IN THE UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF TENNESSEE

In re	
CAM-PLEK OF VIRGINIA IQ CONVERTING DIVISION, INC., d/b/a IQ PAPER, EI #54-1023994,	No. 96-21367 Chapter 11
	[affirmed E.D. Tenn. No. 2:99-CV-202; 11/26/1999]
Debtor.	

M E M O R A N D U M

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE

This chapter 11 case is before the court upon the amended objections of Coronet Paper Products, Inc. ("Coronet") to the administrative expense claims of Charles P. Quillen III, Lisa Q. Loggans, and Andrew J. Quillen, former insiders of the debtor, for unpaid postpetition wages and the administrative expense claim of Andrew J. Quillen d/b/a Mid-Atlantic Paper ("Mid-Atlantic") for postpetition sales of inventory to the debtor. The court having concluded that the claim of Mid-Atlantic is not entitled to administrative expense status because it was not incurred in the ordinary course of business as required by 11 U.S.C. § 364(a) and that each of the three individual claims should be equitably subordinated as provided by 11 U.S.C. § 510(c)(1), the objections will be sustained. This is a core proceeding. *See* 28 U.S.C. § 157(b)(2)(B).

I.

Pursuant to the plan confirmed by this court on May 13, 1998, the debtor's assets were transferred on May 27, 1998, to a corporation formed by Coronet, Coronet Paper Products of Tennessee, Inc. ("Coronet Tennessee"), and Coronet Tennessee is operating as the reorganized debtor.[1] Prior to the transfer, the

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[1]No party has raised the issue of whether Coronet, an unsecured creditor of the debtor and the proponent of the (continued...)

debtor, Cam-Plek of Virginia IQ Converting Division, Inc., d/b/a IQ Paper ("Cam-Plek"), a paper conversion and waste recycling business, was owned and operated by members of the Quillen family. Charles P. Quillen III ("Skip Quillen") was a 50% shareholder and president of Cam-Plek. His father, Charles Pat Quillen II ("Pat Quillen"), who formed the corporation in 1976, owned the remaining 50% of the shares of stock. Lisa Q. Loggans, the daughter of Pat Quillen and sister to Skip Quillen, was Cam-Plek's secretary-treasurer and its office manager since 1980. Andrew J. Quillen, another sibling, was employed by Cam-Plek as director of sales and formerly served as a board member of Cam-Plek.

Skip Quillen, Lisa Loggans, and Andrew Quillen seek payments pursuant to 11 U.S.C. § 503(b)(1)(A) for wages which accrued during May 1998, the last month that Cam-Plek operated as a debtor-in-possession. Skip Quillen and Lisa Loggans have filed claims, as amended, in the respective amounts of $3,000.00 and $2,600.00, representing respective weekly wages of $750.00 and

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[1](...continued)
confirmed plan, has standing to object to the claims. Under the terms of the confirmed plan, plan obligations are the responsibility of Coronet Tennessee rather than those of Coronet. Presumably, however, if the court, *sua sponte,* overruled the objections based on lack of standing, Coronet Tennessee would pursue the objections to claims since the plan does not provide a time limit thereon.

$650.00 for the pay periods ending May 8, 15, 22, and 29. Andrew Quillen has filed a wage claim for $1,300.00, which includes the pay periods ending May 8 and 15 at the rate of $650.00 per week. In addition, Mid-Atlantic Paper has filed an administrative expense claim in the amount of $38,032.08 for sales of inventory to Cam-Plek between April 27 and May 12, 1998.

Coronet objects to payment of the wage claims as administrative expenses on the grounds that: (1) there is insufficient documentation to support the claims; (2) the services were not beneficial to the estate especially to the extent they were rendered after confirmation of Coronet's plan on May 13, 1998, when Cam-Plek ceased being a debtor-in-possession; and (3) each of the claims "should be equitably subordinated to the status of an unsecured claim under Coronet's Plan" because the claimants have engaged in unethical conduct which resulted in injury to creditors or conferred an unfair advantage on the claimants. Coronet additionally argues with respect to Skip and Andrew Quillen that their wage claims should be denied because they were working for Mid-Atlantic at the same time they were employed by Cam-Plek. Finally, Coronet asserts that any liability of the estate to Andrew Quillen should be offset by monies loaned to him by Cam-Plek in the amount of

$3,723.31.

With respect to the claim of Mid-Atlantic, Coronet maintains that the claim should be disallowed because: (1) there is insufficient documentation to support the claim; (2) Coronet is entitled to a setoff of $3,723.31 for the monies loaned by Cam-Plek to Mid-Atlantic; and (3) the obligation was incurred outside the ordinary course of business without court approval and thus is not entitled to administrative expense status under 11 U.S.C. § 364(a). Coronet also asserts the same equitable subordination argument that it makes with respect to the individual claims—that even if the administrative expense claim of Mid-Atlantic is otherwise proper, it should be equitably subordinated to the status of an unsecured claim because Mid-Atlantic has engaged in unethical conduct that has resulted in injury to creditors or conferred an unfair advantage on Mid-Atlantic.

II.

Administrative expenses under the Bankruptcy Code include "the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case." 11 U.S.C. § 503(b)(1)(A). If allowed, they have first priority among

unsecured claims against the bankruptcy estate. *See* 11 U.S.C. § 507(a)(1).

To qualify as an administrative expense, the claimant "must prove that the debt (1) arose from a transaction with the debtor-in-possession as opposed to the preceding entity (or, alternatively, that the claimant gave consideration to the debtor-in-possession); and (2) directly and substantially benefited the estate." *Employee Transfer Corp. v. Grigsby (In re White Motor Corp.)*, 831 F.2d 106, 110 (6th Cir. 1987). Administrative expenses "should be narrowly construed in order to maximize the value of the estate preserved for the benefit of all creditors." *Wolf Creek Collieries Co. v. GEX Ky., Inc.*, 127 B.R. 374, 378 (N.D. Ohio 1991)(quoting *United Trucking Serv., Inc. v. Trailer Rental Co. (In re United Trucking Serv., Inc.*), 851 F.2d 159, 161 (6th Cir. 1988)). "There is, of course, an overriding concern in the Act with keeping fees and administrative expenses at a minimum so as to preserve as much of the estate as possible for the creditors." *Id.* (quoting *Otte v. U.S.*, 419 U.S. 43, 53, 95 S. Ct. 247, 254 (1974)).

