UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
ROOM 211
FEDERAL BUILDING AND U.S. POST OFFICE
225 SOUTH PIERRE STREET
PIERRE, SOUTH DAKOTA 57501-2463

IRVIN N. HOYT
BANKRUPTCY JUDGE

TELEPHONE (605) 224-0560
FAX (605) 224-9020

March 14, 2005

Jerrold L. Strasheim, Esq.
Counsel for Tri-State Financial, L.L.C.
1500 Woodmen Tower
Omaha, Nebraska 68102-2068

Robert E. Hayes, Esq.
Counsel for Trustee John S. Lovald
Post Office Box 1030
Sioux Falls, South Dakota 57101-1030

Patrick Lee-O'Halloran, Esq.
Counsel for American Prairie Construction Company
800 LaSalle Avenue, Suite 1900
Minneapolis, Minnesota 55402

Subject: *In re Tri-State Ethanol Company, L.L.C.*,
Chapter 7, Bankr. No. 03-10194

Dear Counsel:

The matter before the Court is the Request for Allowance of Administrative Expenses filed by Tri-State Financial, L.L.C., and the objections thereto filed by Trustee John S. Lovald and North Central Construction, Inc. (now known as American Prairie Construction Company). A telephonic hearing was held March 2, 2005. The Court took under advisement Tri-State Financial, L.L.C.'s request for an evidentiary hearing and its argument that North Central Construction, Inc., did not have standing to object to its administrative expense request. As set forth below, an evidentiary hearing will be held.

Summary. Tri-State Ethanol, L.L.C., ("Debtor") filed a Chapter 11 petition on May 23, 2003. Several motions seeking approval for Debtor to use cash collateral or seeking authority for Debtor to borrow funds were filed. Motions that were granted post-petition but before Debtor's Chapter 11 case was converted to Chapter 7 on July 29, 2004, included:

June 5, 2003 — First Dakota National Bank ("Bank") was authorized to pay Debtor's casualty

	insurance premium of $21,544.95.
June 6, 2003	Debtor was authorized under a preliminary order to use $24,000.00 of the Bank's cash collateral to meet payroll and health insurance expenses.
June 13, 2003	Debtor was authorized to borrow from the Bank up to $20,000.00 plus fees and costs for the credit for Debtor's June 13, 2003, payroll and past due payroll taxes.
June 27, 2003	As part of two separate orders, Debtor was authorized to expend insurance proceeds of $31,500.00, which was the Bank's cash collateral: $20,000.00 for payroll and payroll taxes, $6,500.00 for health insurance premiums, and $5,000.00 for an electricity deposit to Otter Tail Power Company.
September 12, 2003	Debtor was authorized to make certain post-petition installment payments on a commercial premium financing agreement with First Insurance Funding Corporation.
October 17, 2003	Debtor was authorized under a preliminary order to use a total of $51,869.00 in cash collateral from the Bank ($26,763.35) and new credit from Tri-State Financial, L.L.C. ("Tri-State Financial") ($25,105.65) for payroll and other operating costs. This order was amended on November 14, 2003. A final order for this request was entered November 18, 2003.
December 24, 2003	Debtor was authorized under a preliminary order to use $40,000.00 in cash collateral from the Bank to pay certain insurance payments. A final order for this request was entered December 29, 2003.
February 18, 2004	Debtor was authorized to enter into an insurance premium financing agreement with First Insurance Funding Corporation.

April 14, 2004	Debtor was again authorized to enter into an insurance premium financing agreement with First Insurance Funding Corporation.
July 9, 2004	Debtor was authorized to use $10,401.49 in preliminary cash collateral from the Bank for payroll due that day.

