IN THE UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF UTAH

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UNPUBLISHED

In re GLEED INVESTMENT CORP., Debtor.	Bankruptcy Case No. 81C-03268
In re VERLIN GLEED, dba AZTEC COPY, Debtor.	Bankruptcy Case No. 81C-03263
HARRIET E. STYLER, Trustee, Plaintiff. vs. AZTEC COPY, INC., a Utah corporation, Defendant.	Civil Proceeding No. 83PC-0152 FINDINGS OF FACT AND CONCLUSIONS OF LAW

Appearances: Harriet E. Styler, Salt Lake City, Utah, for herself as plaintiff-trustee; Richard F. Bojanowski and Peter J. Kuhn, Salt Lake City, Utah, for Aztec Copy, Inc.

BACKGROUND

This matter comes before the Court on a complaint filed by plaintiff, the trustee of the estates of Gleed Investment Corp. and Verlin Gleed dba Aztec Copy, seeking a determination that certain transfers of funds to the defendant, Aztec Copy, Inc.,

may be set aside and recovered for the benefit of their creditors. Testimony was presented on January 24, January 26, March 14, March 15, April 17, and April 18, 1984. Following the presentation of evidence, the parties submitted lengthy and helpful post-trial briefs. The Court, having heard the testimony, examined all exhibits received in evidence, observed the candor and demeanor of the witnesses, considered the representations, stipulations, arguments and briefs of counsel, and upon its own review of the applicable statutes, rules, and case authorities, does hereby make the following findings of fact and conclusions of law as required by Bankruptcy Rule 7052. The findings of fact made herein may be considered conclusions of law to the extent appropriate, and the conclusions of law may be considered findings of fact to the extent appropriate.

FINDINGS OF FACT

1. The debtor[1] was a franchisee of three copy shops doing business as "Aztec Copy" under three franchise agreements with the defendant. On November 3, 1981, the debtor filed a voluntary petition for relief under Chapter 11 of the Bankruptcy Code. These Chapter 11 cases were converted to cases under

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1 The terms "debtor" or "debtors" as used in these findings and conclusions are used interchangeably and refer both to Gleed Investment Corp. and Verlin Gleed individually, unless the context indicates otherwise.

Chapter 7 of the Bankruptcy Code by order dated December 15, 1982, and Harriet E. Styler was appointed trustee.

2. The debtor acquired the first franchise in May, 1980, and opened a store in South Salt Lake City, after paying defendant an initial franchise fee in the amount of $15,000.00.

3. The debtor acquired a second franchise in January, 1981, and opened a store in the Kearns Building in Salt Lake City, Utah, after paying the defendant an initial franchise fee in the amount of $12,750.00.

4. The debtor also acquired a third franchise in January, 1981, and opened a store in Provo, Utah, after paying the defendant an initial franchise fee in the amount of $17,000.00.

5. In order to purchase the franchises and operate the business, the debtor borrowed $23,000.00 from The Continental Bank & Trust Company, secured by a lien on the debtor's home, and $29,000.00 from his brother-in-law, Art Diaz.

6. The debtor's financial problems began almost immediately after opening the South Salt Lake City store. By the Summer and Fall of 1981, the business was in serious financial difficulty.

7. In mid-September, 1981, Gleed met with Donna and Steve Porter, the President and Vice President, respectively, of Aztec Copy, Inc., at their request to attempt to resolve his financial problems.

8. At the end of September, 1981, the debtor owed Aztec Copy, Inc. $24,524.61 for supplies, directory advertising, late charges, and franchise fees.

9. At the end of October, 1981, the debtor owed the defendant $38,409.75.

10. In an attempt to salvage the business, it was verbally agreed that the defendant would take over management of the stores, and Gleed would not interfere with the operation but would confine himself to soliciting prospective accounts at the Provo store.

11. The testimony of the Porters was diametrically opposed to that of Verlin Gleed concerning what was said and agreed to by the parties concerning payments that would be made to creditors, including Aztec Copy, Inc., while the defendant was managing the stores. After sifting and weighing the often self-serving testimony that was presented on this matter, the Court finds by a preponderance of the evidence that the agreement between the parties for the operation and management of the debtor's business included the express or implied authority to do whatever the defendant could to try to save the enterprise. Under this agreement, the defendant did not exceed the limits of its authority from the debtor by paying itself for supplies used in the business and current franchise royalty fees.

12. Within a day or two after meeting with the Porters, Gleed delivered the books and records of his business to them.

13. About a week after delivering his books and records to the Porters, Gleed met with Steven Porter. Porter requested that the bookkeeper of Aztec Copy, Inc., Ann McDade, be authorized to sign checks for the debtor's business. The arrangement was primarily for the convenience of the defendant.

14. Ann McDade, on behalf of the defendant, became an authorized signatory on the debtor's checking account on September 30, 1981.

15. Pursuant to the terms of the franchise agreements between the debtor and the defendant, the debtor was obligated to pay defendant for supplies and directory advertising by the last day of the month in which the obligation was incurred.

16. Pursuant to the terms of the franchise agreements between the debtor and the defendant, the debtor was obligated to pay monthly franchise royalty fees and monthly advertising fees no later than the 15th day of the following month.

17. During the month of October, 1981, Ann McDade caused checks nos. 2002, 2037, 1001, 2054, and 2055, in the aggregate sum of $36,000.84, payable to the defendant, to be drawn on an account of the debtor at Valley Bank and Trust Company. The disposition of $3,500.00, represented by check no. 2055, dated October 29, 1981, is not in issue in this proceeding.

18. Defendant Aztec Copy, Inc. received check no. 2002, dated October 4, 1981, executed by Ann McDade, in the sum of $14,500.00, drawn on an account of the debtor at Valley Bank and Trust Company. Defendant applied the funds represented by check no. 2002 as follows:[2]

(a)	June Supplies		
	(1)	Kearns Bldg. Store	$1,350.32
	(2)	So. Salt Lake Store	$2,290.80
	(3)	Provo Store	$ 701.79
(b)	Late Charges on June Supplies		
	(1)	Kearns Bldg. Store	$ 43.12
	(2)	So. Salt Lake Store	$ 75.60
	(3)	Provo Store	$ 23.15
(c)	July Supplies		
	(1)	Kearns Bldg. Store	$ 586.24
	(2)	So. Salt Lake Store	$1,823.77
	(3)	Provo Store	$1,757.34
(d)	Late Charges on July Supplies		
	(1)	Kearns Bldg. Store	$ 10.26
	(2)	So. Salt Lake Store	$ 32.82
	(3)	Provo Store	$ 31.63
(e)	July Franchise Royalties		
	(1)	Kearns Bldg. Store	$ 237.74
	(2)	So. Salt Lake Store	$1,177.25
	(3)	Provo Store	$ 501.68
(f)	July Advertising Payments		
	(1)	Kearns Bldg. Store	$ 47.55
	(2)	So. Salt Lake Store	$ 504.53
	(3)	Provo Store	$ 215.00

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2 The sum of the following figures is $14,511.87. The Court has been unable to reconcile the $11.87 difference between this and the $14,500.00 amount of check no. 2002. In view of the Court's ruling, this discrepancy is inconsequential.

(g)	August Franchise Royalties	
	(1) Kearns Bldg. Store	$ 226.18
	(2) So. Salt Lake Store	$1,106.42
	(3) Provo Store	$ 440.73
(h)	August Advertising Payments	
	(1) Kearns Bldg. Store	$ 45.24
	(2) So. Salt Lake Store	$ 474.18
	(3) Provo Store	$ 188.88
(i)	October Directory Advertising	
	(1) Kearns Bldg. Store	--
	(2) So. Salt Lake Store	$ 529.10
	(3) Provo Store	--
(j)	Miscellaneous Debts to Aztec Copy, Inc. (not specified)	$ 90.55

19. Of the $14,500.00 represented by check no. 2002, the sum of $13,892.22 was transferred to defendant Aztec Copy, Inc. for or on account of antecedent debts owed by the debtor before the transfers were made.

20. Of the $14,500.00 represented by check no. 2002, the sum of $619.65, representing October directory advertising expenses and miscellaneous unspecified debts to Aztec Copy, Inc., was applied to debts incurred within 45 days of payment.

21. Defendant Aztec Copy, Inc. received check no. 2037, dated October 21, 1981, executed by Ann McDade, in the sum of $4,350.84, drawn on an account of the debtor at Valley Bank and Trust Company. Defendant applied the funds represented by check no. 2037 as follows:

(a)	August Supplies	
	(1) Kearns Bldg. Store	$ 623.87
	(2) So. Salt Lake Store	$3,476.52
	(3) Provo Store	--

(b)	August Late Charges	
	(1) Kearns Bldg. Store	--
	(2) So. Salt Lake Store	$ 250.45
	(3) Provo Store	--

22. The entire sum of $4,350.84 represented by check no. 2037 was transferred to defendant Aztec Copy, Inc. for or on account of antecedent debts owed by the debtor before the transfers were made.

23. Defendant Aztec Copy, Inc. received check no. 1001, dated October 27, 1981 executed by Ann McDade, in the sum of $3,950.00, drawn on an account of the debtor at Valley Bank and Trust Company. Defendant applied the funds represented by check no. 1001 as follows:[3]

(a)	Unspecified debts of Kearns Bldg. Store	$ 287.95
(b)	Unspecified debts of So. Salt Lake Store	$2,649.73
(c)	Unspecified debts of So. Salt Lake Store[4]	$ 962.32

24. The funds represented by check no. 1001 were transferred to defendant Aztec Copy, Inc. for or on account of antecedent debts owed by the debtor before the transfers were made.

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3 The parties are unable to account for the disposition of $50.00 of this check.

4 In her post-trial brief, and proposed findings of fact and conclusions of law, the trustee admits that the sum of $962.32 was used to pay a portion of the debtor's September franchise royalties and current advertising expenses, though no evidence was presented at trial. The trustee agrees that this payment was not for or on account of an antecedent debt.

25. Defendant Aztec Copy, Inc. received check no. 2054, dated October 27, 1981, in the amount of $9,700.00, drawn on an account of the debtor at Valley Bank and Trust Company.

26. The evidence regarding the application of check no. 2054 was very sketchy and incomplete. However, the Court finds that the sum of $4,533.34 was applied by the defendant to satisfy the debtor's obligation for its initial franchise fee for the Kearns Building store, which constitutes an antecedent debt owed by the debtor before the transfer was made.

27. Thus, of the above-described four transfers, defendant received $26,726.40 for or on account of antecedent debts owed by the debtor before the transfers were made:

Check No. 2002	$13,892.22
Check No. 2037	$ 4,350.84
Check No. 1001	$ 3,950.00
Check No. 2054	$ 4,533.34

28. On the question of the debtor's insolvency, the expert testimony was in stark conflict. Plaintiff's expert, Boyd Fjeldsted, testified that the fair market value of the debtor's three franchises was at most $44,750.00, the total amount paid for the franchises initially. Fjeldsted used the Market Transaction Method for valuing the franchises, which looks primarily to what the property has sold for in the market within a recent period of time. In contrast, defendant's expert, Samuel

Stewart, placed the fair market value of the three franchises at $130,000.00. Stewart used three valuation methods: an asset-based approach, which looks to the acquisition cost of an asset, together with developments since the acquisition; a revenue approach, which looks solely to the ability of the business to generate revenue; and, a price earnings value approach, which estimates the net income of a business assuming it has better expense controls and applies a multiplier to these hypothetical earnings to arrive at its value. In arriving at his revenue valuation, Stewart considered Postal Instant Press, a chain print shop. On rebuttal, Fjeldsted testified that Postal Instant Press failed to meet generally accepted standards of comparability, namely (1) the comparable company must be in the same or similar line of business; (2) the comparable company must have the same or similar capital structure; and (3) the comparable company must have the same or a similar growth trend.