The court can easily dispose of the first two objections to the wage claims—that they are not supported by adequate documentation and the provided services did not benefit the estate to the extent they were rendered after confirmation of

Coronet's plan on May 13, 1998. Any defect in documentation was remedied by the testimony of the respective claimants that they continued to perform the same type of services for Cam-Plek in May as they had performed throughout their employment.

Through the first two pay periods of May ending May 8 and 15, Lisa Loggans as office manager filed, invoiced, collected accounts receivables, answered the telephone, made bank deposits, reconciled monthly bank statements, and processed payroll, just as she had done both prior to and during Cam-Plek's bankruptcy. Skip Quillen, the chief operating officer of Cam-Plek, likewise was engaged in performing the same tasks during the first two pay periods of May as he had throughout his employment. Similarly, Andrew Quillen, who was employed by Cam-Plek as its sales manager, continued to perform this function, working eight-to-five each weekday on behalf of Cam-Plek, until the court approved Coronet's plan. Coronet offered nothing to contradict this evidence.

After Coronet's plan was approved on May 13, 1998, Skip Quillen and Lisa Loggans continued to work on behalf of Cam-Plek in closing down its operations and finalizing the transfer of its assets to Coronet which did not take place until May 27, 1998. Specifically, Lisa Loggans prepared the May 22 payroll; processed the daily mail; answered the telephone and forwarded

the necessary calls to Coronet's representative; drafted letters to suppliers and clients advising them of the takeover by Coronet and the identity of their future contact; and responded to Coronet's and its counsel's information requests such as for customer and accounts receivable lists. In fact, Lisa Loggans remained on site until June 15, 1998, to complete the process of shutting down Cam-Plek's office.

Similarly, in the almost two-week transition period between plan confirmation and the transfer of assets, Skip Quillen played a vital role on behalf of Cam-Plek in meeting with Coronet's representatives and counsel and taking such steps as were necessary to effectuate the transfer. As was the case with Lisa Loggans, Skip Quillen continued to work for Cam-Plek through June 15, 1998, although both are only seeking payment through May 29, 1998. There was no evidence that after confirmation of Coronet's plan any representative of Coronet terminated the employment of Skip Quillen or Lisa Loggans or otherwise advised them that their services were no longer needed. To the contrary, Coronet in fact took advantage of and utilized Skip Quillen and Lisa Loggans as employees of Cam-Plek to facilitate Coronet's acquisition of Cam-Plek's assets. Accordingly, Coronet's argument that the services provided by Skip Quillen and Lisa Loggans did not directly and substantially

benefit the estate is simply without merit.

The third basis for Coronet's objection to the wage claims, that the claims should be equitably subordinated to unsecured status because the claimants have engaged in unethical conduct, in large measure arises out of the claimants' connection with Andrew Quillen's business, Mid-Atlantic. Therefore, prior to addressing the equitable subordination issue concerning the wage claims, the court believes it would be helpful to first proceed with a discussion of Mid-Atlantic and the allowability of its administrative expense claim.

III.

Mid-Atlantic is a business established by Andrew Quillen in June 1996 in order to provide Cam-Plek a source of outside financing for its paper purchases while it was in bankruptcy. As detailed in previous memoranda of this court filed in this case, by late 1995 and early 1996 Cam-Plek was experiencing large monthly losses and severe cash flow problems due to a drastic downturn in the recycling market. In March 1996, Skip Quillen sought counsel from Dean Greer, a bankruptcy attorney who subsequently was appointed as attorney for the debtor-in-possession, regarding the filing of a chapter 11 if market conditions did not improve. According to Skip Quillen, Mr.

Greer advised Cam-Plek not to file for relief at that time, but to reorganize as much as possible outside of bankruptcy. These informal reorganization efforts were unsuccessful and Cam-Plek's financial decline escalated as its suppliers began demanding cash on delivery, collection suits were filed and judgments rendered, and taxing authorities began levying on Cam-Plek's bank accounts. In May 1996, after Cam-Plek had exhausted all of its cash and it was apparent that the company would not be able to survive without an influx of cash or a source of credit, Skip Quillen asked Mr. Greer that if he were able to raise some "seed money" for paper purchases by borrowing against the equity in his home or by convincing others to invest, would there be a way to protect this money from the reach of the levying taxing authorities. According to Skip Quillen, Mr. Greer advised him that any such actions would have to be done by someone other than an officer or director of Cam-Plek. As a result of this conversation, Skip Quillen asked his brother Andrew to resign from Cam-Plek's board of directors so that he could seek and manage investments that would enable Cam-Plek to purchase paper. Andrew Quillen resigned from the board on June 3, 1996, and on June 11, 1996, applied for a business tax license from the City of Kingsport, Tennessee for Mid-Atlantic Paper, "a paper brokerage firm," in the business of "buying and selling paper

wholesale." Andrew Quillen personally invested $3,700.00 in Mid-Atlantic, and obtained an additional $5,000.00 investment from an unrelated third party named Paul Bellamy. In addition, Lisa H. Quillen, the wife of Skip Quillen, invested $10,000.00 after borrowing the money from a bank and pledging their home as collateral. Thereafter, Cam-Plek filed for chapter 11 relief on June 24, 1996.

Notwithstanding Mid-Atlantic's separate business identity as a paper broker, it operated as little more than a separate bank account managed by Andrew Quillen to fund Cam-Plek's paper purchases during its chapter 11 proceeding. In keeping with the Cam-Plek's regular business practices, paper suppliers and Skip Quillen on behalf of Cam-Plek would make tentative deals for the purchase of paper. Skip Quillen would then prepare a purchase order for the proposed purchase, and if Cam-Plek did not have the necessary cash on hand to make the purchase directly, Skip Quillen would take the proposal to Andrew Quillen, who more often than not, would approve the purchase on behalf of Mid-Atlantic as broker. The seller would then invoice Mid-Atlantic, but would ship the goods directly to Cam-Plek, which would in turn pay Mid-Atlantic after it converted and resold the paper.