Not all of Debtor's requests to borrow funds or use cash collateral were granted. In particular, Debtor made a wide-sweeping request on September 25, 2003, to borrow substantial funds, use certain cash collateral, and enter into various agreements in order to re-engineer and reconstruct its ethanol plant. This proposal was set forth primarily in a Stipulation among Debtor, the Bank, and Tri-State Financial. Following an evidentiary hearing, Debtor's September 25, 2003, request was denied by order entered December 12, 2003. The authority Debtor had requested that was denied included, in part:

1. Debtor's request to contract with a company called ICM and a general contractor, which also might be ICM, to reconstruct the ethanol plant in the manner outlined in an August 7, 2003, report by David VanderGriend, the President of ICM. The August 7, 2003, report was defined as the "Startup Plan." The parties to the Stipulation estimated that interim overhead costs between September 2003 and January 2004 would be $270,530.00 and that startup costs, through the first 14 days of production, would be $467,500.00.

2. Debtor's request to contract with "an independent management firm ... to direct the future operations" of the ethanol plant. The management that was hired was to be acceptable to both Tri-State Financial and the Bank.

3. Debtor's request for approval of an operating plan whereby Tri-State Financial and the Bank would approve all expenditures in advance and Tri-State Financial and the Bank would also approve in writing any expenditures incurred in addition to the "Budget" a term that was defined as Exhibits 1, 2, and 3 attached to the Stipulation.

4. Debtor's request to borrow from Tri-State Financial not less than $2,000,000.00 to finance the "Startup Plan," interim costs, and startup costs. The $2,000,000.00 was to include "the funds that Tri-State Financial has already advanced to [Debtor] to finance [Debtor's] post-petition operating expenses." Under this request, Debtor would not make any

payments to Tri-State Financial or pay any interest on the loan until Debtor obtained confirmation of a plan. If the loan was not repaid by September 1, 2004, it was then to bear interest at the prime rate (defined in the Stipulation) or 6%, whichever was less, with a repayment term of 20 years.

5. Debtor's request to use $663,599.75 of the Bank's cash collateral that was in its debtor-in-possession account at the Bank plus certain other described funds received by Debtor during the planned re-engineering and reconstruction of the plant. The total cash collateral used was not to exceed $1,386,599.75. This additional cash collateral was to be used after the $2,000,000.00 in credit from Tri-State Financial was used. For the use of this cash collateral, the Bank was to have been given additional security or priority liens. Debtor's proposal also included terms defining the priority of liens between the Bank and Tri-State Financial.

6. Debtor's proposal that it would bear "any shortfall in the funds needed for the Startup Plan, interim costs and startup costs."

7. Debtor's proposal that "Phase II" improvements as set forth in the Startup Plan, except the thermal oxidizer that may not be legally required, would be completed with financing through operating profits or additional capital, and its proposal that no distributions would be made to equity holders until Debtor, the Bank, and Tri-State Financial were satisfied that the Phase II improvements had been appropriately financed.

8. Debtor's request to begin making payments to the Bank on March 1, 2004, or 30 days after the plant recommenced production, whichever was earlier. The payments were to be $117,700.00 per month on the original note and $10,500.00 per month on the operating note.

9. Debtor's request that, upon confirmation of a plan proposed by Debtors, Tri-State Financial's position would be converted purely to equity and the Bank would retain its lien position in certain assets.

10. Debtor's request that nothing other than the entry of an order approving the Stipulation would be required to render the Bank's and Tri-State Financial's rights under the Stipulation "valid, enforceable, attach[ed] and perfected[.]"

Debtor's amended disclosure statement was eventually approved,

and an evidentiary confirmation hearing on Debtors' modified plan dated June 24, 2004, was held July 28, 2004. The United States Trustee's motion to dismiss or convert was also heard that day. The case was converted to Chapter 7 on July 29, 2004.

On October 19, 2004, ICM, Inc., ("ICM") filed an application for payment of an administrative expense. ICM stated that while the case was in Chapter 11, Debtor asked it to re-engineer the plant and it agreed to provide "expertise, labor, material, and taxes, on an unsecured basis pursuant to 11 U.S.C. § 364(a). ICM said its contributions were necessary to preserve the estate, and it argued it had made a substantial contribution. It requested payment of $2,310,552.51 and said it had already been paid $1,190,000.00. An attachment to the application itemized the charges, but the dates and amounts of the payments to ICM were not listed. Consequently, the Court requested an amended application. The Court also cautioned ICM that Debtor's request that ICM re-engineer the ethanol plant may not have been made in the ordinary course of Debtor's business, contrary to ICM's assumption in its application. Trustee Lovald objected to paying ICM as an administrative claimant but agreed ICM should be given an unsecured claim for the beneficial work it performed at the ethanol plant.

