In the United States Bankruptcy Court

for the Northern District of Iowa

Western Division

E. R. BUSKE MANUFACTURING CO. INC.
Debtor(s).

Bankruptcy No. 96-30500X

Chapter 11
Contested No. 6033

ORDER RE: DEBTOR'S MOTION FOR RELIEF UNDER BANKRUPTCY CODE § 105

E. R. Buske Manufacturing Co., Inc. asks the court to extend the automatic stay to protect a non-debtor affiliate from the collection efforts of a common judgment creditor, Century Wrecker Company, and to bar the sale of debtor's stock by the trustee in the bankruptcy case of its largest shareholder, Earl Buske. This is a core proceeding under 28 U.S.C. § 157(b)(2)(A). Hearing was held on March 28, 1996 in Sioux City. A. Frank Baron, Esq. appeared for debtor E. R. Buske Manufacturing Co., Inc. (MANUFACTURING or DEBTOR); Donald H. Molstad, Esq. appeared for Century Wrecker Company (CENTURY); Habbo G. Fokkena, Esq., trustee in the chapter 7 bankruptcy case of Earl R. Buske, appeared pro se. Mark D. Walz, Esq. appeared for E. R. Buske Distributing Company (DISTRIBUTING); David A. Sergeant, Esq. appeared for Citizens State Bank of Pocahontas, Iowa (STATE BANK).

Debtor's motion to extend was served on all parties, but it is directed against Century. The dispute has been posed, without procedural objection, as a contested matter proceeding.

I.

Manufacturing was founded approximately 40 years ago by Earl R. Buske (BUSKE). It began as an auto body/automotive repair shop. It started making tow trucks for its own use but turned to manufacturing them for resale as a result of a demand in the marketplace. It has been successful and profitable. Manufacturing is a family-owned corporation. Earl Buske owned 87.5 per cent of Manufacturing's shares. His spouse, Mary Ann Buske, owns 10 per cent. Both are corporate directors. Earl is president; Mary Ann is secretary-treasurer.

The Buskes established E. R. Buske Distributing Company in 1966 to facilitate the calculation of excise taxes on the sale of Manufacturing's products and parts. Both Mr. and Mrs. Buske are officers and directors. Earl owned approximately 30 per cent of the shares of Distributing. Family members own the remaining shares.

The two companies operate out of Pocahontas, Iowa. Together they employ 80 people. They are located in the same building complex and share some of the employees. They keep separate books, but they produce combined as well as separate financial reports. Manufacturing sells 100 per cent of its output to Distributing which resells to end-users either directly or through other distributors. Generally, it is Manufacturing's name that is advertised in the marketplace.

Pocahontas is a county seat city in rural northwest Iowa. The city's population is about 2,200. The county has a population of about 9,100. Manufacturing employs approximately 25 per cent of the city's manufacturing work force. Manufacturing is involved in city affairs. Changes in the state's farm economy have had adverse effects on the city. It relies increasingly on its manufacturing enterprises to survive. If Manufacturing were to go out of business, it would have a devastating effect on the city. Lowell Pedersen, its mayor, believes that there would be a loss of population and significant adverse effects on the city's economy and its schools.

The affiliates' relationship is not the subject of a written agreement. The Buskes, with help from an accountant, determine the wholesale prices to be charged Distributing by Manufacturing, and each year they determine how to allocate expenses. Some expenses, such as clerical costs, are allocated to the recipient of the work. Overall, however, an effort is made to have taxable income evenly divided between the two companies.

In the year preceding Manufacturing's bankruptcy filing, Earl and Mary Ann Buske were paid $95,160.00 in salary. The couple is paid aggregate annual salaries of $250,000.00 by the two corporations. In 1995, interest payments from Distributing to the Buskes were $60,000.00.

In tax jargon, Manufacturing is a "C corporation," paying taxes on its income. Distributing is a "subchapter S corporation" with its income taxed to the shareholders after distribution to them. It appears that, for the most part, the two companies have been able to operate over the years without substantial commercial borrowing. The Buskes have lent substantial sums to Distributing. By mid-1995, such loans exceeded $600,000; the debt was represented by a joint unsecured note to the Buskes. Distributing made annual interest payments on the debt. Manufacturing borrowed from time to time also from State Bank. Because of the relatively small sizes of the loans, the Bank was able to lend without requiring security.