Thus as a broker, Mid-Atlantic routinely purchased loads of paper which would have otherwise been purchased directly by Cam-

Plek had it the available cash. Mid-Atlantic would then turn around and sell the paper to Cam-Plek on credit at a half-cent to one and a half-cent per pound increase. Cam-Plek was Mid-Atlantic's only customer, with the exception of one load which was sold on one occasion to an Atlanta company, and Mid-Atlantic was Cam-Plek's principal supplier.[2] Furthermore, Andrew Quillen was Mid-Atlantic's only employee; he maintained its books and records and operated the business from his office at Cam-Plek's place of business and his home.

In addition to brokering purchases for Cam-Plek, Mid-Atlantic on occasion made short-term, interest-free loans to Cam-Plek. The parties would treat these loans as "factored," whereby Mid-Atlantic would lend funds to Cam-Plek based on the agreement that Cam-Plek would repay the loan from certain accounts receivables, although no paper work was formally prepared granting Mid-Atlantic a security interest therein. Instead, the loans would be recorded on the books of Mid-Atlantic and Cam-Plek and when Cam-Plek received payment on a

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[2]Between June 1996 and May 1998, Mid-Atlantic had gross sales of $875,966.23, all but some $13,000.00 having been made to Cam-Plek. Although no evidence was presented as to what percentage of Cam-Plek's paper purchases were through Mid-Atlantic as broker, the last monthly operating report filed by Cam-Plek, which was for the month of March 1998, indicated that Cam-Plek's raw material costs from the beginning of its bankruptcy case on June 24, 1996, through March 1998 was $2,369,538.69.

"factored" account receivable, the actual check received by Cam-Plek would be endorsed over to Mid-Atlantic. The cash disbursements journal of Mid-Atlantic indicates that between July 1996 and November 1997, Mid-Atlantic made 14 different loans to Cam-Plek in various amounts ranging from $500.00 to $6,675.68. Each of these loans were repaid by Cam-Plek shortly after the loans were made and no such loans remain outstanding.

Mid-Atlantic's administrative expense claim arises out of purchases which it brokered for Cam-Plek in late April and early May 1998. Although copies of the invoices reflecting these purchases were attached to the proof of claim, Coronet asserts that Mid-Atlantic's claim is not supported by sufficient documentation. The invoices reflect that Mid-Atlantic is seeking reimbursement for the following sales:

Date	Invoice No.	Dollar Amount
4/27/98	150	493.21[3]
4/27/98	151	5,602.78
4/27/98	152	7,380.64
5/04/98	153	4,477.13
5/04/98	154	5,032.36
5/11/98	155	4,282.89
5/12/98	156	10,754.07

[3]Originally, invoice no. 150 was in the amount of $7,933.02, but this amount was reduced after Mid-Atlantic applied the proceeds from the sale of two loads of waste paper which Cam-Plek gave Mid-Atlantic in partial payment of the invoice. *See infra* note 5.

Total $38,023.08[4]

All of these transactions involved paper purchased by Mid-Atlantic from Karl M. Harrop Co., Inc. ("Harrop") for shipment directly to Cam-Plek. Coronet observes that all but one of the Harrop invoices indicate that the purchaser is Cam-Plek rather than Mid-Atlantic and questions whether any of the inventory was actually received by Cam-Plek. Murray Kossman, a vice-president of Coronet and the sole shareholder of Coronet Tennessee, testified that Cam-Plek had only about 20,000 pounds of inventory in stock when Coronet Tennessee acquired Cam-Plek's assets on May 27, 1998, and that he had been unable to determine whether any of the inventory for which Mid-Atlantic is currently seeking payment was included in the inventory which Coronet Tennessee acquired. Mr. Kossman testified that if the inventory had been sold by Cam-Plek between the time it was acquired and the time of the takeover by Coronet Tennessee, the sales were not reflected in Cam-Plek's accounts receivables, which only totaled $17,302.24 on May 27, 1998. Although the paperwork in connection with invoice no. 156 indicated that immediately upon receiving this shipment Cam-Plek resold the paper to Sylvan

[4]Notwithstanding that these amounts total $38,023.08, Mid-Atlantic seeks payment in the amount of $38,032.08. In the absence of any other explanation, the court attributes the error to a typing transposition by claimant.

Paper Company, Mr. Kossman testified that he had been unable to determine that Sylvan had paid Cam-Plek and Sylvan was not listed on Cam-Plek's accounts receivables.

To counter this testimony, Mid-Atlantic offered evidence establishing that each of the purchase orders to Harrop was in the name of Mid-Atlantic, albeit for direct shipment to the debtor, and that Mid-Atlantic paid Harrop in full for each order prior to its delivery to Cam-Plek. Furthermore, the shipping memos which correspond with each invoice were each signed by an employee of Cam-Plek indicating receipt of the shipments and Skip Quillen testified that the inventory acquired by Coronet of Tennessee from Cam-Plek included some of the inventory purchased through Mid-Atlantic. When asked if any paper brokered through Mid-Atlantic had been removed from Cam-Plek's premises, Skip Quillen testified that a load from Mid-Atlantic was being delivered to the Cam-Plek's warehouse when he learned in a telephone call from Mr. Greer that the court had denied confirmation of Cam-Plek's plan and approved Coronet's. Skip Quillen stated that as a result of this call, he directed his brother Andrew to take the load back and the Cam-Plek was never invoiced for the load. Both Skip and Andrew Quillen confirmed that within a couple of hours of receiving the load represented by invoice no. 156, the debtor resold the load to Sylvan,

although neither was asked if Cam-Plek received payment from Sylvan for the load.

Based on the evidence that inventory was shipped to Cam-Plek which had been brokered and paid for by Mid-Atlantic, the court is persuaded that Mid-Atlantic has established a legitimate claim against the estate. Although with the exception of the Sylvan load, no evidence was offered to explain what subsequently happened to the majority of the inventory after it was delivered to Cam-Plek, the court does not construe the lack of evidence offered on this subject against the claimant. As in every hearing before this court, the Quillens were found to be very credible. The fact that the inventory was not subsequently available when Cam-Plek's assets were acquired by Coronet Tennessee does not invalidate Mid-Atlantic's claim for its sales to Cam-Plek as the absence thereof may be accounted for by the simple explanation that the inventory was sold by Cam-Plek for cash.