Chapter 7 Trustee John S. Lovald sold essentially all Debtor's assets, including the ethanol plant, to Tri-State Financial on February 5, 2005. The principal terms of the sale were set forth in a September 22, 2004, bidding procedures order and attendant Purchase Agreement and a December 22, 2004, sale order. As provided therein, the successful bidder agreed to pay, in addition to the purchase price, up to $1,500,000.00 for post-conversion construction work at the ethanol plant.

ICM filed an amended application for allowance of an administrative expense on November 17, 2004. Trustee Lovald again objected on the same grounds. North Central Construction, Inc. ("North Central") also objected on similar grounds. It, too, argued the work performed by ICM was not in the ordinary course of business and was not an administrative expense. Like Trustee Lovald, it wanted the amended application to be fully considered after Trustee Lovald's sale of the ethanol plant, which had not closed at the time of the objections. At a continued hearing on February 8, 2005, ICM withdrew its amended application.

On January 24, 2005, Tri-State Financial filed an application for allowance of an administrative expense. In the application, Tri-State Financial stated that it made unsecured post-petition,

pre-conversion loans to Debtor totaling $1,983.654.42[1] based on an oral agreement. It argued that the loans were an expense of administration because they were each made in the ordinary course of Debtor's business; they enabled Debtor to pay debts it incurred in the ordinary course of business; they enabled Debtor to pay actual, necessary costs and expenses of preserving the estate and the value of the estate during the Chapter 11; or they were actual and necessary expenses of Tri-State Financial and incurred by Tri-State Financial "in making a substantial contribution which directly and materially increased the value of [Debtor]'s Chapter 11 bankruptcy estate by increasing the value of [Debtor]'s ethanol plant by millions of dollars."

Tri-State Financial acknowledged that with the exception of one loan on October 21, 2003, none of the loans were made with court approval. It stated, "The Loans were made by [Tri-State Financial] in good faith reliance upon the advice of former Omaha counsel that the Loans were all made in credit transactions in the ordinary course of [Debtor]'s business and no prior court approval was required." To the extent court approval was required, Tri-State Financial asked the Court, "in justice and equity" to grant retroactive approval. Alternatively, Tri-State Financial asked in its application that the loans be paid with interest on a *quantum meruit* basis or as a general unsecured claim.

Tri-State Financial also filed two proofs of claim on January 24, 2005. In one, Tri-State Financial claimed an equity interest of $2,500,000.00. In the other, it said it held an unsecured claim of $1,983,654.42 for money loaned to Debtor between July 14, 2003, and June 15, 2004; this claim apparently was a contingency or alternative claim to its administrative expense claim.

Two objections to Tri-State Financial's application for an administrative expense were filed. Trustee Lovald said the loans were not an administrative expense because they were not court approved and because they were not made in the ordinary course of Debtor's business. He also said the loans should not be approved

---

[1] According to an attachment to the application, a total of $1,190,000.00 was paid to ICM, not Debtor, for equipment. The balance of just under $800,000.00 was, at various times, for payroll, payroll taxes, insurance, utilities, fuel, permits and fees, leases, "R/M," "reimbursements to [Debtor's] employee," United States Trustee's fees, office supplies, trash, and computer repair.

as an unsecured claim. He argued that after the loan amounts are verified, Tri-State Financial's claim instead should be subordinated to unsecured claims but paid ahead of equity holders.

North Central also objected. It said that some of the transactions were not loans to Debtor because Tri-State Financial actually contracted with and made payments directly to ICM, not Debtor. It argued that Tri-State Financial made advances to Debtor and ICM at its own risk to advance its own interests and agenda in the Chapter 11 case. Because approval of these loans had already been denied by the Court, North Central argued Tri-State Financial could not simply re-label the loans and seek court approval through an alternative route.

