IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

In re: Welded Construction, L.P., *et al.,* Debtors.	Chapter 11 Case No. 18-12378 (LSS) (Jointly Administered)
Welded Construction, L.P., Plaintiff, vs. Industrial Fabrics, Inc., Defendant.	Adv. No. 20-50932 (LSS) Re: Adversary Docket No. 39,40,47,50

REPLY TO THE PLAINTIFF'S RESPONSE TO DEFENDANT'S MOTION FOR SUMMARY JUDGMENT

Filed on: May 16, 2022

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11 U.S.C. §547(c)(2)

Industrial Fabrics, Inc. (the "Defendant"), by and through its undersigned counsel, submits this Reply in support of its *Motion for Summary Judgment* (the "Motion") [Adv. D.I. 39] and in response to the *Response in Opposition to Defendant's Motion for Summary Judgment* (the "Opposition") [Adv. D.I. 47] filed by Welded Construction, L.P. (the "Plaintiff").

PRELIMINARY STATEMENT

The Court should grant the Defendant's Motion since the record evidence proves that without any genuine issue of material fact, and as a matter of law, that the Transfers[1] cannot be avoided since they were made: (i) in exchange of the Defendant's waiver of its inchoate lien rights which resulted in an "indirect transfer" that benefitted the Debtors (the "Indirect Transfer Defense"); and (ii) in the ordinary course of business or financial affairs of the parties (the "Ordinary Course of Business Defense").

This outcome is required by the terms of the Bankruptcy Code and the case law construing it.

Under the Indirect Transfer Defense, the Defendant's release of its inchoate lien rights against the Pipeline Projects caused a coincident and equivalent release of the Project Owner's claims against the Debtors, thereby allowing the Debtors to collect more fully on the amounts owed to them by the Project Owners.

In its Opposition, the Plaintiff argues that the absence of a written lien waiver from the Defendant would have hampered the Debtors' ability to collect payment from the Project Owners. This argument is absurd for several reasons, but primarily because it assumes the Project Owners would act against their own interests.

If the Defendant asserted a lien against the Pipeline Projects and was paid by the Project Owners consequent to that lien, the Project Owners would have insisted that the amount paid to

[1] Capitalized terms in this Reply are defined in the Motion.

the Defendant be set off against the amount owed to the Debtors. The Project Owners would have insisted on the set off regardless of the absence of a written lien waiver. To assume otherwise would be to assume that the Project Owners acting against their own interests which is clearly unreasonable.

Moreover, the Ordinary Course of Business Defense is designed to protect recurring credit transactions that are consistent with the parties' prior course of dealings.

In its Opposition, the Plaintiff argues that the length of the parties' relationship is insufficient to establish a baseline of dealings for the Ordinary Course of Business Defense. It also argues that the Transfers were paid significantly later than the prior payments. The Plaintiff, however, is mistaken.

Contrary to the Plaintiff's allegation, the Historical Period presented by the Defendant spanned 14 months (not 8 months) which is more than sufficient to establish a baseline of dealings between the parties. Moreover, the timing of the Transfers was consistent with the timing of Historical Period payments based on several well-established methods of analysis. The Plaintiff heavily relies on the declaration of the Debtor's former Human Resources Manager to dispute the consistency of the Transfers, but such declaration was not based on the affiant's personal knowledge and is therefore inadmissible.

For the reasons set forth above, summary judgment should be granted in favor of the Defendant and the Plaintiff's claims dismissed.

ARGUMENTS IN REPLY

I. PLAINTIFF CANNOT MEET ITS BURDEN OF PROOF UNDER 11 U.S.C. §547(b)(5)

In a preference case, it is the plaintiff's burden to show that the alleged transferee received more on account of the transfer than it would have had received in a hypothetical chapter 7 liquidation. 11 U.S.C. §547(b)(5); *AFA Inv. Inc. v. Trade Source, Inc. (In re AFA Inv. Inc.),* 538 B.R. 237, 243 (Bankr. D. Del. 2015); and *Giuliano v. RPG Mgmt. (In re NWL Holdings, Inc.),* Case No. 08-12847 (MFW), Adv. No. 10-53535 (MFW), 2013 Bankr. LEXIS 2360 at *7- 8 (Bankr. D. Del. June 4, 2013).