The court turns next to Coronet's allegation that it is entitled to a setoff of $3,723.31 for the monies loaned by Cam-Plek to Mid-Atlantic or Andrew Quillen. The only evidence of an obligation by either Mid-Atlantic or Andrew Quillen to Cam-Plek is the hand-written accounts receivables list attached to the bill of sale from Cam-Plek to Coronet Tennessee, which at the

bottom of the last page, in handwriting distinct from the listing of the other accounts, references Mid-Atlantic twice, once in the amount of $1,289.81 on May 1, 1998, for account #98-5-6663 and the other in the amount of $2,433.50 on May 8, 1998, for account #98-5-6664. Skip Quillen testified that he gave the original accounts receivables list to Coronet's counsel and its representative on May 19, 1998, and that the original list did not include Mid-Atlantic. Skip Quillen stated that he did not know how Mid-Atlantic was added to the list and that he did not recognize the handwriting; it was neither his nor that of Lisa Loggans. In a colloquy with the court, Coronet's counsel stated that Lisa Loggans wrote the two Mid-Atlantic accounts on the accounts receivables list, but Lisa Loggans denied this assertion in her testimony while acknowledging that she had prepared the original list. No evidence was offered by Coronet explaining the addition of Mid-Atlantic to the accounts receivables list or otherwise establishing that Mid-Atlantic was indebted to Cam-Plek. Skip Quillen testified that to his knowledge, Cam-Plek had never loaned monies to Mid-Atlantic and this testimony was confirmed by that of Andrew Quillen. Because the evidence does not establish that Mid-Atlantic or Andrew Quillen is indebted to Cam-Plek, Coronet's assertion that it is

entitled to a setoff is without merit.[5]

Whether Mid-Atlantic's claim against the estate is entitled to administrative claim status is determined by reference to section 364(a) and (b) of the Bankruptcy Code which provide:

> (a) If the trustee is authorized to operate the business of the debtor under section 721, 1108, 1203, 1204 or 1304 of this title, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable under section 503(b)(1) of this title as an administrative expense.
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> (b) The court, after notice and a hearing, may authorize the trustee to obtain unsecured credit or to incur unsecured debt other than under subsection (a) of this section, allowable under section 503(b)(1) of this title as an administrative expense.

11 U.S.C. § 364(a) and (b).[6]

Under these provisions, persons who extend credit to the trustee or debtor-in-possession in the ordinary course of

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[5]It appears that the two Mid-Atlantic accounts referenced on the accounts receivables list were actually two loads of waste paper which Cam-Plek gave Mid-Atlantic in early May 1998 to apply toward the total indebtedness owed by Cam-Plek to Mid-Atlantic. Mid-Atlantic sold these loads to Tamco and applied the proceeds to invoice no. 150 owed by Cam-Plek to Mid-Atlantic, reducing the amount owed on this particular invoice from $7,933.02 to $493.21.

[6]Under section 1107, a debtor-in-possession has all of the rights, functions and duties possessed by a trustee. *See* 11 U.S.C. § 1107. Under section 1108, a trustee is allowed to operate the debtor's business. *See* 11 U.S.C. § 1108. Accordingly, a debtor-in-possession operating under the authority of sections 1107 and 1108 has the authority under section 364(a) to obtain unsecured credit in the ordinary course of business.

business will have administrative expense priority without any need for notice or a hearing prior to the credit extension. However, incurrence of debt or extension of unsecured credit outside the ordinary course of business will be accorded administrative expense status only if the court, after notice and a hearing, authorizes the trustee or debtor-in-possession to incur the debt. *See* 3 COLLIER ON BANKRUPTCY ¶ 364.02 (15th ed. rev. 1999). The distinction is critical in the present case because under the confirmed plan, administrative expenses will be paid in full as soon as the allowability of the claims is determined while general unsecured claimants will receive only five percent of their allowed claims paid in ten annual installments.

There is no dispute that the transactions between the debtor and Mid-Atlantic took place without court approval. In fact, as noted in a previous memorandum by the court in this case, the existence of Mid-Atlantic and its role in the Cam-Plek's chapter 11 proceeding was not even disclosed until the fall of 1997. Because Cam-Plek did not seek and obtain court approval for its credit purchases from Mid-Atlantic, Mid-Atlantic's claim against the estate is entitled to administrative expense priority under § 364(a) of the Bankruptcy Code only if the debts to Mid-Atlantic were incurred in the "ordinary course of business."

Unfortunately, neither the Bankruptcy Code nor its

legislative history provides a definition of the phrase "ordinary course of business." In an excellent discussion in the *Media Central* decision, Judge Cook of this district noted that the courts have considered two approaches in ascertaining whether a particular postpetition transaction is in the ordinary course of business. *See In re Media Central, Inc.*, 115 B.R. 119, 123 (Bankr. E.D. Tenn. 1990). This court takes the liberty of quoting extensively from the *Media Central* decision since its discussion is particularly helpful:

> One approach is to focus upon the creditor's expectation; that is, one views the disputed transaction from the creditor's vantage point and inquires whether the creditor would expect notice and hearing on the contemplated transaction. [Citations omitted.] If the transaction is an ordinary one in the debtor's business operation, the creditor would not expect notice and opportunity to object because the creditor is well aware the debtor-in-possession has been authorized by the Code to operate its business in the usual manner from day to day. On the other hand, if the contemplated transaction is unusual, out of the ordinary, the type of transaction that might be considered controversial or questionable for the debtor to undertake during its chapter 11 case, the creditors would expect to be notified and provided an opportunity to object. Even if the debtor-in-possession believes its contemplated action would be beneficial to the estate, and even if it later turns out the transaction was beneficial to the estate, if the transaction is not in the ordinary course of business, creditors still have the right to notice and hearing before the transaction is entered into. As one district court has explained:
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> > [T]he apparent purpose of requiring notice only where the use of property is extraordinary is to assure interested