In 1993, Century filed a civil action in the United States Court for this district against Manufacturing, Distributing and Earl Buske claiming violations of Century patents in Manufacturing's use of a lift mechanism in its tow trucks. In March 1995, the District Court[(1)] granted partial summary judgment in favor of Century on the issue of infringement. On October 18, 1995, a jury returned a verdict for Century. It "found that Earl Buske was guilty of inducing infringement of the patents-in-suit, that each defendant had committed willful infringement, that the patents-in-suit were not invalid, and that actual damages in the case should be awarded in the amount of $1,088,457.00" (Exhibit B, District Court Memorandum Opinion, p. 4).

In ruling on post-trial motions, the District Court denied defendants' motions for judgment as a matter of law and new trial. (Exhibit B). As to Century's post-trial motions, the court awarded pre-judgment interest and post-judgment interest. The court exercised its discretion in awarding enhanced damages in the amount of one-third of actual damages. The award was based on the jury's finding of willful infringement and the court's own examination of various factors relevant to enhancement. One such factor was the defendants' ability to pay. Judge Bennett noted that since 1987, the companies had sold $43,000,000.00 worth of product, and of those sales, $32,000,000.00 had been derived from the sales of product with the mechanism patented by Century. He noted Mary Ann Buske's testimony that since 1987, family members had taken more than $2,500,000.00 in salaries plus interest on loans. The court declined to award Century attorney fees. As of January 9, 1996, the awards of actual damages, enhanced damages and pre-judgment interest totaled $1,685,764.30. Judgment entered against defendants jointly and severally; they appealed. None has filed a supersedeas bond. Century began efforts to collect its judgment.

After summary judgment entered against the defendants, but before the jury verdict, Distributing and Manufacturing obtained a joint line of credit from State Bank. The corporations executed a "Revolving or Draw Note" in the amount of $750,000.00 on September 25, 1995. To secure advances on the line of credit, they granted State Bank security interests in accounts and contract rights, chattel paper, documents, equipment, fixtures, general intangibles, instruments and inventory. The balance of Manufacturing's debt to State Bank at the time of its bankruptcy filing was approximately $350,000.00. Debtor considers State Bank fully secured.

At the time the corporations obtained the line of credit, Buskes executed a subordination agreement subordinating their security interests in the same collateral to State Bank (Exhibit 8, deposition exhibit 1). Although Buskes in the past had loaned money to Distributing on an unsecured basis, sometime in September 1995, Distributing granted each of the Buskes security interests in company assets. At that time, Distributing and Buskes agreed that Distributing would execute new promissory notes--one to Mary Ann Buske for one-half of the then balance due to the couple and one to Earl for one-half of the balance. Mr. and Mrs. Buske each received a separate security agreement and a separate financing statement to perfect their separate interests.

When questioned at trial why Distributing gave security for Buskes' previously unsecured debt, Mr. and Mrs. Buske each testified that the reason was the subject of communication from legal counsel, and each declined to answer the

question on the basis of attorney-client privilege. The court sustained the objections. The admissible evidence is sufficient, in my view, to permit the inference in this proceeding that the loan balances from Buskes to Distributing were secured because of the desire of Buskes and the corporations to protect the corporate assets from execution from Century or to prefer Buskes in payment of debt. Previously, the Buskes had made unsecured loans to Distributing. There is no evidence they had previously requested security. Distributing and Buske were being sued for a substantial amount by Century, and the District Court had already granted partial summary judgment for patent infringement. Trial was nearing. Distributing's assets were apparently unencumbered. The value of Distributing's assets was such that a judgment levy by Century would probably have put it out of business. Distributing might have perceived itself as better off granting a security interest to "friendly" corporate insiders. Buskes might well have been concerned about repayment to them. Buskes declined to testify as to why the security interests were granted at that time. I find that the loans were secured to protect Distributing's assets from the potential judgment of Century or to prefer Buskes' claims over Century's claims.

Century attempted levies on the assets of each company, but execution was not completed because Century did not pay off the prior security interests of State Bank and the Buskes. Century is asking the District Court to appoint a receiver of Distributing's assets. Hearing on its motion is set for 9:00 A.M., April 1, 1996.

Earl Buske filed a chapter 7 bankruptcy petition on March 6, 1996. Habbo G. Fokkena was appointed trustee. Buske's shares of stock in Manufacturing and his shares of stock in Distributing are assets of his estate.

Manufacturing filed its chapter 11 petition on March 8, 1996. Its schedule D shows three creditors holding secured claims. It lists Century as having a disputed secured claim in the amount of $1,696,624.00, although debtor believes the debt is really unsecured. It lists State Bank as having a secured claim in the amount of $350,000.00, and its lists $3,000.00 in real estate taxes owing to Pocahontas County. Manufacturing has scheduled no priority unsecured claims. It lists 63 general unsecured claims aggregating $62,088.84. The individual amounts of the claims range from $15.92 to $14,205.20. The unsecured claims average $985.54. Most appear to be trade creditors.