To meet its burden under 11 U.S.C. §547(b)(5), the Plaintiff must show that the Defendant, by receiving Transfers, received **more** than it could have received in a hypothetical chapter 7 liquidation of the Debtors' estate. The Plaintiff, however, cannot meet that burden because the Defendant would have had a lien over the Debtors' estate if the Transfers were not paid.

A. Inchoate Liens are Security Interests

As fully explained in the Motion, the Defendant held an inchoate materialman's lien under W. Va. Code § 38-2-4 at the time that the two Transfers were made by the Debtors to pay the Defendant's invoice for goods shipped to and utilized in the Mountaineer Pipeline. The Defendant likewise held an inchoate mechanic's lien under 49 Pa. Stat. Ann. § 1301 when the remaining Transfer was made by the Debtors to pay the Defendant's invoice for goods shipped to and utilized in the Mariner Pipeline. The Defendant contemporaneously waived these inchoate liens when it received the Transfers from the Debtors.

A lienor with a right to perfect an unperfected statutory lien holds an inchoate lien. *In re Vienna Park Properties*, 976 F.2d 106, 112 (2nd Cir. 1992) cited favorably by *In re SeSide Co.*

152, B.R. 878, 1993 U.S. Dist. LEXIS 4177 (E.D. Pa. 1993).

Hence, as a preliminary matter, it must be noted that the Defendant would have been a secured creditor of the Debtors for the entirety of the Transfers had the Defendant not been paid for its goods.

B. Plaintiff's Evidence is Inadmissible

To show that the Defendant received more than it could have received in a hypothetical chapter 7 liquidation, the Plaintiff relies heavily on the Declaration of Jacklyn Krzysztofik (the "Krzysztofik Decl."), the former Human Resources Manager and post-Effective Date consultant of the Debtors, to establish the elements of its preference case.

In the Krzysztofik Decl., Ms. Krzysztofik simply states that she became "generally familiar with the Debtors' books and records, operations and vendor relationships" in the course of her duties.[2] However, neither the position Human Resources Manager nor the position of consultant would require Ms. Krzysztofik to regularly access or control the Debtors' financial books and records. In fact, aside from the sweeping and self-serving declaration quoted above, Ms. Krzysztofik does not sufficiently explain *how* she became familiar enough with the Debtor's financial books and records to make claims and representations about the parties' relationship and payment practices.

For example, Ms. Krzysztofik claims that there "do not appear to be enough assets to pay general unsecured claims in full." However, this claim was based merely on "the schedules filed in this bankruptcy proceeding," not Ms. Krzysztofik's personal knowledge.

To the extent that Ms. Krzysztofik based her claims on the Debtors' financial books and records, Ms. Krzysztofik has also failed to show any personal knowledge which could confirm the accuracy of the data entered in the books and records. Ms. Krzysztofik did not personally

[2] *See* ¶2, Krzysztofik Decl.

enter the data nor did her duties regularly allow her access to such data.

Hence, the Plaintiff's primary basis for asserting that the element in §547(b)(5), i.e., the Krzysztofik Decl., was not based on the affiant's personal knowledge and is consequently inadmissible.

Based on the foregoing, the Plaintiff is unable to meet its burden under 11 U.S.C. §547(b)(5) and the Transfers cannot be avoided.

II. PAYMENTS MADE IN EXCHANGE FOR WAIVER OF INCHOATE LIENS ARE MADE IN EXCHANGE FOR NEW VALUE AND CANNOT BE AVOIDED PURSUANT TO 11 U.S.C. 547(c)(1)

Given that the Defendant was an inchoate lien holder, the waiver of those inchoate liens bars the avoidance of the Transfers under 11 U.S.C. §547(c)(1).

As more already explained in the Motion, courts have consistently found a waiver of inchoate liens in exchange for the receipt of an otherwise preferential transfer is a transfer of new value under 11 U.S.C. 547(c)(1).