> persons of an opportunity to be heard concerning transactions different from those that might be expected to take place so long as the debtor in possession is allowed to continue normal business operations under 11 U.S.C. §§ 1107(a) & 1108. The touchstone of "ordinariness" is thus the interested parties' reasonable expectations of what transactions the debtor in possession is likely to enter in the course of its business.
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> *Armstrong World Indus. v. James A. Phillips, Inc. (In re James A. Phillips, Inc.)*, 29 B.R. at 394.
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> Another approach is to compare the debtor's business with like businesses to ascertain whether the disputed transaction is ordinary for the particular type of business concerned. Under this approach, the test is "whether the postpetition transaction is of a type that other similar businesses would engage in as ordinary business." [Citations omitted.] As one court observed in illustrating this approach, "raising a crop would not be the ordinary course of business for a widget manufacturer because that is not a widget manufacturer's ordinary business." [Citation omitted.]
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> The two approaches or tests have been characterized by some courts as two dimensions to the concept of ordinary course of business. The creditor expectation test has been called the vertical dimension, and the comparable businesses test has been called the horizontal dimension. [Citations omitted.] Regardless of the labels used, however, both tests or dimensions provide an analytical framework for determining whether a transaction is in the ordinary course of business. If either test or dimension is not satisfied, most likely the disputed transaction is not in the ordinary course of business.

In re Media Central, Inc., 115 B.R. at 123-124.

Mid-Atlantic argues that its transactions with Cam-Plek meet both of these tests. With respect to the comparable business or

horizontal dimension, the evidence clearly established that purchases through a broker were not out of the ordinary, either for Cam-Plek or others in Cam-Plek's line of business. Coronet's representative conceded that it was not unusual for a paper converter to purchase paper from a broker. Furthermore, although Cam-Plek certainly had not purchased from Mid-Atlantic prior to its bankruptcy filing, Cam-Plek had conducted business with other paper brokers.

Mid-Atlantic asserts that its status as an insider does not destroy the ordinariness of the transactions between it and Cam-Plek, citing *Goodman v. Nat'l Labor Relations Bd. (In re Gloria Mfg. Corp.),* 47 B.R. 370 (E.D. Va. 1984). In *Gloria*, the court found that monies advanced to fund the debtor's payroll on an emergency basis by the son of an officer of the debtor corporation was in the "ordinary course of business" and thus entitled to administrative expense priority. *Id.* at 374. Another court has noted that there is no *per se* rule disallowing administrative expense status to an insider under all circumstances, although it denied the administrative expense claim of the president and sole shareholder of a corporate debtor who had advanced funds to the debtor to meet ordinary operating expenses. *In re C.E.N., Inc.*, 86 B.R. 303, 307 n.1 (Bankr. D. Me. 1988). The court concluded that the loans were

not in the ordinary course of business because they were incurred for the purpose of liquidating, rather than continuing the business, and no explanation had been given as to why prior court authorization for the loans had not been sought. *Id.* at 305-307.

In this court's view, the transactions in question fail to meet the creditor expectation dimension of ordinary course of business. Unlike *Gloria*, the credit extended by Mid-Atlantic in the present case for which it is now seeking payment was not on an emergency basis to meet shortfalls in operating expenses.[7] Instead, Mid-Atlantic was a separate company set up by an insider of Cam-Plek for the sole purpose of providing funds to enable Cam-Plek to purchase raw materials during its chapter 11 proceeding, without creditor intervention. The potential for abuse was enormous, as there were no safeguards, other than the involved individuals' personal honesty and integrity, which would have prevented Mid-Atlantic from charging Cam-Plek an exorbitant markup to the detriment of Cam-Plek's creditors.

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[7]Insider loans were made to Cam-Plek by Lisa H. Quillen during Cam-Plek's bankruptcy, three in the amount of $5,000.00 each and one in the amount of $3,000.00, apparently to meet shortfalls in operating expenses. These loans were repaid by Cam-Plek as follows: $2,000.00 on January 2, 1998; $3,000.00 on January 5, 1998; $2,500.00 on April 3, 1999; $2,500.00 on April 5, 1998; $2,500.00 on April 13, 1998; $2,500.00 on April 15, 1998; $1,500.00 on April 21, 1998; and $1,500.00 on May 9, 1998.

This court can not imagine a scenario more questionable or fraught with the potential for controversy. As such, creditors would expect to be notified and provided the opportunity to object prior to Cam-Plek's engagement in such a course of action. Because the transactions with Mid-Atlantic were not "ordinary" in that they do not meet the creditors' expectation of ordinariness, any indebtedness to Mid-Atlantic is not allowable as an administrative expense under 11 U.S.C. § 364(a) since it was incurred without court approval.[8]

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[8]Although this argument has not been raised by Mid-Atlantic, some courts have retroactively granted administrative expense status under unusual circumstances which justify equitable relief, notwithstanding the failure to obtain prior court approval. *See* 3 Collier on Bankruptcy ¶ 364.03[3] (15th ed. rev. 1999)(citing *Sapir v. C.P.Q. Colorchrome Corp. (In re Photo Promotion Assoc., Inc.*), 881 F.2d 6, 9 (2d Cir. 1989)(*Nunc pro tunc* authorization should only be granted in "unusual circumstances." "Whether to grant or deny retroactive authorization requires an *ad hoc* assessment of the facts and equities of each case."); *In re Braniff Int'l Airlines, Inc.*, 164 B.R. 820 (Bankr. E.D.N.Y. 1994); and *General Elec. Capital Corp. v. Hoerner (In re Grand Valley Sport & Marine, Inc.*), 143 B.R. 840, 850 (Bankr. W.D Mich. 1992)). *See also Martino v. First Nat'l Bank of Harvey (Matter of Garofalo's Finer Foods, Inc.)*, 186 B.R. 414, 431 n.10 (N.D. Ill. 1995)(District court refused to consider *nunc pro tunc* argument which had been raised for the first time on appeal, noting that "[r]etroactive authorizations are generally disfavored because they 'circumvent Congress' determination that before a court authorizes a post-petition transfer, prior notice must be given to creditors."); and *In re Massetti*, 95 B.R. 360, 364 (Bankr. E.D. Penn. 1989)(*Nunc pro tunc* relief may only be granted in "exceptional circumstances," the equities must be "compelling," and the exercise of any such discretion must take into account the
(continued...)

