

UNITED STATES BANKRUPTCY COURT  
MIDDLE DISTRICT OF TENNESSEE  
NASHVILLE DIVISION

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IN RE:

WASHINGTON MANUFACTURING  
COMPANY; KSA, INC.; and  
WASHINGTON INDUSTRIES, INC.,

Case Nos. 388-01467-WHB  
388-01468  
388-01469

Debtors.

Jointly Administered  
Chapter 11  
Judge Brown

RONALD R. PETERSON, SUCCESSOR  
TRUSTEE,

Plaintiff,

v.

Adversary Proceeding  
No. 390-0071A

BNHH PROPERTIES, INC.,  
BORDEAUX WAREHOUSE ASSOCIATES,  
VAN E. HILL, ROBERT H. HAMBLETON,  
GILBERT BIGIO, INTER-CORP, S.A. and  
FIRST AMERICAN NATIONAL BANK,

Defendants.

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MEMORANDUM OPINION ON COMPLAINT  
TO RECOVER FRAUDULENT CONVEYANCE  
FROM FIRST AMERICAN NATIONAL BANK

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This cause is before the Court on the Trustee's complaint to avoid and recover alleged fraudulent conveyances received by the defendant First American National Bank shortly before the Washington Manufacturing Company bankruptcy petition was filed. At issue is whether the conveyances were fraudulent within the meaning of 11 U.S.C. §548(a)(2). The following constitutes

findings of fact and conclusions of law in accordance with F.R.B.P. 7052. This matter is a core proceeding pursuant to 28 U.S.C. §157(b)(2)(H).

### **FACTUAL SUMMARY**

Most of the pertinent facts are stipulated and have been submitted into evidence along with exhibits and the depositions of Ms. Nedda Pollack, Ms. Lisa Butts and Mr. Paschall Young in lieu of live testimony. The stipulations are as follows:

1. In March 1987, BNHH Properties, Inc. ("BNHH") and Washington Manufacturing Company ("Washington") entered into an agreement by which BNHH agreed to arrange for the manufacture and purchase of clothing from overseas manufacturers for the benefit of Washington. The parties executed an Agreement Regarding Letters of Credit providing, in part, that BNHH would serve as account party and use its credit to secure a letter of credit facility with First American National Bank ("First American") for the benefit of Washington. [Exhibit A] Neither party canceled this agreement.

2. As of April 30, 1987, BNHH and First American entered into a Letter of Credit Facility and Security Agreement (the "Letter of Credit Facility") by which First American agreed to provide a letter of credit facility to BNHH in the aggregate amount of \$1,500,000.00 to be used for the importation of apparel goods. [Exhibit B]

3. As of April 30, 1987, First American and BNHH entered into a guaranty agreement in favor of First American. [Exhibit C] Also as of that same date, First American and Van E. Hill entered into a guaranty agreement in favor of First American. [Exhibit D]

4. Likewise, as of April 30, 1987, BNHH and First American entered into a Collateral Assignment of Sale Documents, assigning to First American all of BNHH's right, title and interest in and to the Agreement Regarding Letters of Credit, [*i.e.*, Exhibit A]. [Exhibit E]

5. For several months after First American entered into the Letter of Credit Facility, First American issued many letters of credit and honored thousands of dollars in drafts drawn on those letters. Each letter of credit transaction was commenced in this manner:

- (a) BNHH applied for each letter of credit and each letter of credit application was signed by Mr. Paschall Young as Vice-President of BNHH Properties, Inc. The letters of credit were issued in favor of overseas manufacturers.
- (b) The overseas manufacturers produced and shipped the ordered goods to the United States by way of international carrier. The manufacturers also sent to First American drafts drawn on the particular letter of credit as well as the documents of title necessary to obtain the goods upon their arrival in this country. Within three days of receipt of these documents, First American honored the draft from the overseas manufacturer if there were no discrepancies in the request from the manufacturer of goods.
- (c) Upon receipt of these documents, First American made written demand upon BNHH to reimburse First American the funds used to honor the drafts. First American also called Mr. Young or Ms. Carol Finney, who was an employee of Washington and secretary to Mr. Young. Mr. Young was an officer of both BNHH and of Washington.