A. Indirect Transfer Defense

The "indirect transfer" defense theory is invoked when there is a nexus between a bankruptcy debtor's facially preferential payment to a creditor and the transfer of new value to the debtor by a third party. *Instrumentation & Controls, Inc. v. Ne. Union, Inc. (In re Instrumentation & Controls, Inc.)*, 506 B.R. 677 at 679 (Bankr. E.D. Pa. 2014). Reduced to its essence, a creditor raising this defense theory is asserting that when it received the payment from the debtor, it waived rights against or otherwise caused a third party to provide value to the debtor. *Id.*

In evaluating a §547(c)(1) defense based on the "indirect benefit" theory, the touchstone is the ultimate impact on the bankruptcy estate. *Id.* at 680. If the value the debtor received from the third party equaled the payment the debtor made to the creditor, there was no loss to the estate and 11 U.S.C.S. § 547(c)(1) provides a defense to the preference claim. *Id.* at 679

Commonly, the "indirect transfer" defense theory is asserted when: (1) the debtor owes a debt to its creditor; (2) the creditor has recourse in some form against the third party if the debtor defaults; and (3) after the creditor could exercise its rights against the third party, as a result of which the third party may invoke indemnification rights against the debtor. *Id.* at 679. A significant variable in this three-party relationship, insofar as the §547(c)(1) defense is concerned, is whether the third party itself owes an obligation to the debtor giving rise to an ability to set off its payment to the creditor against amounts that it may owe the debtor. *Id.*

The reasoning behind the "indirect transfer" defense was discussed in *In re J.A. Jones*, 361 B.R. 94 at 103 (Bankr. W.D.N.C. 2007) which held that, "Section 547 requires [the court] to hypothesize what the subcontractor would have received in bankruptcy had the allegedly preferential payment not been made. We cannot fairly assess how the subcontractor would have fared without projecting how it would have reacted to nonpayment. Since an individual subcontractor's reaction is unknowable, an objective approach should be employed, asking 'what would a reasonable materialman have done in response to that nonpayment.' It takes little commercial construction expertise to answer. A reasonable subcontractor would assert his legal rights, liening the project, perfecting those liens and forcing payment through the owner. We should also assume a reasonable behavior by the project owner. Again, this requires almost no imagination. With liens on this project, the owner would have no reasonable alternative but to pay the subcontractor and then seek indemnification from the general contractor. To make any other assumption would defy reality. It would also penalize the lien creditor for accepting payments. It would also defy commercial reality. A subcontractor would not long remain in business if it made a practice of refusing payments from its general contractor in favor of enforcing lien rights against the underlying project. No one would hire such a subcontractor."

B. Non-ownership of the Pipeline Projects does not defeat the Defendant's affirmative defense

The Plaintiff argues that no value was received by the Debtors since it did not own the Pipeline Projects. The Plaintiff, however, is mistaken.

In fact, as discussed above, the relationship and interplay of rights between a creditor (i.e., the Defendant), debtor (i.e., the Debtors), and third-party (i.e., the Project Owners) is essential for the Indirect Transfer Defense.

In applying the Indirect Transfer Defense, courts have found value in the inchoate liens of subcontractors even though the debtor was merely a general contractor and did not own the properties on which the inchoate liens would have attached. See *JWJ v. Reuter*, 2003 U.S. APP. LEXIS 18413 (9th Cir. 2003) (where the Court of Appeals for the 9th Circuit affirmed the district court's decision that the debtor's payment to the subcontractors avoided the imposition of an equitable lien by a surety); *Taylor v. White*, 257 B.R. 289 (Bankr. W.D. Mo. 2000) (holding that in the event the subcontractor had not been paid by the debtor, the third-party owner would have paid the subcontractor/defendant and liened the debtor); *Gem Construction v. Guard Masonry*, 262 B.R. 638 (E.D. Va. 2000) (holding that the defendant, by forbearing to place a lien on the surety in exchange for the payments, did contribute new value since the surety would have placed a lien on the monies owed from the owner to the debtor); *In re J.A. Jones*, 361 B.R. 94 (Bankr. W.D.N.C. 2007) (holding that a subcontractor's release of inchoate lien rights against projects serviced by the general contractor debtor can constitute new value if, at the time of the alleged preference payment, the project owners still owed sufficient sums to the debtor on the project to permit a setoff); and *Instrumentation & Controls, Inc. v. Ne. Union, Inc. (In re*

Instrumentation & Controls, Inc.), 506 B.R. 677 (Bankr. E.D. Pa. 2014) (same).

Similar to the foregoing cases, the Defendant provided new value to the Debtors despite the fact that the Debtors did not own the Pipeline Projects. According to the Indirect Transfer Defense, the Defendant's release of its inchoate lien rights against the Pipeline Projects caused a coincident and equivalent release of the Project Owner's claims against the Debtors, thereby allowing the Debtors to collect more fully on the amounts owed to them by the Project Owners. Consequently, there was a contemporaneous exchange of new value for the Transfers which prevents their avoidance under 11 U.S.C. §547(c)(1)

C. Absence of a written lien waiver does not defeat the Defendant's affirmative defense

The Plaintiff argues that no value was received by the Debtors since the Defendant did not execute written lien waivers in exchange for the Transfers. The Plaintiff claims that the Debtors "could not be assured of payment" from the Project Owners in the absence of the written lien waivers.

i. Written lien waivers were not an indispensable requirement for the Project Owner's payments to the Debtors

The Plaintiff claims that the Debtors were not "assured" of repayment based on the terms of their agreements with the Project Owners.

The Plaintiff cites Section 3.2(d), (e) of the agreement pertaining to the Mountaineer Pipeline requires, as a condition to payment, that the Debtors furnish "signed and notarized unconditional partial Lien waivers and releases from Contractor and each **Major Subcontractor** applicable to Work completed". [Emphasis added].

Since the term "Contractor" in the said agreement clearly refers to the Debtors, the Plaintiff appears to argue that the Defendant was a "Major Subcontractor" and that the Debtors were required to furnish a signed and notarized lien waiver was required from the Defendant before they could be paid.

The term "Major Subcontractor" is defined in Section 1.1(VV) of the said agreement as "any Subcontractor with a contract with a cumulative expected value of more than $500,000."[3]

The Plaintiff, however, has offered no evidence to show that the Defendant even qualifies as a Major Subcontractor, i.e., that the cumulative value of the goods purchased from the Defendant exceeded $500,000. Presently, only the second and third Transfers amounting to $197,520 have been shown to relate to the Mountaineer Pipeline.

The Plaintiff also cites Section 5.3.1 of the Debtors' agreement pertaining to the Mariner Pipeline provides that "Contractor shall also provide partial lien waivers from its subcontractors ***when required by Sunoco***." [Emphasis added].

Based on the plain language of the above-cited provision, the Debtors would only be compelled to present written lien waivers when required by Sunoco. The Plaintiff, however, has offered no evidence to show that Sunoco ever required the Debtors to present written lien waivers.

For the foregoing reasons, it should be abundantly clear that the written lien waivers were not an indispensable requirement for the Debtors to receive payment from the Project Owners. As further evidence of this, the Court need only examine the Appendices H and I of the Motion which show that the Debtors were still paid despite the absence of the written lien waivers.

ii. The Debtors were paid by the Project Owners despite the absence of a written lien waiver

Despite claiming that the Debtors were not "assured" of repayment, the Plaintiff does not directly state that the Debtors were "never" paid. The reason for this is simple – the Debtors

[3] Section 1.1(VV), Exhibit G of the Opposition.

were, in fact, paid by the Project Owners despite the absence of the written lien waivers.

As indicated in Appendix H of the Motion, Sunoco consistently paid the Debtors for work done on the Mariner Pipeline. In fact, on the exact date of the first Transfer,[4] the Debtors were paid for work done on at least two invoices with a combined total of $1,037,350.9.[5] The Debtors also had at least two invoices outstanding with a combined total of $636,995.64.[6]

Similarly, as indicated in Appendix I of the Motion, Columbia Gas consistently paid the Debtors for work done on the Mountaineer Pipeline. In fact, on or about the date of the second Transfer, the Debtor had an outstanding invoice for $15,236,051.11;[7] and, on or about the date of the third Transfer, the Debtor had an outstanding invoice for $7,755,982.40.[8] Both of which were eventually paid by the Project Owners.