IV.

Lastly, the court addresses the equitable subordination issue, *i.e.*, whether the wage claims of Skip and Andrew Quillen and Lisa Loggans, which are normally entitled to administrative

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[8](...continued)
policy of construing priorities narrowly so as to protect the estate.). *But see Bezanson v. Indian Head Nat'l Bank (In re J.L. Graphics, Inc.)*, 62 B.R. 750, 756 (Bankr. D.N.H. 1986)(Bankruptcy court declined to retroactively validate an unapproved post-petition transaction. "To do otherwise would be to re-write the statute, contrary to its clear intent.").

At a minimum, the courts have required the claimant to satisfy three standards for *nunc pro tunc* approval: the court must be confident it would have authorized the postpetition financing if a timely application had been made; the court must be reasonably persuaded that no creditor has been harmed by the continuation of the business made possible by the loan; and the debtor and lender must have honestly believed they had the authority to enter into the loan transaction. *See, e.g., In re Grand Valley Sport & Marine, Inc.*, 143 B.R. at 850 (citing *In re American Cooler Co.*, 125 F.2d 496, 497 (2d Cir. 1942). Although the court is convinced that the principals involved were acting in good faith and honestly believed that they had the authority to engage in the transactions in question, the court is not persuaded that the arrangement with Mid-Atlantic would have been approved if it had been timely brought before the court. The potential for abuse was much too great and the insiders could have invested the money directly in Cam-Plek as capital contributions. Furthermore, as discussed in the equitable subordination section of this memorandum opinion, Mid-Atlantic's extension of credit to Cam-Plek harmed creditors because Cam-Plek's continued operations resulted in the incurrence of postpetition tax liability. The standards for retroactive approval of credit outside the ordinary course of business having not been met, the court refuses to exercise its discretion (if such discretion does in fact exist) and grant administrative expense status to Mid-Atlantic's claim.

expense status, should be equitably subordinated to unsecured status because the claimants have engaged in unethical behavior which resulted in injury to creditors or conferred an unfair advantage on the claimants. As evidence of the claimants' alleged unethical behavior, Coronet cites Mid-Atlantic and the role it played in the Cam-Plek's bankruptcy case. From its transactions with Cam-Plek over a twenty-three month period, Mid-Atlantic made a gross profit of $58,498.26 on gross sales of $875,966.23, which include the $38,023.08 in sales invoiced to the debtor for which Mid-Atlantic is currently seeking payment. From this gross profit, Andrew Quillen paid himself wages of $18,450.00, reimbursed himself for sales expenses (travel, gas, and meals) of $4,091.79, and paid office expenses of $4,078.39 (stationery, supplies, postage, telephone, and bank wiring charges). Andrew Quillen also paid a total of $9,600.00 in dividends to Lisa Quillen and Paul Bellamy, the other two investors in Mid-Atlantic,[9] and paid other wages of $6,450.00,

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[9]Under Lisa Quillen's investment agreement with Mid-Atlantic, she received $300.00 per month as a dividend on her $10,000.00 investment, plus the right to demand a refund of the investment plus accrued interest upon 60 days' notice. Similarly, Paul Bellamy received $150.00 per month as a dividend until November 1997 when his investment was returned to him. No evidence was offered establishing exactly how much of the $9,600.00 went to each investor although Mid-Atlantic's cash disbursement journal through December 1997 indicates that Lisa Quillen was paid $4,800.00 in dividends from June 1996 through (continued...)

of which $6,000.00 went to Skip Quillen.[10]

As an additional basis for equitable subordination, Coronet offered evidence regarding the alleged misrepresentation of the ownership of certain insurance policies, the premiums for which were paid by Cam-Plek. Listed in Cam-Plek's "SCHEDULE B - PERSONAL PROPERTY" in response to item no. 9 which requires a debtor to disclose any interests in insurance policies were two life insurance policies, one with Massachusetts Mutual on the life of Pat Quillen and another with New York Life on the life of Lisa Loggans. On July 18, 1996, shortly after the commencement of the bankruptcy case, Cam-Plek filed a motion requesting authorization to pay certain prepetition obligations, including the premium for the insurance policy on Pat Quillen which had accrued but had not been paid prepetition. Specifically, the motion requested payment of $2,085.75 to Mass Mutual Life Insurance Company for the life insurance policy on Pat Quillen in order to replace a check dated May 13, 1996, which had not been presented for deposit prior to Cam-Plek's bankruptcy filing. The motion recited that the policy was an

[9](...continued)
December 1997 and Paul Bellamy was paid $2,400.00 in dividends during this same time period.

[10]No evidence was offered as to who received the other $450.00 in wages.

asset of Cam-Plek and that the benefits were payable to Cam-Plek. By order entered August 7, 1996, the motion was granted without opposition.

Notwithstanding the representations in Cam-Plek's Schedule B and its motion, it appears that the policies were actually owned by the insured individuals rather than by Cam-Plek. The life insurance policy on Lisa Loggans was a whole life insurance policy in the face amount of $50,000.00 with a cash value of $600.00 owned by her and for which her husband was the named beneficiary. Cam-Plek paid the monthly premiums of $67.00 on this policy throughout the bankruptcy as it had done since 1994. Although the ownership of the policy on the life of Pat Quillen was not entirely clear,[11] it appears that he owned the policy and that his wife was the beneficiary instead of Cam-Plek. Again, however, the monthly premiums on this policy were paid by Cam-Plek in the amount of $1,600.00 initially, but subsequently reduced to $330.00 per month during the bankruptcy.