In resolving the conflict in expert testimony, the Court is convinced that the correct standard of value in this case was that applied by plaintiff's expert. The Court specifically finds that utilizing the comparison to Postal Instant Press was not an acceptable method of determining the value of the debtor's franchises. In light of the testimony regarding the nature of the debtor's business and the history of the enterprise from its inception, and taking into account the absence of testimony

regarding the profitability of other Aztec Copy franchises and the future earning potential of the debtor's franchises, the Court finds that the value of these stores at all relevant times was $44,750.00.

29. The second point relating to the insolvency issue on which the parties disagree is the value of the "option to purchase credits" with Xerox. The debtor, while doing business as a franchisee of the defendant, leased photocopying machines from Xerox. Xerox offered lessees of its machines credit towards the purchase of the machines, but could change the price, terms, and conditions, including the availability of the "option to purchase" credits, at any time and without notice to the lessee. The credits had no value separate from the leases and could only be used in connection with the purchase of the leased equipment. Furthermore, the credits could not be used if there was a past due obligation owing to Xerox by the lessee. The debtor owed Xerox at least $32,647.00 at the time it transferred funds to the defendant, Aztec Copy, Inc.

In order to determine whether the debtor was insolvent at the time of the subject transfers, the Court is obliged to determine the "fair valuation" of the credits. Fair value is a fact to be found by considering the price the property would actually bring if offered for sale by the owner, given a reasonable time to negotiate. See In re Richardson, 23 B.R. 434,

442 & 443 n. 12, 9 B.C.D. 895 (Bkrtcy. D. Utah 1982). From what has just been determined regarding the past due obligation owing to Xerox and the limited use of the credits in connection with an equipment purchase, it follows that the option to purchase credits could not have been used by the debtor for the purpose of paying its creditors, and therefore, had no value at the time of the subject transfers.

30. The debtor's accounts receivable had a value of $16,244.56 at the time the transfers occurred.

31. The value of the debtor's assets as of October 4, 1981 was $88,018.45, consisting of the following:

(a)	Assets from Plaintiff's Exhibit #27, except for balance in account and accounts receivable	$58,246.00
(b)	Accounts receivable	$16,244.56
(c)	Balance in account (Plaintiff's Exhibit #6)	$13,527.89

32. The debtor had liabilities as of October 4, 1981 in the amount of $128,921.60, calculated as follows:

(a)	Liabilities as of September 30, 1981 (Plaintiff's Exhibit #27)	$131,606.00
(b)	Less payment on Art Diaz note	$ 2,684.40

33. On October 4, 1981, the debtor's liabilities exceeded its assets by $40,903.15.

34. The value of the debtor's assets on October 21, 1981 was $90,058.34, consisting of the following:

(a) Assets from Plaintiff's Exhibit #27, except for balance in account and accounts receivable $58,246.00

(b) Accounts receivable $16,244.56

(c) Balance in account (Plaintiff's Exhibit #6) $15,567.78

35. The debtor had liabilities on October 21, 1981, in the amount of $153,921.60, calculated as follows:

(a) Liabilities on October 4, 1981 $128,921.60

(b) Obligation to Aztec Copy, Inc. (Plaintiff's Exhibit #3) $ 25,000.00

36. On October 21, 1981, the debtor's liabilities exceeded its assets by $63,863.26.

37. The value of the debtor's assets on October 27, 1981 was $84,244.17, consisting of the following:

(a) Assets from Plaintiff's Exhibit #27, except for balance in account and accounts receivable $58,246.00

(b) Accounts receivable $16,244.56

(c) Balance in account (Plaintiff's Exhibit #6) $ 9,753.61

38. The debtor had liabilities on October 27, 1981 in the amount of $153,921.60.

39. On October 27, 1981, the debtor's liabilities exceeded its assets by $69,677.43.

40. The transfers enabled the defendant to receive more than it would have received if the transfers had not been made

and the defendant was paid to the extent provided by the distributive provisions of Chapter 7 of the Bankruptcy Code. See In re Independent Clearing House Co., 41 B.R. 985, 1012-13, 12 B.C.D. 44, 11 C.B.C.2d 196 (Bkrtcy. D. Utah 1984).

