

IN THE UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF UTAH
UNPUBLISHED OPINION

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In re)	Bankruptcy Case No. 82C-00626
)	
JOHN WESLEY PALMER and)	
KATHRYN LEE PALMER,)	
)	
Debtors.)	
)	
JAMES Z. DAVIS, Trustee,)	Civil Proceeding No. 83PC-3110
)	
Plaintiff.)	
)	
-vs-)	
)	
CLARENCE PAINTER,)	
)	
Defendant.)	MEMORANDUM OPINION

Appearances: James Z. Davis, Ray, Quinney & Nebeker, Ogden, Utah, for himself as trustee; Dale E. Stratford, Ogden, Utah, for defendant.

CASE SUMMARY

This matter is before the Court on the trustee's complaint to avoid a transfer of property of the debtor to the defendant as a preference. The Court is called upon to decide whether payment of certain rent arrearages from the prepetition sale proceeds of the debtor's business assets constitutes a payment in the ordinary course of business which is immune from preference liability under Section 547(c)(2).

FACTUAL AND PROCEDURAL BACKGROUND

This matter was presented to the Court on March 20, 1985, on stipulated facts. Those facts, slightly simplified, are as follows:

(1) Prior to March 1, 1982, the debtors owned a restaurant business in Roy, Utah.

(2) The defendant was the landlord of the debtor's business premises.

(3) On March 1, 1982, the debtors were insolvent.

(4) On March 1, 1982, the debtors were indebted to the defendant for delinquent rent in the sum of \$3,345.00.

(5) On March 1, 1982, the debtors sold their assets to Dean G. and Betty A. Owen for the sum of \$17,000.00.

(6) At the closing of the sale on March 1, 1982, the debtors' attorney, Dale E. Stratford, distributed the sales proceeds, which included payment of the sum of \$3,345.00 to the defendant for delinquent rent.

(7) On March 12, 1982, the debtors filed a joint petition for relief under Chapter 7 of the Bankruptcy Code.

(8) At the time the debtors filed their bankruptcy petition, the value of their reachable assets, exclusive of allowable exemptions, was approximately \$265.00.

DISCUSSION

The term "preference," as it is used in Section 547 of the Bankruptcy Code, refers generally to a transfer of the debtor's property in payment of a pre-existing debt within 90 days of filing bankruptcy, at a time when the debtor was insolvent.¹ The elements of a voidable preference, as they relate to the stipulated facts in this proceeding, are as follows:

1.

Section 547(b) provides:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of property of the debtor--

(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; or

(B) between 90 days and one year before the date of the filing of the petition, if such creditor, at the time of such transfer--

(i) was an insider; and

(ii) had reasonable cause to believe the debtor was insolvent at the time of such transfer; and

(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.

(1) A Transfer of Property of the Debtor. On March 1, 1982, at the closing on the sale of the debtors' property, the sum of \$3,345.00 representing a portion of such proceeds, was transferred to the defendant. (Stipulation of Fact ¶ 7).

(2) To or For the Benefit of a Creditor. The defendant was a creditor of the debtors within the meaning of Section 101(a) of the Code, with a claim for delinquent rent. (Stipulation of Fact ¶ 4).

(3) For or on Account of an Antecedent Debt. At the time of the transfer, the debtors were indebted to the defendant for delinquent rent. (Stipulation of Fact ¶ 4).

(4) Made While the Debtors Were Insolvent. The debtors were insolvent at the time of the transfer. (Stipulation of Fact ¶ 3).

(5) Made Within 90 Days of Bankruptcy. The transfer of funds to the defendant occurred on March 1, 1982. The debtors filed their bankruptcy petition on March 12, 1982. (Stipulation of Fact ¶¶ 7-8).

(6) That Enables the Creditor to Receive More Than He Would Receive Under Chapter 7. At the time the debtors filed their bankruptcy petition, the value of their non-exempt assets was approximately \$265.00. Scheduled creditors' claims totaled more than \$27,000.00.

From the foregoing facts, the Court must conclude that every element of a preferential transfer exists with respect to the

payment of the pre-existing rent debt to the defendant. The Court now turns to defendant's asserted defense under Section 547(c).

The Ordinary Course of Business Exception

Preferences violate the basic principle that there should be equal distribution of an insolvent debtor's assets among its creditors. 2 G. Glenn, FRAUDULENT CONVEYANCES AND PREFERENCES § 376, at 651 (1940). However, Congress has determined that certain transactions which interfere with this principle should nonetheless be shielded from the trustee's avoiding powers. These statutory exceptions are found in Section 547(c).²

Defendant contends that the exception found in Section 547(c)(2) applies in this proceeding. It provides as follows:

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Section 547(c)(2) was amended by Section 462 of the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. 98-353, 98 Stat. 378 (July 10, 1984), to eliminate the 45-day rule found in Section 547(c)(2)(B). The exception applicable to cases filed after October 8, 1984, now provides:

(c) The trustee may not avoid under this section a transfer--

. . .