Both Skip Quillen, who signed the Cam-Plek's schedules on

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[11]In response to interrogatories propounded by Coronet, Lisa Loggans listed Pat Quillen as the owner of the Mass Mutual life insurance policy on his life. When questioned at trial as to whether the representation in the motion that the policy was an asset of Cam-Plek was incorrect, Lisa Loggans responded "in its present state, I would say yes" although at two earlier points in her testimony, she testified that the policy had been "assigned" to Cam-Plek.

behalf of the corporation, and Lisa Loggans testified that the reason the policies had been listed in Cam-Plek's Schedule B was because they thought they were supposed to list all of the policies for which Cam-Plek paid the premiums. Skip Quillen stated he did not fully understand that he was supposed to list only policies actually owned by the corporation and Lisa Loggans testified that they did their best to ensure that accurate schedules were filed with the court. Although no explanation was given for the misrepresentation of ownership set forth in the motion, Lisa Loggans testified that she believed that the attorney for Cam-Plek had looked at the actual policies but admitted that she could be wrong.

In addition to the premiums which Cam-Plek paid for life insurance policies on Pat Quillen and Lisa Loggans, Cam-Plek also maintained disability insurance policies for Lisa Loggans and Skip Quillen, paying monthly premiums of $75.00 or $80.00 for her policy and $84.00 for his. Coronet's counsel questioned why Cam-Plek never issued Internal Revenue Service form no. 1099 for the premiums it paid on Messrs. Quillens' and Mrs. Loggans' behalf, to which Lisa Loggans responded that she had never been told by Cam-Plek's certified public accountant that this was necessary.

Section 510(c)(1) of the Bankruptcy Code provides in

pertinent part:

> [A]fter notice and a hearing, the court may—
> (1) under principles of equitable subordination, subordinate for purposes of distribution all or part of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest.

11 U.S.C. § 510(c)(1).

The Sixth Circuit along with most courts follow the legal standard for establishing equitable subordination set forth in *Benjamin v. Diamond (In the Matter of Mobile Steel Co.*), 563 F.2d 692 (5th Cir. 1977). *See First Nat'l Bank of Barnesville v. Rafoth (In re Baker & Getty Fin. Serv., Inc.*), 974 F.2d 712, 717 (6th Cir. 1992). Under *Mobile Steel*, the following three conditions must be shown by a preponderance of the evidence to justify equitable subordination:

> 1. The claimant must have engaged in some type of inequitable conduct.
>
> 2. The misconduct must have resulted in injury to the creditors of the bankrupt or conferred an unfair advantage on the claimant.
>
> 3. Equitable subordination of the claim must not be inconsistent with the provisions of the Bankruptcy Act.

Id. at 717-18 (quoting *Matter of Mobile Steel Co.*, 563 F.2d at 699-700). *See also SPC Plastics Corp. v. Griffith (In re Structurlite Plastics Corp.*), 224 B.R. 27, 33 (B.A.P. 6th Cir. 1998). "In order to justify equitable subordination, the

bankruptcy court is required to make specific findings and conclusions with respect to each of the requirements." *Fabricators, Inc. v. Technical Fabricators, Inc. (Matter of Fabricators, Inc.)*, 926 F.2d 1458, 1465 (5th Cir. 1991).

The exact parameters of the first requirement—that the claimant must have engaged in some type of inequitable conduct—have not been comprehensively or precisely delineated, but it has been recognized to encompass: (1) fraud, illegality, breach of fiduciary duty; (2) undercapitalization; and (3) the claimant's misuse of the debtor corporation as a mere instrumentality or alter ego. *Summit Coffee Co. v. Herby's Foods, Inc. (Matter of Herby's Foods, Inc.)*, 2 F.3d 128, 131 (5th Cir. 1993). *See also In re Southwest Equip. Rental, Inc.*, 193 B.R. 276, 282 (E.D. Tenn. 1996). Claims of insiders are to be rigorously scrutinized by the courts, and less egregious conduct by an insider may support equitable subordination. *Id.* "The reason that transactions of insiders will be closely studied is because such parties usually have greater opportunities for such inequitable conduct, not because the relationship itself is somehow a ground for subordination." *Matter of Fabricators, Inc.*, 926 F.2d at 1465 (quoting *Wilson v. Huffman (Matter of Missionary Baptist Found. of Am., Inc.)*, 818 F.2d 1135, 1144 n.8 (5th Cir. 1987). Furthermore, the

claimant's inequitable conduct may be sufficient to warrant subordination regardless of whether the misconduct related to the acquisition or assertion of the claim. *Matter of Herby's Foods, Inc.*, 2 F.3d at 131.

In this court's view, Cam-Plek's payment of the monthly premiums on life and disability insurance policies for Lisa Loggans and on a disability policy for Skip Quillen was not inequitable conduct justifying subordination of claimants' wage claims. The claimants' actions in this regard were not fraudulent, illegal, or breaches of fiduciary duty; nor did they constitute the claimants' misuse of Cam-Plek as an alter ego. It is not uncommon for an employer to provide insurance benefits for its employees, especially those in management positions. The amounts of the premiums were not unreasonable and the evidence did not establish that the claimants were otherwise paying themselves exorbitant salaries and lavish benefits. Lisa Loggans' annual salary was $33,800.00 and Skip Quillen's was $35,000.00. Of course these benefits should have been reported to the Internal Revenue Service as income, probably on their annual W-2 wage statements provided by Cam-Plek. However, that failure was not intentional but rather the result of ignorance of the tax laws. Thus, while the nondisclosure may cause tax problems for Skip Quillen and Lisa Loggans, it was not

inequitable to Cam-Plek's creditors.

Similarly, the court concludes that the misstatement of ownership of the life insurance policies in Cam-Plek's Schedule B was unintentional. The court found Skip Quillen and Lisa Loggans to be sincere when they testified that they did not understand that the schedule should have only reflected policies actually owned by Cam-Plek. The error arose from the desire of Skip Quillen and Lisa Loggans to be comprehensive by reporting all life policies for which Cam-Plek paid the premiums, rather than from an effort to deceive creditors and other interested parties.