6. With the exception of the transactions at issue here, First American received reimbursement in the following manner:

- (a) In response to First American's demand, Mr. Young brought by hand delivery a check drawn on Washington's account at First American in the precise amount demanded. Mr. Young handed this check to a First American representative at the International Division of the bank; the First American representative was usually either Ms. Cynthia Nicely or a receptionist at the International Division of First American. Upon receipt of the check, the First American representative handed the corresponding documents of title to Mr. Young. There was no substantive conversations between Mr. Young and the First American representative; the parties merely exchanged payment for documents of title.
- (b) Using documents of title, the goods shipped by the overseas manufacturer were obtained from the shipper, cleared through customs and sold. Washington received the proceeds of the sale of goods.

7. In February 1988, Washington was expecting shipments of spring goods from overseas manufacturers under several different letters of credit. When these apparel shipments arrived, First American honored several drafts from overseas manufacturers and made a corresponding demand for reimbursement on BNHH. First American honored drafts drawn on the following letters of credit, designated by number (which are the transactions at issue here), and made a corresponding demand on the date indicated:

- (a) On February 9, 1988:
  - (1) 1004039001                      \$10,236.50

	(2)	1004045001	\$8,135.00
(b)	On February 18, 1988:		
	(1)	1004043001	\$20,049.62
	(2)	1004039002	\$9,862.00
	(3)	1004039003	\$24,960.81
	(4)	1004017001	\$90,314.37
	(5)	1004018001	\$91,774.76
(c)	On February 23, 1988:		
	(1)	1004035001	\$82,771.36
(d)	On February 25, 1988:		
	(1)	1004033001	\$26,193.85
	(2)	1004039004	\$37,535.82

Copies of the Letter of Credit files for each of the letters of credit listed above [comprise] Exhibit F.

8. After honoring the drafts drawn on the letters of credit, First American made demand on BNHH in the same manner that First American had previously, and, as described above, on the dates set forth in ¶ 7. On February 9, 1988, First American made demand on BNHH in the amounts corresponding with the letters of credit honored on that date as set forth above. On February 18, 1988, First American made demand on BNHH in the amounts corresponding with the letters of credit honored on that date as set forth above. In response, Mr. Young delivered two (2) checks to First American, each dated February 18, 1988, drawn on Washington's account at First American in the amounts of \$150,000.00 and \$150,837.26 respectively. These two checks were

cashied by First American on February 19, 1988. Copies of these two checks are . . . Exhibit G. The combined amount of these two checks did not match exactly the amounts then due to First American. The amount paid exceeded by approximately \$44,000.00 the amount then owed to First American.

9. When Mr. Young hand delivered these two checks, not all of the expected shipments had arrived. Mr. Young instructed First American to hold the documents of title for the goods received through that date until all of the expected shipments had arrived. First American complied with the request and held the documents of title for the February 9 and February 18 shipments.

10. On February 23, 1988, First American made demand on BNHH in the amounts corresponding with the letters of credit honored on that date as set forth in paragraph 7 above. On February 25, 1988, First American made demand on BNHH in the amounts corresponding with the letters of credit honored on that date as set forth in Paragraph 7 above. First American had honored drafts drawn on letters of credit on these dates. As of February 25, 1988, there remained outstanding demands for reimbursement that neither Washington, nor BNHH had paid in the amount of \$100,996.83.

11. On March 1, 1988, Washington filed a voluntary petition for relief under chapter 11 of the United States Bankruptcy Code.

12. On March 3, 1988, Mr. Young and Ms. Nedda Pollack met regarding the outstanding sums owed to First American under the Letter of Credit Facility. Ms. Pollack is the First American representative who had negotiated the letter of credit facility on behalf of First American and was the corporate relationship manager for all Washington, or Washington affiliate, accounts. Ms. Pollack dealt with Mr. Young when problems arose in any of those relationships. At this meeting,

Mr. Young authorized Ms. Pollack to draw \$101,223.92 from BNHH's account in order to pay First American. This amount represented the \$100,996.83 outstanding under the Letter of Credit Facility, as well as an interest charge of \$227.09. This is the only letter of credit transaction in which Ms. Pollack, as a representative of First American, met with Mr. Young and the only transaction in which any amounts due were paid by BNHH.

13. In return for payment authorization from BNHH, Ms. Pollack provided Mr. Young with the documents of title for the goods relating to the letters of credit listed in ¶ [7], including the documents which First American had been holding pursuant to Mr. Young's instructions. Ms. Pollack did not ask to whom Mr. Young would deliver the documents. Ms. Pollack and Mr. Young did not discuss what entity Mr. Young represented in the transaction, and they did not discuss the fact that some of the documents of title had been paid for by Washington in February 1988 and some by BNHH on March 3, 1989.