41. On October 6, 1981, the defendant transferred the sum of $25,000.00 to the debtor, as a loan, for which the debtor gave a promissory note and executed a security agreement. The defendant did not perfect its security interest.

42. The transfers to defendant were not intended by the parties as a contemporaneous exchange for new value given to the debtor, since no agreement existed for the compensation of defendant's agents, the transfers were made in payment of the debtor's existing obligations, and the debtor was unaware of the payments at the time they were made.

43. There was no proof upon which the Court could find that the transfers to defendant, other than the $619.65 referred to in paragraph 20 above, were made in the ordinary course of business or financial affairs of the debtor and the defendants, or that the transfers were made according to ordinary business terms.

DISCUSSION

Section 547(b) of the Bankruptcy Code sets out the elements that the trustee must prove in order to avoid transfers of the debtor's property as preferences:

> [T]he 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.

The trustee must prove each element of § 547(b) by a preponderance of the evidence. First National Bank of Clinton v. Vance, 383 F.2d 329 (8th Cir. 1967); Moran Brothers, Inc. v. Yinger, 323 F.2d 699, 701 (10th Cir. 1963); Cohn v. Industrial Salvage Material Co., 238 F.Supp. 491, 492-93 (E.D. Wis. 1965); Matter of Newman Company, 193 F.Supp. 554, 556 (N.D. Ohio 1961); In re Alithochrome Corp., 53 B.R. 906, 909 (Bkrtcy. S.D. N.Y. 1985); Matter of Prescott, 51 B.R. 751, 754, 41 U.C.C.R.S. 1873 (Bkrtcy. W.D. Wis. 1985); In re Jaggers, 48 B.R. 33, 36 (Bkrtcy. W.D. Texas 1985); In re Polar Chips International, Inc., 39 B.R. 864, 865 (Bkrtcy. S.D. Fla. 1984); Matter of Kennesaw Mint, Inc.,

32 B.R. 799, (Bkrtcy. N.D. Ga. 1983). See generally 4 COLLIER ON BANKRUPTCY ¶ 547.55, at 547-190 to 547-191 (15th ed. 1985). The parties have agreed that with the exception of insolvency the elements of a preference are present in this case. On that issue, the Court has rejected the valuation testimony presented by the defendant's expert witness in favor of that offered by the plaintiff's expert and, therefore, finds that the debtor was insolvent when each transfer occurred.

To preclude avoidance under Section 547(b), the defendant must establish that the transfers were either a contemporaneous exchange, or a new value transaction, or were (1) in payment of a debt incurred in the ordinary course of the debtor's business, (2) made not later than 45 days after the debt was incurred, (3) made in the ordinary course of the debtor's and the defendant's businesses, and (4) made according to ordinary business terms. 11 U.S.C. § 547(c)(1), (2), and (4). The burden is on the defendant to establish the § 547(c)(1), (2), and (4) affirmative defenses by a preponderance of the evidence. See Matter of Fasanol Harriss Pie Company, 43 B.R. 871, 877 Bankr.L.Rep. (CCH) ¶ 70,108, 40 U.C.C.R.S. 538 (Bkrtcy. W.D. Mich. 1984); In re Tinnell Traffic Services, Inc., 43 B.R. 277, 279 (Bkrtcy. M.D. Tenn. 1984); In re Independent Clearing House Co., 41 B.R. 985, 1014, 12 B.C.D. 44, 11 C.B.C.2d 196 (Bkrtcy. D. Utah 1984); Matter of Triple A Coal Company, Inc., 41 B.R. 641, 644 (Bkrtcy.

