finish the project. The owner of the property was the obligee for the performance bonds the subcontractors were attempting to recover on. The subcontractors argued to the Minnesota Supreme Court that the payment by the surety would discharge a duty owed to them by the owner of the land. The Minnesota Supreme Court disagreed and found that the owner had no legal responsibility to pay subcontractors who made their own separate contract with the general contractor. Cretex at 137. In this case, the letter of credit was issued by Vision in favor of Cumberland. It was required as part of the contract which American Coal had entered into with Vision. While American Coal entered into a similar contract with Cumberland, which also required a letter of credit in the amount of $50,000 to be issued in favor of Cumberland, the letter of credit Vision issued did not discharge the duty of American Coal to obtain a $50,000 letter of credit in favor of Cumberland. In fact, American Coal did not recognize this letter of credit as being related to the letter of credit American Coal was to issue in favor of Cumberland. On January 23, 1995 American Coal's counsel stated to this Court:

> "There is a separate requirement as a rider to the Cumberland Surety bond which calls for the debtor, American, to submit a letter of credit payable to Cumberland but that's a completely different contract, a completely different obligation."
>
> (Hearing Transcript, January 23, 1995, at 31-32).

Based on this analysis, Cumberland does not satisfy the "duty owed" test or the "intent to benefit" test. Therefore, Cumberland is not a third party contract beneficiary of the letter of credit.

2) Property was transferred after the filing of the petition

All parties agree that the $56,000 was transferred after the petition for bankruptcy was filed.

3) The transfer of the property was not authorized by

the Court

Cumberland does not argue that the portion of the $56,000, which is attributable to the $13,500 settlement of the compensatory and punitive damage award, was authorized by this Court to be transferred. This Court finds that portion of the transfer was not authorized by this Court.

Cumberland argues that this Court was on notice that the letter of credit proceeds were to be used for reclamation, and the Court implicitly approved of the use of funds for reclamation in connection with the Court's order requiring the bank to pay the letter of credit. Cumberland cites two cases in support of this theory. The first case is In the matter of Sullivan Central Plaza I, Ltd., 935 F.2d 723 (5th Cir. 1991). At issue in Sullivan Central Plaza was a court action where the court lifted an automatic stay under Section 349 resulting in foreclosure actions being taken by the creditor. The court stated that the bankruptcy judge lifted the automatic stay knowing the result would be the transfer of the property. The court went on to state that, "[u]nder these circumstances we cannot say that the transfer was not authorized by the court." In the matter of Sullivan Central Plaza I, Ltd., 935 F.2d at 726. When a court determines that an automatic stay should be lifted, the natural and expected consequence is a transfer of that property by a creditor foreclosing or repossessing the property.

However, the situation involved in this case is not the same. At issue before this Court was whether the letter of credit proceeds should be turned over to the Debtor in whose favor the letter of credit was issued, or whether the bank, which had no claim to the proceeds, could refuse to honor the irrevocable letter of credit. In its decision, this Court did not consider, nor did it have any interest in considering, the possible claims of third parties in the property or what use might actually be made of the proceeds. This Court held that the proceeds of the letter of credit should be turned over to the Debtor, but the determination did not explicitly or implicitly give the Debtor the Court's consent to subsequently transfer the property. While use of the money for reclamation was mentioned by parties, this Court did not address what the money should be used for, nor examined the appropriateness of such expenditures. This Court acknowledged it was not addressing such issues when it stated:

> [w]e are not here to de termine whether or not it was appropria te for Ame rican Coal to draw on the letter of credit. We are not here to determine whether or not it was good business for them to do so, whether there was a defense by somebody to the drawing on the letter of credit, whether it was in the best interest or the worst interest of the debtor's estate. The fact of the matter is the value of that letter of credit was bankruptcy estate property over which this Court has and had at all times exclusive jurisdiction.

(Hearing Transcript, January 23, 1995, at 34).

The second case Cumberland relies on is Cataldo v. Meidar, 90 B.R. 660 (Bankr. E.D. Penn. 1988). Cumberland argues that Cataldo applies to this situation as all parties including the court were aware and consented to the use of the funds for reclamation. In Cataldo, the court held that because all were aware and approved of a compensation arrangement, compensation should be awarded. In that case, an express agreement limited the aggregate amount for salaries of top managers to $100,000, and the defendant was the only top manager at the time engaged in running the corporation. All parties, including the court were aware that the defendant was performing this position. Therefore, the court held that the defendant was entitled to the fees he received.

