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District of New Mexico

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:
FURRS,
Debtor. No. 7-01-10779 SA

YVETTE GONZALES,
Plaintiff,
v. Adv. No. 02-1117 S

WISCONSIN'S FINEST, INC.,
Defendant.

MEMORANDUM OPINION ON PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT and ORDER

This matter is before the Court on Plaintiff's Motion for Summary Judgment (Doc. 24), Defendant's Response (Doc. 25), and Plaintiff's Reply in Support of Plaintiff's Motion for Summary Judgment (Doc. 30). Defendant filed a Motion for Summary Judgment based on standing that was addressed in another opinion. This is a core proceeding. 28 U.S.C. § 158(b)(2)(F). Plaintiff appears through her attorney Davis & Pierce, P.C. (Chris W. Pierce). Wisconsin's Finest, Inc. ("WF" or "Defendant") appears through its attorney Bingham, Hurst, Apodaca & Wile, P.C. (Michael W. Wile). For the reasons set forth below, the Court finds that summary judgment for the trustee should be granted in part.

Summary judgment is proper when there is no genuine issue as to any material fact and the moving party is entitled to a judgment as a matter of law. Bankruptcy Rule 7056(c). In

determining the facts for summary judgment purposes, the Court may rely on affidavits made with personal knowledge that set forth specific facts otherwise admissible in evidence and sworn or certified copies of papers attached to the affidavits. Fed.R.Civ.P. 56(e). When a motion for summary judgment is made and supported by affidavits or other evidence, an adverse party may not rest upon mere allegations or denials. Id. The court does not try the case on competing affidavits or depositions; the court's function is only to determine if there is a genuine issue for trial. Anderson v. Liberty Lobby, Inc., 477 U.S. 242, 249 (1986).

Plaintiff's motion seeks summary judgment on her complaint to avoid and recover preferential transfers. Defendant denied all allegations in the complaint except jurisdiction, and asserted defenses under section 547(c)(1) (contemporaneous exchange), 547(c)(2) (ordinary course of business) and 547(c)(4) (subsequent new value). As discussed below, the Court will award summary judgment to the Plaintiff on the complaint, and deny WF's defenses of contemporaneous exchange and subsequent new value, leaving the ordinary course of business defense for trial.

STATUTORY PROVISIONS

Section 547(b) provides:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--
> (1) to or for the benefit of a creditor;
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
> (3) made while the debtor was insolvent;
> (4) made--
> (A) on or within 90 days before the date of the filing of the petition;
> ...
> (5) that enables such creditor to receive more than such creditor would receive if--
> (A) the case were a case under chapter 7 of this title;
> (B) the transfer had not been made; and
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Section 547(c) provides in relevant part:

> The trustee may not avoid under this section a transfer--
> (1) to the extent such transfer was--
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
> (B) in fact a substantially contemporaneous exchange;
> (2) to the extent that such transfer was--
> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
> (C) made according to ordinary business terms.
> ...
> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor

gave new value to or for the benefit of the debtor--
(A) not secured by an otherwise unavoidable security interest, and
(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

Section 547(f) provides:

For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.

Section 547(g) provides:

For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of a transfer under subsection (c) of this section.

CONTEMPORANEOUS EXCHANGE FOR VALUE DEFENSE: SECTION 547(c)(1)

Section 547(c)(1) protects transfers from attack if (1) the preference defendant extended new value to the debtor, (2) both the defendant and the debtor intended the new value and reciprocal transfer by the debtor to be contemporaneous and (3) the exchange was in fact contemporaneous.

The purpose of the contemporaneous exchange exception ... is to encourage creditors to continue to deal with troubled debtors without fear that they will have to disgorge payments received for value given. If creditors continue to deal with a troubled debtor, it is possible that bankruptcy will be avoided altogether.