Manufacturing has scheduled its ownership interest in real estate, but has estimated only nominal value for it, indicating that an appraisal will be made to ascertain its value in the case. It has scheduled personal property valued at $592,116.00, but it lists only nominal value ($1.00 each) for equipment and inventory, again indicating that an appraisal will be obtained. Included in Manufacturing's accounts receivable is an account from Distributing. It owes Manufacturing approximately $438,000.00. A receivership of Distributing's assets could detrimentally affect Manufacturing's being paid, and thus its operation while in chapter 11.

Both companies are operating. Manufacturing has orders which will engage its production line through June 1996. Buske says that Manufacturing has come up with a substitute for the lift mechanism that he thinks will improve its product and which has been accepted by customers. He says the corporations are not infringing on Century's patents. Judge Bennett found that the defendants have "discontinued manufacture and sale of the infringed products after a jury verdict ruled against it on this issue of liability and on its defense of invalidity." (Exhibit B, Memorandum Opinion, p. 63).

II.

Manufacturing asks that the court extend the automatic stay to protect Distributing from Century's collection efforts, including Century's pending attempt to obtain the appointment of a receiver for Distributing's assets. Debtor asks that Century be enjoined through the time of confirmation of a chapter 11 plan. The automatic stay of 11 U.S.C. § 362(a), by its terms, protects the debtor and its property, not a non-debtor. Debtor asks the court to extend the stay or to enjoin Century under 11 U.S.C.

§ 105(a) which in pertinent part states:

> The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.

"It has been clearly established that bankruptcy courts may enjoin actions against guarantors, sureties, and other co-

defendants of the debtor in appropriate circumstances. River Family Farms, Inc. v. Federal Land Bank of Omaha (In re River Family Farms, Inc.), 85 B.R. 816, 818-19 (Bankr. N.D. Iowa 1987). It is an extraordinary remedy. The power should be exercised under limited circumstances "where a determination is made that failure to so enjoin would adversely affect the bankruptcy estate and pressure the debtor through that third party." Id. at 819. The court must determine whether Century's pressure on Distributing allows it to accomplish indirectly what it cannot do directly. Id. at 819. The court must consider the four factors traditionally examined to determine if a preliminary injunction should issue. These factors are:

(1) whether movant will have an adequate remedy at law or will suffer irreparable harm if the injunction is not granted; (2) the harm to Century if the injunction is granted; (3) the likelihood that Manufacturing will succeed on the merits; and (4) the public interest. Id. at 819; see also Dataphase Systems, Inc. v. CL Systems, Inc., 640 F.2d 109, 112 (8th Cir. 1981).

The "traditional test" as to an injunction has been restated in a bankruptcy context. Manufacturing must prove "(1) that there is a danger of imminent, irreparable harm to the estate or [Manufacturing's] ability to reorganize; (2) there is a reasonable likelihood of a successful reorganization; (3) the harm to [Manufacturing] outweighs the damage which the injunction causes to [Century]; the public interest in a successful bankruptcy reorganization outweighs other competing social interests." Stadium Management Corp. v. The Connecticut Bank and Trust Co., N.A. (In re Stadium Management Corp.), 95 B.R. 264, 268 (D. Mass. 1988).

Our circuit court has adopted a restated version of the traditional test. An injunction should issue

> upon a clear showing of either (1) probable success on the merits and possible irreparable injury, or (2) sufficiently serious questions going to the merits to make them a fair ground for litigation and a balance of hardships tipping decidedly toward the party requesting preliminary relief.

Dataphase System, Inc. v. CL Systems, Inc., 640 F.2d 109, 112 (8th Cir. 1981) *citing* Fennell v. Butler, 570 F.2d 263, 264 (8th Cir. 1978) *cert. denied*, 473 U.S. 906, 98 S.Ct. 3093 (1979).

Manufacturing contends it has satisfied its burden of proof and an injunction should issue. Counsel for the debtor argues that although the debtor does not yet know the elements of a plan, it may well be able to propose a plan that pays Century 100 per cent of its claim or perhaps one that Century will accept. As support for the likelihood that it can do so, it points to the debtor's past profitability. Regarding irreparable harm, debtor contends that if Century is allowed to pursue Distributing's assets or to place it in receivership, it will be a catastrophe for the operation of debtor. Debtor sells through Distributing, and the latter has set up a network of distribution through others, the value of which debtor says would be lost if Distributing is put out of business. Century counters that even if there is harm to debtor, there is an adequate remedy at law--a chapter 11 filing by Distributing. Debtor argues that this remedy is inadequate as it will at least double the administrative costs of the bankruptcy through additional legal fees. Quarterly fees could also increase. An implied reason for the injunction is that if Distributing is permitted to continue its operation, without bankruptcy, but with the protection of an injunction, it will be able to operate in the marketplace without the stigma of bankruptcy. Debtor believes that a bankruptcy filing by Distributing will make it more difficult to collect accounts and to sell in competition with those selling against Distributing's thus weakened reputation.