14. At the time of this meeting, Ms. Pollack understood that Mr. Young was an officer of Washington and an officer of BNHH. At the time of the meeting, Mr. Young was an officer of Washington and an officer of BNHH. Ms. Pollack also knew that Washington had filed bankruptcy.

15. Prior to the March 3 meeting between Mr. Young and Ms. Pollack, Washington had shut down all of its operations, but Mr. Young believed that Washington would be resuming operations soon as a debtor-in-possession.

16. After receiving the documents of title, Mr. Young met with Mr. Van Hill and delivered the documents to him. Mr. Young knew at the time that Mr. Hill had been barred from Washington's building, or, if he did go to the building, he was accompanied by security. Mr. Young

understood, however, that Mr. Hill was still an officer of Washington and an officer of BNHH. Mr. Hill had resigned as President of Washington.

17. Van Hill and BNHH subsequently refused to turn over any portion of the documents of title Mr. Young picked up at First American on March 3, 1988. Despite demands from Robert Dunn, an employee of Timothy F. Finley, Trustee, Mr. Hill never turned over the documents of title for any of the goods to Washington. BNHH took the position that the goods had been imported under the BNHH Letter of Credit Facility and belonged to BNHH. Mr. Hill later attempted to use the documents of title as leverage for a global settlement of all claims the Trustee had against BNHH and Mr. Hill. A copy of the one of the BNHH letters offering the documents of title as part of a global settlement is . . . Exhibit H.

18. Washington Manufacturing was insolvent on the date that \$300,837.26 was transferred to First American.

19. The parties stipulate that the [filed] transcripts of the depositions of Ms. Pollack, Lisa Butts, and Mr. Young are, along with the exhibits thereto, offered into evidence as the testimony of lieu of live testimony.

20. To the extent that the recitations contained herein regarding the terms of the documents and deposition testimony are inconsistent with the documents and deposition testimony themselves, the language of the documents and deposition testimony shall be controlling.

### **FRAUDULENT CONVEYANCE**

The alleged fraudulent conveyances at issue here are transfers of the two Washington checks totalling \$300,837.26 to First American on February 19, 1988. As discussed above, the checks were

paid to First American for documents of title representing imported items of apparel. Washington never received the documents or the goods.

Section 548 of the Bankruptcy Code governs fraudulent conveyance questions in this context. For purposes of this proceeding, the pertinent language of the section is:

(a) [t]he trustee may avoid any transfer of an interest of the debtor in property . . . that was made . . . within one year before the date of the filing of the petition if the debtor voluntarily or involuntarily - . . .

(2)(A) received less than reasonably equivalent value in exchange for such transfer or obligation; and

(B)(i) was insolvent on the date that such transfer was made . . . .

There is no question but that the funds belonged to Washington and thus, were "an interest of the debtor in property." 11 U.S.C. §548(a). In addition, the parties here have stipulated that the transfers were made within one year before the date of Washington's bankruptcy filing and when Washington was insolvent. The only remaining issue is whether the debtor received "reasonably equivalent value" for the transfers. The Bankruptcy Code defines "value" for purposes of §548 as "property, or satisfaction or securing of a present or antecedent debt of the debtor . . ." 11 U.S.C. §548(d)(2)(A).

As noted above, Washington never received the documents of title representing the goods for which it paid. Nonetheless, First American contends that Washington received reasonably equivalent value in exchange for the \$300,837.26 because it "received satisfaction of its liability to First American." Pretrial Brief of Defendant . . . Bank, p 7. Washington's liability to First American is outlined at ¶ 2 of Exhibit A, the "Agreement Regarding Letters of Credit" executed only by Washington and BNHH as follows:

2. Washington acknowledges that issuance of the letters of credit contemplated by this agreement will benefit Washington, and, accordingly, Washington hereby agrees that it will promptly on demand reimburse BNHH or the issuing bank, as appropriate, for any and all fees, costs or other charges which may be imposed by such issuing bank in connection with issuance or administration of the letters of credit, as well as for the amounts of any and all drawings thereunder, plus interest thereon, if applicable.