5 Alan N. Resnick & Henry J. Sommer, Collier on Bankruptcy ¶ 547.04[1], at 547-47 -48 (15th ed. rev.). The parties' intent to make a contemporaneous transfer is an essential element of a

section 547(c)(1) defense. Lowrey v. U.P.G. Inc. (In re Robinson Bros. Drillling, Inc.), 877 F.2d 32, 33 n.1 (10th Cir. 1989). See also Harrah's Tunica Corp. v. Meeks (In re Armstrong), 291 F.3d 517, 525 (8th Cir. 2002)(The parties' intent is the critical inquiry.)(quoting Official Plan Comm. v. Expeditors Int'l of Washington, Inc. (In re Gateway Pac. Corp.), 153 F.3d 915, 918 (8th Cir. 1998).) The section protects transfers that do not result in diminution of the estate because unsecured creditors are not harmed by the transfer if the estate was replenished by an infusion of assets that are of roughly equal value to those transferred. Manchester v. First Bank & Trust Co. (In re Moses), 256 B.R. 641, 652 (10th Cir. B.A.P. 2000).

ORDINARY COURSE OF BUSINESS DEFENSE: SECTION 547(c)(2)

> The purpose of [the ordinary course of business defense] is to leave undisturbed normal financial relations, because doing so does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy. See 11 U.S.C.A. § 547. "This section is intended to protect recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor's transferee." 4 Collier on Bankruptcy, ¶ 547.10 (15th ed. 1991).

Sender v. Nancy Elizabeth R. Heggland Family Trust, 48 F.3d 470, 475 (10th Cir. 1995).

> On the one hand the preference rule aims to ensure that creditors are treated equitably, both by

> deterring the failing debtor from treating preferentially its most obstreperous or demanding creditors in an effort to stave off a hard ride into bankruptcy, and by discouraging the creditors from racing to dismember the debtor. On the other hand, the ordinary course exception to the preference rule is formulated to induce creditors to continue dealing with a distressed debtor so as to kindle its chances of survival without a costly detour through, or a humbling ending in, the sticky web of bankruptcy.

Fiber Lite Corp. v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.), 18 F.3d 217, 219 (3rd Cir. 1994). To be protected, a transfer must be ordinary both from the transferee's perspective and the debtor's perspective. In re Milwaukee Cheese Wisconsin, Inc., 112 F.3d 845, 848 (7th Cir. 1997)(citing Marathon Oil Co. v. Flatau (In re Craig Oil Co.), 785 F.2d 1563 (11th Cir. 1986)) In re Tolona Pizza Products Corp., 3 F.3d 1029, 1032 (7th Cir. 1993)("One condition is that payment be in the ordinary course of both the debtor's and the creditor's business.") See also H.R.Rep. No. 595, 95th Cong., 1st Sess 373 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5874, 6329 (Legislative history suggests that purpose of this section is to avoid unusual actions by either the debtor or its creditors.)

Section 547(c)(2) encourages normal credit transactions and the continuation of short-term credit dealings with troubled debtors to stall rather than hasten bankruptcy. Logan v. Basic Distribution Corp. (In re Fred Hawes Org.), 957 F.2d

239, 243 (6th Cir. 1992). The other often cited policy behind the ordinary course of business exception is to promote equality of distribution to the creditors. Armstrong, 291 F.3d at 527; Union Bank v. Wolas, 502 U.S. 151, 161 (1991):

> [T]he preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally. The operation of the preference section to deter "the race of diligence" of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference section--that of equality of distribution.

See also Johnson v. Barnhill (In re Antweil), 931 F.2d 689, 692 (1991), aff'd 503 U.S. 393 (1992)("The most important purpose of section 547(b) is to facilitate equal distribution of the debtor's assets among the creditors.")

For the purposes of 547(c)(2), a transfer occurs upon delivery of a check. Bernstein v. RJL Leasing (In re White River Corp.), 799 F.2d 631, 633 (10th Cir. 1986). Compare Barnhill v. Johnson, 503 U.S. 393, 394-95 (1992)(For 547(b) purposes a transfer made by check occurs on the date the drawee bank honors it.)