The mere fact that the Debtors were paid by the Project Owners despite the absence of written lien waivers from the Defendant shows that the absurdity of the Plaintiff's argument. Clearly, the written lien waivers were not an indispensable requirement for the Debtors to receive payment from the Project Owners.

iii. The Debtors were paid by the Project Owners precisely because the Defendant waived its inchoate liens

Section 547 requires the Court to hypothesize what how the Defendant would have fared in bankruptcy had the Transfers not been made. *J.A. Jones*, 361 B.R. 94 at 103.

If the Transfers were never made, the Defendant would have placed liens on the Pipeline Projects, pursuant to its standard business practices. *See* ¶12, Appendix A of the Motion. With

[4] The first Transfer represents payment of an invoice for goods shipped to and utilized in the Mariner Pipeline.
[5] Invoice No. 30077-058 for $679,571.32 dated 7/11/2018 and Invoice No. 30082-041 for $357,779.58 dated 7/11/2018.
[6] Invoice No. 30077-064 for $410,228.89 dated August 2, 2018 and Invoice No. 30082-047 for $226,766.75 dated August 2, 2018, both of which were paid on September 4, 2018.
[7] Invoice No. 201801-MXP-011 for $15,236,051.11 dated August 31, 2018.
[8] Invoice No. 201801-MXP-012 for $7,755,982.40 dated September 14, 2018.

liens on this Pipeline Projects, the Project Owners would have no reasonable alternative but to pay the Defendant and then seek indemnification from the Debtors, as the general contractors. The indemnification would take the form of a set off against the amounts that the Project Owners owed to the Debtors, which were more than sufficient at the time of the Transfers.

The foregoing is the exact scenario envisioned in *J.A. Jones,* 361 B.R. 94. Furthermore, as shown in *Instrumentation & Controls,* 506 B.R. 677 and *JWJ v. Reuter*, 2003 U.S. APP. LEXIS 18413, a written lien waiver is unnecessary for new value to result from the transaction. Reduced to its essence, a creditor raising this defense theory is asserting that when it received the payment from the debtor, it waived rights against ***or otherwise caused a third party to provide value to the debtor***. *Instrumentation & Controls,* 506 B.R. 677at 679. In evaluating a §547(c)(1) defense based on the "indirect benefit" theory, the touchstone is the ultimate impact on the bankruptcy estate. *Id.* at 680. If the value the debtor received from the third party equaled the payment the debtor made to the creditor, there was no loss to the estate and 11 U.S.C.S. § 547(c)(1) provides a defense to the preference claim. *Id.* at 679.

In the present case, the Defendant clearly provided value to the Debtors. When the Defendant received the Transfers, it was prevented from asserting its inchoate liens against the Pipeline Projects and seeking payment through the Project Owners, **regardless of the absence of a written lien waiver.** Consequently, the Debtors no longer had to indemnify the Project Owners and were able to collect more fully on the amounts owed to them by the Project Owners. In contrast, if the Transfers were never made, the Project Owners would have paid the Defendant and the Debtors would have had to indemnify the Project Owners for the amount paid. Hence, there was no loss to the bankruptcy estate and the touchstone for the Indirect Transfer Defense has been met. *Instrumentation & Controls*, 506 B.R. 677 at 679.

THE TRANSFERS WERE MADE IN THE ORDINARY COURSE OF BUSINESS OR FINANCIAL AFFAIRS OF THE DEBTORS AND THE DEFENDANT. HENCE, THE TRANSFERS ARE EXEMPT FROM AVOIDANCE PURSUANT TO 11 U.S.C. §547(C)(2)

The Plaintiff argues that the length of the parties' relationship is insufficient to establish a baseline of dealings for the Ordinary Course of Business Defense. It also argues that the Transfers were paid significantly later than the prior payments. The Plaintiff, however, is mistaken.