In this case, representatives of the Debtor made reference that they were drawing on the letter of credit to use the funds for reclamation. As previously stated, this Court never had before it what the money should or could be used for in the Debtor's possession.

Furthermore, at the time of the reference, the Debtor was operating in the ordinary course. American Coal had stipulated to cease all business operations and begin liquidating. Therefore, the transfer of $56,000 was not authorized by this Court.

4) The transfer of the property was not authorized by the Bankruptcy Code

Section 363(c)(1) provides:

If the business of the debtor i s authorized to be operated under section 721, 1 108, 1203, 1204, or 1304 of this title and unless the court orders otherwise, the trustee may enter into transactions, including the sale or lease of property of the estate in the ordinary course of business, without notice or a hearing, and may use property of the estate in the ordinary course of business without notice or a hearing.

At issue in this case is Section 1108 and Section 1107 which allow a debtor in possession to continue to operate the debtor's business. Section 363(c)(1) gives the debtor in possession the authority to enter into transactions in the ordinary course of business without the approval of the court. In this case, the Court did not approve the $56,000 transfer so the issue becomes whether the transfer was in the ordinary course of business.

In In re Waterfront Companies, Inc., 56 B.R. 31 (Bankr. D. Minn. 1985), the court recognized that there are at least two different dimensions (horizontal and vertical) to the concept of ordinary course of business. These tests give courts guidance, but are not to applied rigidly. Habinger, Inc. v. Metropolitan Cosmetic and Reconstructive Surgical Clinic, P.A., 124 B.R. 784, 786 (Bankr. D. Minn. 1990). The tests are helpful when the court is faced with complex fact situations on whether a certain transaction is in the ordinary course of business.

This Court is not faced with such a situation.

In this case, it is clear that the transfer was not in the ordinary course of American Coal's business. This is evident by the undisputed fact that the Debtor, at the time of this transfer, was no longer to be engaged in the ordinary course of its usual mining business pursuant to a March 11, 1995 stipulation in which the Debtor "agreed to cease its normal course business operation". (Stipulation, March 11, 1995, at 3). No party disputes this stipulation. The stipulation provided:

> 1.9 The Debtor has agreed to cease its normal course business operation, commence collection and liquidation of most of its business assets and file a plan of reorganization. (Stipulation, March 11, 1995, at 3).

Based solely on the stipulation the Debtor entered into, the Debtor was not engaged in the ordinary course of business at the time of this transfer.

While the stipulation alone is enough to determine that the Debtor was no longer engaged in the ordinary course of business and the transfer was not in the ordinary course, the actions of the Debtor also support this finding. There is no dispute that the Unsecured Creditors Committee ("UCC") had the authority to unilaterally convert the Debtor's Chapter 11 case to a Chapter 7 case as of March 15, 1995. Nor is it disputed that the Debtor explicitly agreed not to spend any money, in order to prevent the UCC from converting the case. In fact, three days before the wire transfer to Cumberland, the Debtor informed the UCC that it planned to pay a number of "routine account payable and...operating expenses." Memorandum of Law in Support of Plaintiff's Motion for Partial Summary Judgment, June 3, 1996, at 17. The Debtor agreeing not to spend any money and informing the UCC before paying routine operating expenses indicates that the Debtor was no longer engaged in the ordinary course of its business. Further, a facsimile letter dated March 22, 1995 from Debtor's counsel to the counsel for the UCC stated, "it is not anticipated that we will be cutting any checks with regard to reclamation expenses in the next few days", however, on March 31, the Debtor made the $56,000 wire transfer to Cumberland.

Based on the foregoing, the transfer by the Debtor of $56,000 was not in the ordinary course of business.

B) The trustee is entitled to recover the post-petition transfer

Section 550(a) provides:

> ...to the extent that a transfer is avoided under section...549...of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from-
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made.

As the previous analysis demonstrates, the transfer of $56,000 to Cumberland is entitled to be avoided pursuant to Section 549. As there is no dispute the $56,000 was initially transferred to Cumberland, Cumberland is now liable to the Trustee for the total amount of $56,000.

III.
DISPOSITION

Based on the foregoing, it is hereby ORDERED that Plaintiff is entitled to partial summary judgment and is entitled avoid the March 31, 1995 wire transfer to Cumberland; and Plaintiff is entitled to recover $56,000 from Cumberland.

LET JUDGMENT BE ENTERED ACCORDINGLY.

Dated: October 7, 1996

By The Court:
DENNIS D. O'BRIEN
CHIEF U.S. BANKRUPTCY JUDGE