A creditor has the burden of proving that payments qualify for the ordinary course of business exception of § 547(c)(2). 11 U.S.C. § 547(g); Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners), 12 F.3d 1549, 1553 (10th

Cir. 1993) cert. denied, 512 U.S. 1206 (1994). Failure to meet any of the three requirements of § 547(c)(2) results in denial of the defense. Id. The § 547(c)(2) defense is narrowly construed. Payne v. Clarendon Nat'l Ins. Co. (In re Sunset Sales, Inc.), 220 B.R. 1005, 1020 (10th Cir. B.A.P. 1998).

There is generally no disagreement over the first requirement (i.e., § 547(c)(2)(A)) that a debt was incurred in the ordinary course of business of the debtor and the transferee; reported cases under § 547(c)(2) overwhelmingly focus on subsections (B) and (C). Under those sections the creditor must prove that the transfers were ordinary as between the parties (§ 547(c)(2)(B)), which is a "subjective test", and ordinary in the industry (§ 547(c)(2)(C)), which is an "objective test". Id.

Section 547(c)(2)(B)

> Courts consider four primary factors to determine if payments are ordinary between the parties as required under the subjective test set forth in subsection (B): (1) the length of time the parties were engaged in the transaction in issue; (2) whether the amount or form of tender differed from past practices; (3) whether the debtor or creditor engaged in any unusual collection or payment activity; and (4) the circumstances under which the payment was made[1].

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[1]The Tenth Circuit Court's fourth factor differs from some other courts' test, which is "whether the creditor took advantage of debtor's deteriorating financial condition." See, e.g., In re Grand Chevrolet, 25 F.3d 728, 731 (9th Cir.

(continued...)

> These factors are typically considered by comparing pre-preference period transfers with preference period transfers.

Sunset Sales, Inc. 220 B.R. at 1020-21.

> The relations of the debtor and the creditor are placed in a vacuum, and the transfer in question is assessed for its consistency with those relations. What is subjectively ordinary between the parties is answered from comparing and contrasting the timing, amount, manner and circumstances of the transaction against the backdrop of the parties' traditional dealings. The transaction is scrutinized for anything unusual or different.

Morris v. Kansas Drywall Supply Co. (In re Classic Drywall, Inc.), 121 B.R. 69, 75 (D. Kan. 1990)(Citations omitted). In other words, the Court compares the preference period to a prior period. The comparison should be with a period "preferably well before" the preference period, presumably before the Debtor started experiencing financial problems. Tolona Pizza Products, 3 F.3d at 1032. "Generally, the entire course of dealing is considered." Brown v. Shell Canada Ltd. (In re Tennessee Chemical Co.), 112 F.3d 234, 237 (6th Cir. 1997). See also Iannacone v. Klement Sausage Co. (In re Hancock-Nelson Mercantile Co.), 122 B.R. 1006, 1013 (Bankr. D. Minn. 1991)(Baseline period should extend back into the time before debtor became distressed.) Cf. Meridith Hoffman

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[1](...continued)
1994).

Partners, 12 F.3d at 1553 (Ordinary business terms under section 547(b)(2)(C) are those "when debtors are healthy.")

Section 547(c)(2)(C)

Under § 547(c)(2)(C) "[t]he court here compares and contrasts the particular transaction against the 'practices' or 'standards' of the industry. A transaction is objectively ordinary if it does not deviate from industry norm but does conform to industry custom." Classic Drywall, Inc., 121 B.R. at 75.

> Ordinary business terms, as used in paragraph (C), is thought of as an objective test. Courts consider whether the payment is ordinary in relation to the standards prevailing in the relevant industry. The circuit courts are currently divided about how to determine whether a particular transaction falls within the confines of ordinary business terms. Three prevalent views have emerged. One view, espoused by the Second, Sixth, Seventh and Eighth Circuits, emphasizes the range of terms used by firms that are similar to the creditor. The Tenth Circuit follows a narrower definition of ordinary business terms, excluding extraordinary circumstances from consideration, such as collection practices that may be used when the debtor is financially unhealthy. The Third and Fourth Circuits take a middle ground, defining ordinary business terms on a "sliding-scale" approach that is based on the length of the relationship between the debtor and the creditor.