Paragraph 3 of this same agreement describes in further detail the arrangement between these two parties and directs that Washington's liability under paragraph 2 is to be satisfied with proceeds generated from the sale of the imported items of apparel. Specifically, paragraph 3 provides:

3. Washington hereby appoints BNHH as Washington's agent to market items of apparel which have been imported in connection with letters of credit as contemplated hereunder, and hereby grants to BNHH a non-exclusive license to utilize one or more of the Brand Names in connection therewith. Proceeds received by BNHH as a result of such marketing shall be applied first, to the reimbursement of Washington or the issuing banks, as appropriate, for all items and charges as to which Washington is liable, pursuant to paragraph 2 hereof, and the balance shall be paid to or at the direction of Washington. In no event shall BNHH have rights of ownership, sale, or otherwise, in any items of apparel or other property of Washington, other than such items of apparel as have been imported in connection with letters of credit contemplated hereunder, and then only if and to the extent that Washington has failed to reimburse BNHH or the issuing bank, as appropriate pursuant to Paragraph 2 hereof. BNHH agrees that, to the extent reasonably practical, it will conduct such marketing in accordance with customary marketing and distribution practices of Washington, unless otherwise specifically directed by Washington.

(Emphasis added)

Thus, while paragraph 2 may have established that Washington would be ultimately liable for reimbursement of the letter of credit draws and expenses, paragraph three limits the source for satisfaction of that liability to the imported items of apparel that were the subject of the respective letters of credit. The borrower from the Bank was BNHH. Exhibit B. BNHH had assigned its

agreement (Exhibit A) with Washington to First American. Exhibit E. But, Washington was not a guarantor of BNHH's loan and was not directly liable to First American. At the time the funds at issue were paid to First American, and continuing until after Washington's bankruptcy petition was filed, First American had possession of the documents of title for the imported items which were subject to sale for satisfaction of Washington's liability. Given this possession, it may be concluded that Washington's liability to First American was, at a minimum, secured and, in substance, satisfied without the \$300,867.26 payment from Washington. First American's position was analogous to that of an oversecured creditor whose claim is adequately protected. Consequently, even though Washington was theoretically contingently liable to reimburse First American for letter of credit expenses and draws under the above agreement with BNHH, Washington had no actual liability in need of security or satisfaction as required by §548(d)(2)(A) with respect to the transaction at issue because First American possessed the documents of title. Moreover, because Washington did not receive those documents or anything else in exchange for the \$300,867.26 payment, it may be concluded that it received no value, reasonable or otherwise, direct or indirect, for that transfer. See, In re Cavalier Homes of Georgia, Inc., 102 B.R. 878, 885 (Bankr. M.D. Ga. 1989) ("The debtor must receive the required value, not some third party." (quoting In re Vadnais Lumber Supply, Inc., 100 B.R. 127, 136 (Bankr. D. Mass. 1989))). Unlike the prior letter of credit transactions, the last two checks from Washington do not reference specific letters of credit being paid nor can the checks be matched up with a specific letter of credit demand from First American. BNHH paid a portion of the total debt due First American and in return BNHH received all of the documents of title from the bank.

## AGENCY DEFENSE

First American next contends that the Trustee cannot establish that Washington received less than reasonably equivalent value because, postpetition, it released the documents of title for which Washington made payment to Mr. Paschall Young, who was acting as the agent for Washington. According to First American, under these circumstances, delivery of the documents to Mr. Young was "delivery of the documents to Washington as a matter of law.": Pretrial Brief of Defendant . . . Bank, p. 5. As noted above, Mr. Young is the former employee of both Washington and BNHH, who served prepetition as the liaison to First American with respect to the letter of credit transactions and thus, acted as an agent in this regard. As such, it is First American's position that Mr. Young continued to occupy the status of agent for Washington, actual or apparent, postpetition. A finding of actual or apparent agency would defeat the trustee's claim because the debtor, Washington, would be bound as a matter of law by the postpetition acts of its agent. Tosco Corp. v. Federal Deposit Ins. Corp., 723 F. 2d 1242, 1248 (6th Cir. 1983).

Under Tennessee law, applicable here, the burden of establishing the existence of an agency relationship is on the party asserting the relationship. Jack Daniel Distillery, Lem Motlow Prop. v. Jackson, 740 S.W. 2d 413, 416 (Tenn. 1987). The evidence presented here establishes that while Mr. Young was a prepetition employee of Washington, he was instructed on the date the petition was filed "not to come back to work the next day." Deposition of Mr. Young, p. 6. He further testified that he never went back to work for Washington. Id. pp. 7 & 37. Moreover, Mr. Young stated that he acted on his own initiative when he obtained the documents of title postpetition. Id. pp. 17-21. It is evident from these facts that Mr. Young was not acting under actual authority when he obtained the documents of title. In addition to these facts, there is legal authority that contracts of

agency given by the debtor prepetition generally are revoked upon the filing of a bankruptcy petition. See, e.g., In re Universal Motor Express, Inc., 72 B.R. 208, 210 (Bankr. W.D.N.C. 1987); RESTATEMENT (SECOND) OF AGENCY §114 (1992 Supp.); see also generally 11 U.S.C. §365.