(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; [. . . .]

(c) The trustee may not avoid under this section a transfer--

(2) to the extent that such transfer was--

(A) in payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made not later than 45 days after such debt was incurred;

(C) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(D) made according to ordinary business terms; [. . . .]

While the trustee bears the burden of proving every element of a preference by a preponderance of the evidence, Moran Bros., Inc. v. Yinger, 323 F.2d 699, 701 (10th Cir. 1963), the defendant must prove each of the elements of the "ordinary course of business" exception by a preponderance of the evidence. Matter of Richter & Phillips Jewelers & Distributors, Inc., 31 B.R. 512, 515 (Bkrtcy. S.D. Ohio 1983); In re Saco Local Development Corp., 25 B.R. 876, 879 (Bkrtcy. D. Me. 1982). The exception is composed of four elements, (A) through (D), all of which must be proved by the defendant in order to prevent avoidance of the transfer under Section 547(b).

The Court concludes that the defendant has failed to meet its burden of proof as to three of the four elements of the Section 547(c)(2) exception, as shown by the following summary of the evidence presented respecting each element:

(1) The Debt on Account of Which the Transfer was Made was Incurred in the Ordinary Course of Business. The defendant was the debtors' landlord. (Stipulation of Fact ¶ 2). The debtors conducted their restaurant business on the premises. (Stipulation of Fact ¶ 1).

(2) The Transfer was Made Not Later Than 45 Days After the Debt was Incurred. A debt is incurred for purposes of Section 547(c)(2) on the date upon which the debtor first becomes legally bound to pay. In re Iowa Premium Service Co., Inc., 695 F.2d 1109, 1111 (8th Cir. 1982). No evidence was presented by the defendant to prove when the rental obligations were incurred.

(3) The Transfer was Made in the Ordinary Course of Business of Both the Debtors and the Defendant. The legislative history indicates that Congress intended to shield regular payments made to creditors and to discourage unusual transactions between the debtor and its creditors on the eve of bankruptcy.

The second exception protects ordinary course of business (or financial affairs, where a business is not involved) transfers. For the case of a consumer, the paragraph uses the phrase "financial affairs" to include such nonbusiness activities as payment of monthly utility bills. If the debt on account of which the transfer was made was incurred in the ordinary course of both the debtor and the transferee, if the transfer was made not later than 45 days after the debt was incurred, if the transfer itself was made in the ordinary course of both the debtor and the transferee, and if the transfer was made according to ordinary business terms, then the transfer is protected. The purpose of this exception is to leave undisturbed normal financial relations,

because it 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.

H.R. Rep. No. 95-595, 95th Cong. 1st Sess. 373 (1977). Richard Levin, a member of the House Judiciary Committee staff and one of the drafters of the Bankruptcy Code, has elaborated on this point.

The second exception to the preference section insulates ordinary trade credit transactions that are kept current. The requirements of the exception are that the incurring of the credit and the payment both be made in the ordinary course of business of the debtor and the creditor, that the transaction be according to ordinary business terms, and that the debtor's payment to the creditor be made not later than 45 days after the debt was incurred.

Forty-five days was selected as a normal trade credit cycle. For example, a normal trade credit transaction might be as follows: supplier ships goods during month 1 and sends his bill to the debtor at the end of the month or the very early part of the following month. Normally, that bill would become due, or will be payable in the debtor's ordinary course of business, by the 10th of month 2. If it is paid by the 15th, then there will be no question that the entire transaction - incurring of the credit and the payment - took place within 45 days.

Levin, "An Introduction to the Trustee's Avoiding Powers," 53 Am. Bankr. L. J. 173, 186 (1979) (footnote omitted).

In this case, the transfer of funds to satisfy the rent arrearages to the defendant was incident to the sale of the debtors' restaurant. No evidence was presented which would tend

to show that the sale of the restaurant and payment of delinquent rent was a normal commercial transaction or that restaurant sales were in the ordinary course of the debtors' business.

(4) The Transfer was Made According to Ordinary Business Terms. It is difficult to determine the "ordinariness" of the payment to the defendant since, again, no evidence was presented on this point.

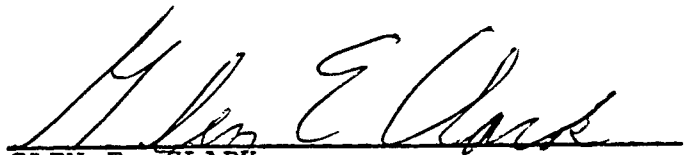
DECISION

From the evidence presented, the Court finds that the trustee has established all of the elements of a voidable preference under 11 U.S.C. § 547(b). The defendant has failed to meet his burden under 11 U.S.C. § 547(c)(2), and is not entitled to invoke that exception. Therefore, the trustee is entitled to judgment in the amount of \$3,345.00, as prayed.

The trustee shall prepare and submit a judgment in accordance with the foregoing pursuant to Local Rule 13.

DATED this 31 day of July, 1985.

BY THE COURT:



GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE