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Dated: September 26, 2007

RANDOLPH J. HAINES
U.S. Bankruptcy Judge

IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF ARIZONA

In re INTERNATIONAL FIBERCOM, INC., an Arizona corporation, et al., Debtors.	Chapter 7 Case No. 2:02-bk-02143-RJH through 2:02-bk-02163-SSC (Jointly Administered)
MAUREEN GAUGHAN, Trustee, Plaintiff, v. ZURICH AMERICAN INSURANCE COMPANY, Defendant.	Adversary No. 2:04-ap-00236 OPINION RE: CROSS MOTIONS FOR PARTIAL SUMMARY JUDGMENT

The issue here is whether the securing of a contingent liability through a security deposit constitutes a transfer for or on account of an antecedent debt for the purposes of 11 U.S.C. § 547(b) and is therefore avoidable as a matter of law. Zurich American Insurance Company ("Zurich") asserts that the security deposit was made to secure future performance of International Fibercom, Inc. ("Debtor" or "Fibercom") and was not made on account of an antecedent debt. Debtor's Chapter 7 Trustee Maureen Gaughan ("Trustee") maintains that the security deposit was made because of a written contract entered into on March 1, 2001 (the "Deductible Agreement"), that the debt was created at the time of this contract, and that payment of the security deposit during the preference period constitutes an avoidable payment on account

of an antecedent debt. The Court denies the summary judgment motions for both Zurich and Trustee because the question of whether the payment of the security deposit was made to secure future performance or was on account of an antecedent debt is a disputed material fact.

Factual Background

Debtor originally filed a Chapter 11 bankruptcy petition on February 13, 2002, which was later converted to this Chapter 7 case. On March 1, 2001, prior to the petition date, Zurich and Debtor entered into a Deductible Agreement for a workers compensation insurance policy, Policy WC 3504164-00, with a coverage term of March 1, 2001 through March 1, 2002. The Deductible Agreement renewed an existing workers compensation insurance policy, for which Debtors paid a $927,962 premium to Zurich. This policy was later extended again from March 1, 2002 through July 1, 2002, pursuant to this Court's Order of March 14, 2002 (the "Assumption Order").

The terms of the workers compensation insurance policy included a very high deductible amount that required Debtor to reimburse Zurich for the first $100,000 of each worker's compensation claim insured and paid by Zurich. When Zurich and Debtor sought this Court's approval of the "assumption" of the contract in March, 2002, they indicated that Debtor was then still current on its premium and deductible obligations.

The terms of the policy also required Debtor to provide initial collateral in the amount of $500,000 to Zurich, to secure it deductible obligations. On December 19, 2001, more than nine months after the Deductible Agreement was entered into, Debtor transferred a $500,000 security deposit to Zurich. The security deposit was to be applied by Zurich only in the event that Debtor subsequently defaulted in reimbursing Zurich for deductible amounts that had come due.

During the coverage period, Zurich provided continuous workers compensation insurance coverage. Zurich also fulfilled its obligations to Debtor by making payments on claims arising from pre- and post-petition incidents.

To continue to operate as a legal entity, Debtor needed to maintain its workers compensation insurance policies until sale of the business. After all of Debtor's assets were sold pursuant to entry of an order approving an expedited sale of all its assets on April 12, 2002, Debtor no longer needed the workers compensation insurance coverage.

Trustee has sued Zurich for the recovery of the $500,000 security deposit as an avoidable preference pursuant to § 547 on the ground that it was paid on account of an antecedent debt arising out of Debtor's obligations to Zurich in the March 1, 2001 Deductible Agreement.

The Parties' Positions

The parties do not dispute that the $500,000 security deposit paid on December 19, 2001 constitutes a transfer, or that it was made within the preference period. Rather, the parties disagree as to whether the transfer was made "on account of" antecedent debt within the meaning of § 547(b)(2).

Zurich asserts that Trustee cannot meet any of the burdens of § 547 in order to avoid the security deposit, and specifically that Trustee has failed to prove that the security deposit was made on account of an antecedent debt. Zurich argues that the security deposit was made to secure future performance of Debtor. Zurich points out that under the Deductible Agreement, it could only draw down on the security deposit if Debtor defaulted on a deductible reimbursement payment. Until that time, Zurich held only a security interest in the funds.

Trustee claims the issue is more straightforward than this. She asserts that Debtor was indebted to Zurich for the amount of the security deposit from the moment the contract was created on March 1, 2001. By Trustee's view, payment anytime after the Deductible Agreement would be a transfer "on account of" an antecedent debt. Since the security deposit was paid more than nine months after the Deductible Agreement came into effect, Trustee asserts that this was a transfer on account of the debt created by the Agreement and is therefore avoidable.

Zurich responds that since Debtor was current on its obligation to pay its deductibles when the security deposit was paid, the deposit could not have been paid on account of an

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antecedent debt. To this point, Trustee argues that Zurich's ability to draw down on the collateral is irrelevant, and that the tender of the security deposit was supposed to have been made in March under the terms of the Deductible Agreement.

Analysis

Section 547(b)(2) requires the Court to determine why the security deposit was paid. To be a preference, the payment must have been "for or on account of" an antecedent debt.[1] The case law interpreting the meaning of the phrase "for or on account of" for purposes of § 547(b)(2), however, is rather sparse.

In *203 North LaSalle*, the Supreme Court analyzed the phrase "on account of" in relation to the absolute priority rule.[2] The Court considered three possible definitions before adopting the view that "on account of" should be understood to mean "because of."[3] In so ruling, the Court cited § 547(b)(2) for support that "because of" is the most obvious understanding of the phrase, as well as the understanding intended by Congress.[4] Six years later, in *Rousey v. Jacoway*, the Supreme Court again interpreted "on account of" to mean "because of," this time in relation to a Code provision allowing debtors to exempt pensions and other benefits from the claims of creditors.[5] Therefore, this Court understands "because of" to be the most common and obvious understanding of the phrase "on account of."