A. Length of time the parties have engaged in the type of dealing at issue

The Plaintiff erroneously claims that the Historical Period presented by the Defendant covers only 8 months. However, even a cursory reading of the Motion would show that the Historical Period presented by the Defendant covers 14 months, i.e., from the date of the first invoice May 13, 2017 to the day immediately preceding the Preference Period.

This 14-month period is sufficient to establish a baseline of dealings between the parties. See e.g. *Troisio v. E.B. Eddy Forest Prods. Ltd. (In re Global Tissue, L.L.C.)*, 302 B.R. 808, 814 (D. Del. 2003) (affirming the bankruptcy court's holding that the parties' relationship of approximately 15 months was sufficient to establish ordinary course of dealings).

B. The timing of the Transfers was consistent with the baseline of dealings during the Historical Period

As more fully explained in the Motion, there was nothing unusual about the timing of the Transfers.

On average, the Debtors paid the Defendant 51.64 days after the invoice date during the Historical Period and 72.33 days after the invoice date during the Preference Period. This 20-day in averages is legally inconsequential and is well within what a number of courts have considered ordinary. See e.g. *McCord v. Venus Foods (In re Lan Yik Foods Corp.)*, 185 B.R. 103, 112-113 (21 day difference considered ordinary).Historically, only much larger shifts in the averages would be able to negate the ordinary course of business defense. See e.g. *Davis v. R.A. Brooks Trucking, Co. (In re Quebecor World (USA), Inc.)*, 491 B.R. 379 (Bankr. S.D.N.Y. 2013) (27.5 days increase from 50 days to 77 days); *In re CIS Corp.*, 214 B.R. 108 (Bankr. S.D.N.Y. 1997) (29 days increase from 51 days to 80 days).

Moreover, the Debtors paid the Defendant between 27 to 71 days after the invoice date during the Historical Period. The first Transfer was made 54 days after the invoice date and falls squarely within the established range. The second Transfer was made 75 days after the invoice date and falls slightly outside the established range. However, the second Transfer can still be considered ordinary since it was made within 10% of the outer limit of the established range. See e.g. H. *L. Hansen Lumber Co. v. G & H Custom Craft, Inc. (In re H.L. Hansen Lumber Co.)*, 270 B.R. 273 (Bankr. C.D. Ill. 2001), citing *In re Tennessee Chemical Co*., 112 F.3d 234, 237 (6th Cir. 1997) (holding that transfers within 10% of the outer limit of the historical period range may still be considered as within the ordinary course of business); and *Miller v. Westfield Steel, Inc. (In re Elrod Holdings)*, 426 B.R. 106, 111 (Bankr. D. Del. 2010) (considering preference period transfers made between 30 to 74 days after the invoice date as ordinary despite the fact that they fell outside the established range of 35 to 73 days).

For the foregoing reasons, the Defendant submits that the timing of the Transfers was consistent with the baseline of dealings established during the Historical Period.

CONCLUSION

It is clear from the foregoing discussion that the Plaintiff has not discharged its burden under 11 U.S.C. § 547(b)(5) and that the Defendant has proven that there are no issues of material fact with regards to Defendant's defenses pursuant to 11 U.S.C. § 547(c)(1) and 11 U.S.C. § 547(c)(2). The Defendant respectfully requests that this Court grant its Motion and deny the Plaintiff's claims in their entirety.

Dated: May 16, 2022

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF DELAWARE

IN RE:	Chapter 11
Welded Construction, L.P., *et al.*	Case No: 18-12378 (LSS)
Debtors.[1]	(Jointly Administered)
Welded Construction, L.P.,	
Plaintiff,	
vs.	Adversary Proceeding No. 20−50932−LSS
Industrial Fabrics, Inc.,	
Defendant.	

CERTIFICATE OF SERVICE

I, James Tobia, hereby certify that on May 16, 2022, I caused the foregoing Reply to the Plaintiff's Response to Defendant's Motion for Summary Judgment to be served upon Plaintiff's counsel by CM/ECF:

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[1] The Debtors in these chapter 11 cases, along with the last four digits of each Debtor's federal tax identification number, are: Welded Construction, L.P. (5008) and Welded Construction Michigan, LLC (9830)