The transactions with Mid-Atlantic, however, pose a far more difficult question. From all of the hearings which have transpired in this case, the court is convinced that Cam-Plek's management throughout this bankruptcy proceeding has acted in good faith with a sincere desire to rehabilitate such that Cam-Plek could be successful as a ongoing operation and repay its obligations. The fact that it was unable to do so was a result of severe undercapitalization, the lack of credit, and the apparent lack of capital sources, rather than management's dishonesty or misuse of Cam-Plek as an alter ego. Notwithstanding Coronet's efforts to villainize the Quillen family for their participation in Mid-Atlantic, the court is

persuaded that the family legitimately believed that their actions were proper because it was their understanding that the only prohibition was that any investment forum could not be operated by an officer or director of Cam-Plek. Furthermore, the evidence did not indicate in any way that the claimants utilized Mid-Atlantic to personally enrich themselves at the expense of Cam-Plek and its creditors. A typical paper broker charges anywhere from three to seven cents per pound yet Mid-Atlantic never charged Cam-Plek more than one and one-half cents a pound. In fact, of the paper for which Mid-Atlantic is now seeking payment, invoice nos. 150, 151, and 153 had only a half cent markup and invoice nos. 152 and 155 had no markup at all. Even if the $58,498.26 in gross profit made by Mid-Atlantic over the twenty-three months that Cam-Plek was operating in chapter 11 had been evenly divided among the three claimants (which it was not),[12] each would still have made well under $50,000.00 a year in salary from Cam-Plek and profit from Mid-Atlantic, less than the average manager of a similar business.

Notwithstanding the foregoing, the fact remains that the claimants, insiders of Cam-Plek, set up a separate, secret

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[12]There was no evidence that Lisa Loggans benefited financially from Mid-Atlantic or from its transactions with Cam-Plek. Although Lisa Loggans testified that she prepared monthly summaries of Mid-Atlantic's financial records as a courtesy for her brother Andrew, she received no renumeration for this work.

company to finance Cam-Plek’s purchases during its chapter 11 proceedings free from creditor intervention or court oversight. The absolute inappropriateness of this conduct can not be ignored when considering whether the claimant’s wage claims against the estate should be allowed, regardless of the claimants’ good intentions, their mistaken good-faith belief that their actions were lawful, and the otherwise reasonableness of the profit realized by Mid-Atlantic. The integrity of the chapter 11 process, in fact of bankruptcy under any chapter, is dependent upon full and complete disclosure of all relevant matters. The claimants’ failure to make this disclosure along with their participation in furthering the secret relationship between Cam-Plek and Mid-Atlantic was a breach of their fiduciary duty to the bankruptcy estate. This court is not prepared to countenance the claimants’ improper behavior in this regard by failing to equitable subordinate their claims.

Not only were the claimants’ action inequitable, but their misconduct resulted in injury to creditors of the estate. The failure to disclose Mid-Atlantic’s existence and its transactions with Cam-Plek prevented the creditors and parties in interest from accurately evaluating Cam-Plek’s financial condition while in chapter 11. If Cam-Plek’s inability to obtain unsecured credit from a unrelated party in an arms-length

transaction had been disclosed, it is questionable whether Cam-Plek would have been allowed to continue its reorganization efforts. The court realizes that this is "Monday morning quarterbacking," but notes that the Cam-Plek's monthly operating reports reveal a debtor who was otherwise continuing its financial decline while in chapter 11. At the commencement of its chapter 11 proceedings on June 24, 1996, Cam-Plek had total assets of $1,155,504.03 and total liabilities of $3,334,416.50. In its March 1998 monthly operating report, the last such report filed by Cam-Plek, its assets had dropped to $862,606.75, while its liabilities had increased to $3,706.018.11, including $280,548.64 in post-petition liabilities. Thus, the extension of credit by Mid-Atlantic allowed Cam-Plek to continue operating at a loss and generate greater debt. In light of these findings and the absence of any basis for concluding that equitable subordination of the claims would be inconsistent with the provisions of the Bankruptcy Code, the claims will be equitably subordinated to unsecured status as requested by Coronet.[13]

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[13]Coronet has also raised the argument that the wage claims of Skip and Andrew Quillen should be denied because they were employed by Mid-Atlantic at the same time they were working for Cam-Plek. However, regardless of the fact that Skip Quillen on occasion signed purchase orders on behalf of Mid-Atlantic, the court does not conclude that Skip Quillen was employed by Mid-Atlantic. The purchase orders prepared by him were simply purchase proposals which he thereafter took to Andrew Quillen (continued...)

V.

The foregoing constitutes the court's findings of facts and conclusions of law pursuant to Fed. R. Civ. P. 52(a), as incorporated by Fed. R. Bankr. P. 7052. An order will be contemporaneously entered in accordance therewith upon the filing of this memorandum opinion.

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[13](...continued)
for approval, and Skip Quillen had no authority on his own to make purchases on behalf of Mid-Atlantic. Although on one occasion Andrew Quillen paid Skip Quillen $6,000.00 for what Mid-Atlantic's records characterize as a sales commission and Skip Quillen's 1996 income tax return lists as dividend income, it appears that in reality the payment was simply a gift, since there was no prior arrangement for the payment of the commission, the commission was not the result of any particular sale, and Skip Quillen other than through his wife had no ownership interest in Mid-Atlantic. Both Skip and Andrew Quillen testified that Skip Quillen was personally experiencing severe financial problems at the time of the payment; he was being pursued in state court on loans which he had guaranteed on behalf of Cam-Plek and his credit cards were "maxed out." Thus, Coronet's argument that the claim of Skip Quillen should be denied because he was employed by Mid-Atlantic is without merit.

On the other hand, Andrew Quillen was admittedly employed by both Mid-Atlantic and Cam-Plek. He received significant renumeration from Mid-Atlantic at the same time he was receiving a full salary from Cam-Plek, often utilizing Cam-Plek's facilities, its equipment, and employees to aid him in running Mid-Atlantic's operations. While this evidence provides an additional basis for equitable subordination, it does not justify denying his wage claim in its entirety since the evidence was uncontradicted that he continued to work full-time for Cam-Plek notwithstanding his Mid-Atlantic venture. Accordingly, Coronet's objection in this regard will be overruled.

FILED: April 30, 1999

BY THE COURT

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MARCIA PHILLIPS PARSONS
UNITED STATES BANKRUPTCY JUDGE