Ann van Bever, Current Preference Issues, 1 J. Small & Emerging Bus. L. 297, 306 (1997)(footnotes omitted).

In Meridith Hoffman Partners the Tenth Circuit discussed the term "ordinary business terms" used in § 547(c)(2)(C). 12

F.3d at 1553. The Court stated that "ordinary business terms" could mean either 1) terms that creditors in similar situations would commonly use, even if the situation itself is extraordinary, or 2) terms that are used in usual or ordinary situations. Id. It adopted the latter meaning, and further elaborated that "Ordinary business terms therefore are those used in 'normal financing relations'; the kinds of terms that creditors and debtors use in ordinary circumstances, when debtors are healthy.[2]" Id. (Emphasis added.) This interpretation raises difficulties for defendants because it makes irrelevant evidence of similar businesses' treatment of delinquent customers who are having financial problems.

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[2]This definition by the Tenth Circuit has been called "unique" because it flatly rejects both the "party-focused view" (court excludes late payments from preference attack when the manner and timing conform to the manner and timing of previous payments made and accepted between the parties) and the "industry-terms view" (court asks whether the manner and timing of the late payments conforms to the general and accepted methods of the parties' industry) adopted by the other circuits. Janet E. Bryne Thabit, Ordinary Business Terms: Setting the Standard for 11 U.S.C. § 547(c)(2)(C), 26 Loy. U. Chi. L.J. 473, 489-90, 496 (1995). In fact, the Tenth Circuit test set out in Meredith Hoffman Partners does accept the “industry-terms” view, although it refines that test by requiring that the behavior of healthy debtors be the measure of behavior. Id. at 1553. Refining the test seems to be commonplace among the circuits; e.g., Molded Acoustical Products, 18 F.3d at 220 (“We will embellish the Seventh Circuit test,...”).

In Meredith Hoffman Partners, the Tenth Circuit ruled that the escrow payment arrangement at issue was not a normal financing arrangement, but rather one only used in the industry when the payor (debtor) is in trouble. 12 F.3d at 1554. The court did not qualify the "ordinary business terms" test by requiring reference to the length of the relationship between the debtor and the creditor. Id. at 1553-54. Compare, e.g., In re Molded Acoustical Products, Inc., 18 F.3d at 226 ("In addition [to what is "not unusual" in the industry], when the parties have had an enduring, steady relationship, one whose terms have not significantly changed during the pre-petition insolvency period, the creditor will be able to depart substantially from the range of terms established under the objective industry standard inquiry and still find a haven in subsection C.") However, most courts of appeal have recognized that the differing language and placement in the statute of subsections B and C require that each subsection have its own meaning as a part of the tripartite "ordinary course" test, e.g., id. at 219 n. 1, and as Meredith Hoffman Partners demonstrates, nothing in the "ordinary business terms" portion of the test requires a partial conflation of subsections B and C.

SUBSEQUENT NEW VALUE DEFENSE: SECTION 547(c)(4)

The purpose of the section 547(c)(4) defense is to encourage creditors to deal with troubled businesses. Rushton v. E & S Int'l Enters. Inc. (In re Eleva, Inc.), 235 B.R. 486, 489 (10th Cir. B.A.P. 1999).

> The exception of 547(c)(4) is intended to encourage creditors to work with troubled companies and to remove the unfairness of allowing the trustee to void all transfers made by the debtor to a creditor during the preference period without giving any corresponding credit for subsequent advances of new value to the debtor for which the preference defendant was not paid.

5 Collier on Bankruptcy ¶ 547.04[4][a], at 547-68.3.

"In order to qualify for the new value defense, the creditor must prove: (1) new value was given to the debtor after the preferential transfer; (2) that the new value was unsecured; and (3) that it remained unpaid." In re Eleva, Inc., 235 B.R. at 488-89 (citing Mosier v. Ever-Fresh Food Co. (In re IRFM, Inc.), 52 F.3d 228 (9th Cir. 1995)). For the purposes of section 547(c), a preferential transfer occurs on the date the check is delivered. Id. at 488. And, the creditor extends new value when goods are shipped. Id. at 489. "Subsequent advances of new value may be used to offset prior ... preferences. A creditor is permitted to carry forward preferences until they are exhausted by subsequent advances of new value." Mosier, 52 F.3d at 232. See also Williams v.