Debtor argues that there is little harm to Century if an injunction should issue because debtor proposes to file a plan within 60 days so that an injunction through the time of confirmation would be short. Also, debtor contends that because Century is unwilling to pay off prior secured creditors, it cannot execute anyway and because Century has no rights in Distributing's property, it has no right to a receiver. Without such right, there is no harm, debtor says, in prohibiting Century from pursuing the appointment. Debtor contends that the loss of employment in the community and the bankruptcy policy of promoting orderly resolution of all claims should weigh in favor of the injunction from the standpoint of public policy.

I will deny the motion to extend because debtor has failed to prove that it will be irreparably harmed if the injunction does not issue. If Distributing desires to protect itself from Century's onslaught, it can file its own chapter 11 case. River Valley Farms, Inc. v. Federal Land Bank of Omaha (In re River Valley Farms, Inc.), 85 B.R. 816, 819 (Bankr. N.D. Iowa 1987). Debtor's argument that this remedy is inadequate is twofold. First is that it will dramatically increase

administrative costs. Second, that a filing by Distributing will make it more difficult to collect accounts and more difficult to compete in the marketplace. Both claims may be true. However, debtor has failed to show that these harms are irreparable. Buskes set up two corporations to facilitate the calculation of excise taxes, and the creation has apparently aided them in the beneficial distribution of profits. Now there are disadvantages to having two corporations. Increased administrative costs is one. But it appears Distributing can bear those costs. Distributing should not escape the scrutiny of its operations in bankruptcy and yet obtain the benefits of a bankruptcy stay merely because of the costs of filing and administration, particularly when debtor has not shown that payment of those costs will substantially, if not irreparably, impair Manufacturing's ability to reorganize. This is particularly so when Buskes and Distributing have engineered transactions which appear to have preferred insider creditors over general creditors. It is true that bankruptcy may make it somewhat more difficult for Distributing to collect its accounts. This may be an unavoidable side effect of the bankruptcy of any merchant. Debtor has not shown that in the case of distributing, the effect rises to the level of irreparable harm to Manufacturing. It is also true that if Distributing did not have to file, it could compete in the marketplace without having to explain to customers a bankruptcy filing or its effect. But again, debtor has not shown that such effects of a filing by Distributing would lead to irreparable harm to the debtor. Distributing can protect itself from Century's execution efforts by filing a chapter 11 case. It will obtain the benefits of the automatic stay. And it will bear the corresponding burden of disclosings to creditors, particularly Century, the nature of its assets, its liabilities and its transactions with others. Accordingly, I will not grant debtor's request for a preliminary injunction to protect Distributing from execution efforts by Century. Other considerations, although not dispositive, influence my decision to to extend the stay. Such extensions might be more appropriate where the non-debtor is only secondarily liable and would have to resort to bankruptcy only because of the pressure by the creditor. Under such circumstances, the indirect pressure on the debtor is more obvious. Here, Distributing is primarily liable to Century, and it appears itself to be insolvent.

I will grant debtor's request for an injunction to prevent Earl Buske's bankruptcy trustee from selling the estate's shares in the debtor. Because of debtor's past profitability, I find it may be able to obtain confirmation of a plan. At least debtor should have the opportunity to propose a plan it believes is confirmable. If trustee Fokkena is able to sell Earl Buske's shares of stock in the debtor, the likely bidders are the Buskes and Century. It is possible the shares may have little dollar value. Under 11 U.S.C. § 1129(b)(2)(B)(i), if Century controls the voting of the unsecured class, and the class dissents as to debtor's proposed plan, either Century's unsecured claim must be paid in full or the equity shareholders can take nothing on account of their interests. Thus, the shares have cash value only if Century's claim is paid in full, which Century argues is all it really wants. If a plan would not propose to pay Century in full, the shareholders can take nothing on account of the shares so they would be valueless to Century as an investment. It appears that the true value of the shares to Century is to control the reorganization process, not for the purpose of negotiating better treatment for equity interests, but rather to prevent reorganization altogether. In Iowa, corporate powers are vested in the board of directors. Iowa Code § 490.801. This continues even in a chapter 11 bankruptcy case. In re Structurlite Plastics Corp., 91 B.R. 813, 819 (Bankr. S.D. Ohio 1988) citing 5 Collier on Bankruptcy 1103.07[3] (15th ed. 1995). If Fokkena were to sell the stock to Century, Century, as controlling shareholder of the debtor, could elect a new board of directors which could move to convert the case or to dismiss it. If Century seeks immediate dismemberment of Manufacturing to obtain immediate payment, rather than take payment over time, purchase of the stock would be an ideal opportunity to obtain that goal.

Moreover, as Century is the main unsecured creditor of Earl Buske, anything it paid for the stock, despite its potential lack of value, would come back to Century, less some administrative costs, as a chapter 7 dividend. If Fokkena sells the stock to Century, Century would get much of its money back, even if the stock is worthless, and would have obtained the power to bring the reorganization process to a halt. With its leverage as the largest unsecured creditor in Buske's case, it could likely outbid anyone else. Buskes would have to bid money which would not likely be returned to them in the nature of a dividend. They would use up their resources in buying stock to allow debtor to keep control of the reorganization process, and that might injure their financial ability to help the debtor reorganize. And whatever they paid might be lost to them if Manufacturing can make no payment to shareholders under the plan. It is not that Buskes' control of the company is more important than Century's in a reorganization sense. It is the company, now a debtor-in-possession, which has an independent right to propose a plan and which as a separate entity is given the opportunity to reorganize. It is more likely that the company will be able to do so if the present directors are continued in office. In analyzing the potential effects of Fokkena's power to sell Buskes' stock in the debtor, I am mindful of the fact that debtor and Century are competitors. As Judge Bennett put it, they are "competing industry titans in the tow truck and

wrecker recovery equipment manufacturing business." (Exhibit B, Memorandum Opinion, p. 2). If Century obtained the stock of debtor, liquidation of the debtor might well be in Century's best interest, not an effort by Century to keep the debtor in business. I find, therefore, that Fokkena's sale of debtor's stock might irreparably harm debtor's efforts to reorganize.

I do not see how prevention of such a sale irreparably harms Century. If the stock has any reorganization value, it will only be by Century's consent or by payment of Century's unsecured claim in full. Century obtains only a distribution from Fokkena in Buske's chapter 7 of something less than it would pay for the stock. Preventing the sale, as a matter of dividend participation in the chapter 7, prevents Century from taking dollars out of one pocket and putting something less than those same dollars back in another pocket. I find no serious harm to Century.

As to Fokkena, I do not believe it essential to measure irreparable harm from his perspective, as it is Buske's creditors, such as Century, who benefit or not from liquidation of his assets. He has not said that the estate otherwise has insufficient assets to allow him to conduct his administration of the estate.

Last, I believe the public interest factor weights in favor of granting the request for the injunction. If Century would buy the controlling shares of the debtor, it is likely that reorganization would not go forward. If debtor ceases to do business, it would have a substantially detrimental effect on the community. It is in the public interest that the debtor, a major employer in the city, have an opportunity to reorganize and continue its business there. There is, of course, a public interest in the trustee's fulfillment of his statutory responsibilities. But in this case, that interest is outweighed, temporarily, by the importance to the community of the debtor being given the opportunity to remain in business.

ORDER

IT IS ORDERED that debtor's motion to extend the stay or for issuance of a preliminary injunction is granted in part and denied in part.

IT IS ORDERED that debtor's motion that the automatic stay be extended to bar execution by Century Wrecker Company against E.R. Buske Distributing Company and to bar proceedings by Century Wrecker Company for the appointment of a receiver for E.R. Buske Distributing Company is DENIED.

IT IS ORDERED that debtor's motion to extend the automatic stay to prohibit Habbo G. Fokkena from selling the shares of common stock which are property of the Earl R. Buske bankruptcy estate is GRANTED. Fokkena is hereby enjoined from the sale of the estate's equity interest in Manufacturing. This stay shall remain in effect until confirmation of a plan of reorganization, dismissal or conversion of the case, or until further order of the court permitting sale. Judgment shall enter accordingly.

SO ORDERED THIS 1st DAY OF APRIL 1996.

William L. Edmonds
Chief Bankruptcy Judge

I certify that on a copy of this order and a judgment were provided to or sent by U.S. mail to: Donald Molstad, A. Frank Baron, Habbo Fokkena, David Sergeant, Mark Walz and U. S. Trustee (also by FAX to Habbo Fokkena, David Sergeant and Mark Walz).

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1. The Hon. Mark W. Bennett.