A telephonic hearing was held March 2, 2005. Tri-State Financial first argued that North Central did not have standing to object. North Central defended saying its position as an equity security holder could be eroded by any payments made to Tri-State Financial on these loan claims. Tri-State Financial countered that since only Debtor would receive any estate residual, only Debtor, not its shareholders, had standing to protect that potential recovery.

Tri-State Financial next requested an evidentiary hearing on its administrative expense claim. Facts Tri-State Financial claimed were in dispute included whether the unsecured loans for operating expenses were made in the ordinary course of Debtor's business and thus did not need court approval under 11 U.S.C. § 364(a) and whether the loans for equipment purchases constituted a substantial contribution to the estate for which the estate must compensate Tri-State Financial. It argued that since the loans benefitted Debtor and enhanced the sale of the ethanol plant, the estate should not reap a windfall of almost $2,000,000.00 while Tri-State Financial was punished in the same amount for failing to obtain court approval. Finally, Tri-State Financial argued Trustee Lovald should commence an adversary proceeding under Fed.R.Bankr.P. 7001(8) if he wanted Tri-State Financial's loan claim subordinated.

Counsel for Trustee Lovald restated the trustee's position that Tri-State Financial did not hold an administrative claim. He argued that by financially supporting Debtor through unauthorized loans, Tri-State Financial instead had made an equity contribution.

Discussion - standing of North Central Construction. A Chapter 7 debtor has standing to object only if the contested matter might produce or affect any surplus in the bankruptcy estate

that would be returned to the debtor. *Nangle v. Surratt-States (In re Nangle)*, 288 B.R. 213, 215-16 (B.A.P. 8th Cir. 2003)(a Chapter 7 debtor holds a pecuniary interest and may object to a proposed settlement if there is a reasonable possibility of a surplus after all estate debts are paid). A shareholder of a Chapter 7 debtor-corporation, however, does not enjoy the same standing. Generally, an action to enforce corporate rights or redress injuries to a corporation may not be maintained by a shareholder in his own name, even though the perceived injury to the corporation may result in a decline in the value of the stock. *Sinclair v. Hawke*, 314 F.3d 934, 939 (8th Cir. 2003)(cites therein).

The Bankruptcy Appellate Panel in this Circuit has held that a shareholder of a Chapter 7 debtor would have standing to object to a proposed settlement by the case trustee if the shareholder could establish that a successful objection would result in an estate surplus. *Yates v. Forker (In re Patriot Co.)*, 303 B.R. 811, 815 (B.A.P. 8th Cir. 2003). While the decision acknowledged that the objector was the *sole* shareholder of the debtor, the Court's conclusion did not appear to hinge on that fact. In light of *Sinclair*, 314 F.3d at 939, however, that distinction undoubtedly remains important. *See, e.g., Freishtat v. Blair (In re Blair)*, 319 B.R. 420, 436 (Bankr. D. Md. 2005)(sole shareholder had standing to object to fee application where its outcome would affect her pecuniary interest).

Accordingly, the Court concludes that North Central does not have standing, as an equity holder in Debtor, to object to Tri-State Financial's administrative expense claim against the bankruptcy estate. Moreover, as long as sufficient funds have been placed in escrow to pay North Central's non equity claim in full, North Central also does not have standing to object as an estate creditor. North Central will, therefore, need to look to Debtor to protect any potential estate surplus from improper or exaggerated claims.

Discussion - necessity of an evidentiary hearing on Tri-State Financial's administrative expense claim. A Chapter 11 debtor-in-possession may incur unsecured post-petition debt without court-approval if the debt is incurred in the ordinary course of business and if the debt constitutes an administrative expense under § 503(b)(1). 11 U.S.C. §§ 364(a), 1107, and 1108. Two tests are usually employed when determining whether unsecured credit is being incurred in the ordinary course of business. *In re Blessing Industries, Inc.*, 263 B.R. 268, 272 (Bankr. N.D. Iowa 2001)(cites therein). The *vertical* test is whether a reasonable creditor would

view the transaction as deviating from the debtor's normal day-to-day operations. *Id.*

> If the transaction is something that might be considered "unusual, controversial or questionable" the creditors have a right to be notified so that they have an opportunity to object.

Id. (quoting *In re Husting Land & Dev., Inc.*, 255 B.R. 772, 779 (Bankr. D. Utah 2000)). The horizontal test considers whether the credit transaction falls within a range of accepted practices within the debtor's particular industry. *Blessing Industries*, 263 B.R. at 272 (cites therein).

For the unsecured debt to be an administrative expense under § 503(b)(1), it must represent "actual, necessary costs and expenses of preserving the estate," a provision which courts generally have construed narrowly. *AgriProcessors, Inc. v. Iowa Quality Beef Supply Network, L.L.C.* (*In re Tama Beef Packing, Inc.*), 290 B.R. 90, 96 (B.A.P. 8th Cir. 2003). Two questions need to be answered. First, did the expense arise from a transaction with the bankruptcy estate? *Id.* Second, did the transaction benefit the estate in some demonstrable way? *Id.*

> The claimant must show that *other* unsecured creditors received tangible benefits from the services or goods provided by the claimant. *In re Jack Winter Apparel, Inc.*, 119 B.R. 629, 633 (E.D. Wisc. 1990); *Kinnan & Kinnan Partnership v. Agristor Leasing*, 116 B.R. 162, 166 (D. Neb. 1990); *In re Herrick*, Bankr. No. 184-00041, slip op. at 2 (Bankr. D.S.D. May 9, 1988). Incidental benefit to the estate or extensive participation in the case, standing alone, is not a sufficient base for an administrative [expense] status. *Jack Winter Apparel, Inc.*, 119 B.R. at 633. A creditor's efforts undertaken solely to further its own self-interest [are] not compensable. *Id.*

In re Bellman Farms, Inc., 140 B.R. 986, 995 (Bankr. D.S.D. 1991). The claimant's burden is by a preponderance of evidence. *Id.*; *In re Bridge Information Systems, Inc.*, 288 B.R. 133, 137-38 (Bankr. E.D. Mo. 2001); and *In re Hanson Industries, Inc.*, 90 B.R. 405, 409 (Bankr. D. Minn. 1988).

Tri-State Financial undoubtedly will have a difficult time establishing that the subject loans it made to Debtor during the

Chapter 11 administration were made in the ordinary course of Debtor's business, especially where Debtor sought court approval for other loans for the same or similar purposes. Nonetheless, the Court will give Tri-State Financial an opportunity to make that showing.

The Court, however, is not going to hold successive hearings on Tri-State Financial's alternative theories of recovery and the objections thereto. Consequently, any objection to Tri-State Financial's alternative theory that it holds a general unsecured claim for repayment of these loans[2] should be filed promptly, and any adversary proceeding by Trustee Lovald or another party in interest that Tri-State Financial's claim should be subordinated under 11 U.S.C. § 510(c) and Fed.R.Bankr.P. 7001(8) should be commenced promptly. A combined evidentiary hearing/trial date will then be set by separate order.

Sincerely,

Irvin N. Hoyt
Bankruptcy Judge

INH:sh

CC: case file (docket as interim letter decision; serve parties in interest)

I hereby certify that a copy of this document was electronically transmitted, mailed, hand delivered or faxed this date to the parties on the attached service list.

MAR 14 2005

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court District of South Dakota
By

NOTICE OF ENTRY
Under F.R.Bankr.P. 9022(a)
Entered

MAR 14 2005

Charles L. Nail, Jr., Clerk
U.S. Bankruptcy Court
District of South Dakota

[2] This contested matter would arise via a party in interest's objection to Tri-State Financial's proof of its unsecured claim. 11 U.S.C. § 502(a), Fed.R.Bankr.P. 3007, and Local Bankr. R. 2002-1(c).

Label Matrix for USBC
South Dakota
Case 03-10194
Mon Mar 14 16:11:02 CST 2005

Warrenn C. Anderson
Fluegel, Helseth, McLaughlin, Anderson
215 Atlantic Avenue
PO Box 527
Morris, MN 56267

J. Douglas Austin
PO Box 966
Watertown, SD 57301

William L. Biggs
Gross & Welch, P.C.
2120 South 72nd Street, #800
Omaha, NE 68124

Jason A. Campbell
PO Box 919
Britton, SD 57430

James E. Carlon
PO Box 249
Pierre, SD 57501

James A. Craig
Craig Law Office
714 W. 41st St.
Sioux Falls, SD 57105-6406

James M. Cremer
PO Box 970
Aberdeen, SD 57402-0970

Roger W. Damgaard
PO Box 5027
Sioux Falls, SD 57117

Patrick T. Dougherty
PO Box 1004
Sioux Falls, SD 57101-1004

Timothy M. Engel
PO Box 160
Pierre, SD 57501

Curt R. Ewinger
PO Box 96
Aberdeen, SD 57402-0096

Marvin T. Fabyanske
Fabyanske, Westra & Hart, P.C.
800 LaSalle Avenue, Suite 1900
Minneapolis, MN 55402

Keith A. Gauer
PO Box 1030
Sioux Falls, SD 57101-1030

Bruce J. Gering
Office of the U.S. Trustee
230 S Phillips Ave, Suite 502
Sioux Falls, SD 57104-6321

Clair R. Gerry
PO Box 966
Sioux Falls, SD 57101-0966

Ronald J. Hall
202 S. Main Street #310
Aberdeen, SD 57401

Roger Hansen
PO Box 174
Woodlake, MN 56297

Daniel L. Hartnett
PO Box 27
614 Pierce St
Sioux City, IA 51102

Robert E. Hayes
PO Box 1030
Sioux Falls, SD 57101-1030

Steven Heesch
10481 475th Avenue
Rosholt, SD 57260

Steven K. Huff
PO Box 667
Yankton, SD 57078

ICM, Inc.
P.O. Box 397
Colwich, KS 67030

Pamela Gale Johnson
Baker & Hostetler LLP
1000 Louisiana, Suite 2000
Houston, TX 77002

Patrick J. Lee-O'Halloran
Fabyanske, Westra & Hart
800 LaSalle Avenue
Suite 1900
Minneapolis, MN 55402

John S. Lovald
Box 66
Pierre, SD 57501

John S. Lovald
Trustee
PO Box 66
Pierre, SD 57501

Michael F. Marlow
PO Box 667
Yankton, SD 57078

John P. Mullen
Bangs, McCullen, Butler, Foye & Simmons
100 N Phillips Ave Ste 610
PO Box 949
Sioux Falls, SD 57101-0949

David Nadolski
PO Box 1920
Sioux Falls, SD 57101-3020

Eugene Paulson
10454 1st St.
Rosholt, SD 57260

Scott M. Perrenoud
200 E 10th St Ste200
Sioux Falls, SD 57104

A. Thomas Pokela
PO Box 1102
Sioux Falls, SD 57101

Terry N. Prendergast
PO Box 1728
Sioux Falls, SD 57101-1728

James C. Robbennolt
505 West Ninth St., Ste. 101
Sioux Falls, SD 57104

Robert M. Ronayne
PO Box 759
Aberdeen, SD 57402-0759

Laura D. Schmitt
614 Pierce Street
PO Box 27
Sioux City, IA 51102-0027

Cheryl Schrempp DuPris
Assistant U.S. Attorney
225 South Pierre Street #337
Pierre, SD 57501

Jerrold L. Strasheim
1500 Woodmen Tower
Omaha, NE 68102

William G. Taylor Jr.
300 S Phillips Ave Ste 300
Sioux Falls, SD 57102

Tri-State Ethanol Company LLC
P.O. Box 78
Rosholt, SD 57260

Tri-State Financial, LLC
6534 "L" Street
Omaha, NE 68117

Dale A. Wein
PO Box 759
Aberdeen, SD 57402-0759

Margaret R. Westbrook
435 Fayetteville Street Mall
PO Box 1070
Raleigh, NC 27602-1070