Moreover, *203 North LaSalle* specifically rejected mere "but for" causation as sufficient to satisfy the meaning of "because of."[6] Although it did not use the term, the Court's analysis suggests that what is required is more akin to the tort law concept of "proximate cause."[7]

Under § 547, Trustee bears the burden proving each element of a preference payment, including the requirement that the transfer be on account of antecedent debt.[8] Here, Trustee has

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[1] 11 U.S.C.A. § 547(b)(2) (2007).
[2] *Bank of Am. v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 449-51 (1999).
[3] *Id.*
[4] *Id.* at 450-51.
[5] *Rousey v. Jacoway*, 544 U.S. 320, 326-27 (2005).
[6] 526 U.S. at 451-52.
[7] Randolph J. Haines, *The Unwarranted Attack on New Value*, 72 AM. BANKR. L.J. 387, 421-22 (Summer 1998).

failed to establish that the transfer to Zurich was on account of antecedent debt. A jury considering the transfer might conclude that Debtor made the transfer because it was contractually obligated to do so. Or, it might conclude that the real reason for the payment was to secure future obligations rather than to satisfy a past contractual obligation.[9] Or, a jury might conclude that the proximate cause of Debtor's payment was Debtor's need to ensure continued coverage and future performance by Zurich, which would clearly seem not to be on account of the antecedent debt.[10]

As part of its burdens under § 547, Trustee must also prove that Zurich received more than it would have been entitled to under a hypothetical liquidation analysis as of the petition date. As of the petition date, the Deductible Agreement was an executory contract which had been neither accepted nor rejected.[11] When determining the hypothetical liquidation value of an executory contract claim, the Ninth Circuit has held consideration of the actual resolution of the executory contract election may be proper.[12] Here, the Debtor actually sought to "assume" this

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[8] *See* § 547(g).

[9] Such a conclusion would raise a novel question of whether a contingent liability can be an antecedent debt for preference purposes. Under the Code, a contingent debt is a claim and therefore a debt. Code §§ 101(5) & 101(12). But the "antecedent debt" requirement for a preference derives from § 60 of the Bankruptcy Act, and under the Act contingent claims were not allowed. Act § 57d. This raises the question whether the meaning of "antecedent debt" for preference purposes also changed when the Code was changed to allow contingent claims. Perhaps for preference purposes "debt" retained its original meaning of a current legal obligation to pay. *See, e.g.*, *Nolden v. Van Dyke Seed Co., Inc. (In re Gold Coast Seed Co.)*, 751 F.2d 1118, 1119 (9th Cir. 1985); *CHG International, Inc. v. Barclays Bank (In the Matter of CHG Int'l, Inc.)*, 897 F.2d 1479, 1486 (9th Cir. 1990).

[10] For example, the fact that Debtor did not make the payment to Zurich until receiving a demand letter more than nine months after entering into the Deductible Agreement could support a conclusion that Debtor's payment was meant to secure future coverage and not on account of a long since passed contractual obligation.

[11] This Court's previous conclusion that the Deductible Agreement was not an executory contract when it was "assumed" is not inconsistent with this analysis that it was an executory contract as of the petition date. This Court's previous conclusion was based on a Deductible Agreement that expired prior to assumption. *See Zurich Am. Ins. Co. v. Int'l Fibercom, Inc.* (*In re Int'l Fibercom, Inc.)*, 311 B.R. 862 (Bankr. D. Ariz. 2004). As such, this Court concluded that the Deductible Agreement was not an executory contract because failure of performance at that time by Debtor would not have excused Zurich's coverage of previous injuries under Arizona law. *Id.* In contrast, a default by Debtor at the time of the transfer at issue would have entitled Zurich to cancel the Deductible Agreement and thereby relieve Zurich from coverage of injuries that might occur after the cancellation. Accordingly, a finding that the Deductible Agreement was an executory contract at the time of the transfer at issue is not inconsistent with this Court's prior analysis.

[12] *Alvarado v. Walsh (In re LCO Enterprises)*, 12 F.3d 938 (9th Cir. 1993) (finding no reason to ignore reality when determining whether a hypothetical chapter 7 trustee would assume an executory contract).

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executory contract (albeit after it had expired) and then sold its business as a going concern which necessitated Debtor maintain workers compensation insurance. Given this actual resolution, it is reasonable to assume for purposes of the hypothetical liquidation analysis that the Deductible Agreement would have been assumed on the petition date by a hypothetical chapter 7 trustee. Under such an assumption, the transfer to Zurich would not have constituted a preference because pre-petition transfers made pursuant to a validly assumed executory contract are not preferences.[13] Moreover, Zurich's receipt of the transfer did not entitle Zurich to more than it would have received under a hypothetical liquidation analysis because any failure to make that transfer would have been cured as a condition of the assumption.

For the foregoing reasons, the Court concludes that the issue of whether transfer was made by the Debtor *because of* an antecedent debt cannot be established on summary judgment because it is a material, disputed question of fact.[14] The Court therefore denies both motions for summary judgment.

DATED AND SIGNED ABOVE

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Copy of the foregoing e-mailed/mailed
this 26th day of September, 2007, to:

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[13] Disbursements made pursuant to a validly assumed executory contract do not constitute a preference because any outstanding antecedent debt must be paid as part of the required curing process.

[14] Haines, *supra* note 7, at 422 n.182.

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