Thus, the issue becomes whether Mr. Young was the debtor's "apparent agent" for purposes of the postpetition transaction with First American. It is well settled in Tennessee that:

The apparent power of an agent is to be determined by the acts of the principal and not by the acts of the agent; a principal is responsible for the acts of an agent within his apparent authority only where the principal himself by his acts or conduct has clothed the agent with the appearance of authority, and not where the agent's own conduct has created the apparent authority. The liability of the principal is determined in any particular case, however, not merely by what was the apparent authority of the agent, but by what authority the third person, exercising reasonable care and prudence, was justified in believing that the principal had by his acts under the circumstances conferred upon his agent. (citation omitted).

Tosco Corp. v. FDIC, 723 F. 2d at 1248-49 (quoting, Southern Ry. Co. v. Pickle, 138 Tenn. 238, 245-246 , 197 S.W. 675, 677 (1917)); see also V.L. Nicholson Co. v. Transcon Investment and Financial Ltd., Inc., 595 S.W. 2d 474, 483-484 (Tenn. 1980).

As set forth in the stipulations and in the depositions, the facts are that Ms. Nedda Pollack, First American's representative who handled the transactions at issue here, knew that Washington had filed bankruptcy two days before her meeting with Mr. Young. Stipulations, ¶14; Deposition of Ms. Pollack, p. 12. In fact, she had tried to contact Mr. Young or other Washington officials to inquire about the outstanding indebtedness to the bank of \$101,223.92 at the time the petition was filed. Id. As of March 1, 1988, the day of the bankruptcy filing, all of Washington's operations were shut down.

The filing of a bankruptcy petition creates an estate generally comprised of all legal and equitable interests of the debtor in property wherever and by whomever held. 11 U.S.C. §541. Any entity holding property of the debtor that may be used, leased or sold is obligated by law to turn that property over to the debtor in possession or trustee. 11 U.S.C. §542. Moreover, the Bankruptcy Code empowers the postpetition debtor to "deal with its contracts and property in a manner it could not have done absent the bankruptcy filing." N.L.R.B. v. Bildisco and Bildisco, et al., 465 U.S. 513, 104 S. Ct. 1188, 1197, 79 L. Ed. 2d 482 (1984).

Without making any inquiries of Mr. Young as to the destination of the documents of title or the status of Washington, Ms. Pollack released Washington's documents of title to Mr. Young after Washington had filed bankruptcy. More importantly, Ms. Pollack who had been in the banking industry for four years and was presumably a sophisticated banker at the time of the postpetition transaction released property of the bankruptcy estate upon receipt, for the first time, of a partial payment from BNHH when she knew BNHH to be an affiliated but separate company. Deposition of Ms. Pollack, p. 10. She acted in complete disregard to the effect the bankruptcy filing would have on relations between Washington and its creditors, including First American. Under these circumstances, it may be concluded that First American failed to exercise reasonable care and prudence when it released \$300,867.26 worth of the debtor's documents of title that had become property of the bankruptcy estate to Mr. Young without any inquiry regarding his status with the debtor and his intentions toward the documents. Given its knowledge of the bankruptcy filing, it was not reasonably justifiable for First American to believe that the debtor postpetition had conferred agent authority upon Mr. Young without the bank's inquiry as to such authority. There is no proof that the debtor in bankruptcy affirmed Mr. Young's authority to act for the bankruptcy

estate nor that the bankruptcy estate acted in any manner to create apparent authority. Therefore, the Court finds that Mr. Young was not acting as Washington's apparent agent when he obtained the documents of title from First American and delivered them to Van Hill.

### **CONCLUSION**

From the above findings and conclusions, the Court will order that the Trustee's complaint to recover fraudulent conveyances from First American National Bank is granted, and the Trustee is entitled to judgment against First American in the amount of \$300,827.36. See 11 U.S.C. §550(a). Due to the delay in trial of this proceeding, which was not the fault of the parties, and in view of the total facts and circumstances, the Court does not believe it is appropriate to award prejudgment interest. The judgment will accrue postjudgment interest at the federal rate until satisfied. A separate order and judgment will be entered.

**SO ORDERED** this 16<sup>th</sup> day of May, 1994.

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WILLIAM HOUSTON BROWN  
UNITED STATES BANKRUPTCY JUDGE  
BY DESIGNATION

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