Agama Systems, Inc. (In re Micro Innovations Corp.), 185 F.3d 329, 336-37 (5th Cir. 1999); Crichton v. Wheeling Nat'l Bank (In re Meredith Manor, Inc.), 902 F.2d 257, 258 (4th Cir. 1990).

DISCUSSION

The Court finds that the following facts are not subject to genuine dispute:

(1) Furr's made payments to or for the benefit of WF (Kefauver affidavit ¶ 5);

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made (Interrogatory 7, Exhibit M to Plaintiff's Motion);

(3) made while the debtor was insolvent (Insolvency is presumed under section 547(f) and Defendant has not introduced evidence to the contrary.);

(4) made on or within 90 days before the date of the filing of the petition (Interrogatory 9, Exhibit K to Plaintiff's Motion; Meixelsperger Affidavit ¶5);

(5) that enables such creditor to receive more than such creditor would receive if (A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title. (The Court

takes judicial notice that the bankruptcy case will likely not even pay chapter 11 administrative expenses in full; therefore non-priority unsecured creditors will receive no dividend.)

(6) Defendant offered no evidence that would support its section 547(c)(1) defense of contemporaneous exchange for value. Plaintiff has established that the payments were made weeks or months after delivery of the product.

(7) Defendant offered no evidence that would contradict Plaintiff's schedule of payments to WF and receipts of product from WF with which it calculated the new value defense and net preference amount as set forth in the complaint. The Court has been informed, however, that the parties have agreed to an exhibit that will replace the exhibit to the complaint.

(8) As discussed above, it is not the Court's duty on a summary judgment motion to try the case, but rather to see if it should go to trial. So, while there is an overwhelming body of evidence that supports the proposition that the Debtor was not operating under normal business conditions during the preference period, Defendant did cite conflicting evidence in the record.

For example, WF presented evidence that the ordinary course of business between it and Debtor were that payments

were always late[3]. WF also cites to the Chavez deposition wherein Mr. Chavez states that Furr's always stretched its payments out and that that is a normal practice in the industry. The Meixelsperger affidavit also raises fact questions of industry practice.

For the reasons set forth above, the Court Orders as follows:

IT IS ORDERED that Plaintiff's Motion for Summary Judgment is granted in part as follows:

Plaintiff has established all elements of a preferential transfer under section 547(b).

Defendant has not met its burden under section 547(g) to show that there is a genuine issue of fact with respect to either the contemporaneous exchange defense of section

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[3]The evidence shows that Debtor was on average 36 days late during the preference period and on average 15.2 days late during the two years ending September 30, 2000. WF has a heavy burden for trial, to demonstrate why a greater than 100% change in payment time remained ordinary. See Fiber Lite Corp. v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.), 18 F.3d 217, 228 (3rd Cir. 1994)(Third Circuit rules that, as a matter of law, an increase from 58 days pre-insolvency to 89 days during the preference period demonstrates that payments were not made according to ordinary business terms.) See also Official Plan Committee v. Expeditors Int'l of Washington, Inc. (In re Gateway Pacific Corp.), 214 B.R. 870, 875-76 (8th Cir. BAP 1997)(BAP affirms Bankruptcy Court's findings and conclusions that an increase in payment time from 35 days pre-preference period to 54 days during the preference period was not ordinary.)

547(c)(1) or the subsequent new value defense of section 547(c)(4), and those defenses are hereby overruled.

IT IS FURTHER ORDERED that the ordinary course of business defense remains for trial.

Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that on June 19, 2003, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered, or mailed to the listed counsel and parties.

Chris W Pierce
PO Box 6
Albuquerque, NM 87103-0006

Michael Wile
3908 Carlisle Blvd NE
Albuquerque, NM 87107-4504

David T Thuma
500 Marquette Ave NW Ste 650
Albuquerque, NM 87102-5309

James S. Burke