S.D. Ohio 1984); In re General Office Furniture Wholesalers, Inc., 37 B.R. 180, 183 (Bkrtcy. E.D. Va. 1984); Matter of Richter & Phillips Jewelers & Distributors, Inc., 31 B.R. 512, 515 (Bkrtcy. S.D. Ohio 1983); In re Saco Local Development Corp., 30 B.R. 867, 868 (Bkrtcy. D. Me. 1983); Matter of Saco Local Development Corp., 25 B.R. 880, 881 (Bkrtcy. D. Me. 1982).

I.

The Contemporaneous Exchange Exception

Section 547(c)(1) provides an exception for a transfer made to a creditor shortly after the creditor extends value to the debtor. This section provides:

> The trustee may not avoid under this section a transfer--
> (1) to the extent that 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;

To qualify for this exception, the defendant must prove three things. First, the creditor must have extended new value to the debtor. Second, the parties must have intended that the new value and the reciprocal transfer by the debtor be contemporaneous. Third, the exchange must in fact have been substantially contemporaneous. 2 W. Norton, NORTON BANKRUPTCY LAW AND PRACTICE § 32.13, at pt. 32 - p. 37 (1981).

In enacting Section 547(c)(1), Congress was concerned that transactions not commonly considered credit transactions, such as payment by check, might be construed by the courts as payments on account of an antecedent debt. Because these essentially cash transactions were not intended to be avoidable preferences, Congress created the "contemporaneous exchange" exception. See In re Davis, 734 F.2d 604, 606, 12 B.C.D. 859, 10 C.B.C.2d 859, Bankr.L.Rep. (CCH) ¶ 69,902 (11th Cir. 1984); In re Arnett, 731 F.2d 358, 361, 11 B.C.D. 1097, 10 C.B.C.2d 533, Bankr.L.Rep. (CCH) ¶ 69,839 (6th Cir. 1984). The House Report indicates that Congress intended to protect transactions from preference attack where a cash sale was intended, but a check was accepted and cashed within a reasonable time:

> The first exception is for a transfer that was intended by all parties to be a contemporaneous exchange for new value, and was in fact substantially contemporaneous. Normally, a check is a credit transaction. However, for the purposes of this paragraph, a transfer involving a check is considered to be "intended to be contemporaneous," and if the check is presented for payment in the normal course of affairs, which the Uniform Commercial Code specifies as 30 days, U.C.C. § 3-503(2)(a), that will amount to a transfer that is "in fact substantially contemporaneous."

H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 373 (1977), reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 5787, 6329.

Richard Levin, a member of the House Judiciary Committee staff who participated in the drafting of the Bankruptcy Code, further explained:

> The first exception is a simple one, excepting a transfer that is really not on account of an antecedent. Literally, the transfer must have been intended by the debtor and the creditor to have been a contemporaneous exchange for new value and "in fact a substantially contemporaneous exchange." No doubt a purchase by the debtor of goods or services with a check, if deemed to be on credit by state law, would be insulated by this exception. Though strictly speaking the transaction may be a credit transaction because the seller does not receive payment until the check is cleared through the debtor's bank, it is generally considered and intended to be a contemporaneous transaction, and assuming the check is promptly deposited and cleared, is in fact substantially contemporaneous.

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

Section 547(c)(1) requires that the transfer be in exchange for "new value."[5] In order for the transactions to be exempt

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5 The term "new value" is defined in Section 547(a)(2) as follows:

> "new value" means money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation;

from avoidance under this subsection, the defendant must have given money or money's worth in goods, services, or new credit, or have released a previously obtained property interest that would not otherwise be avoidable in bankruptcy, in exchange for the October checks. While the defendant undisputably provided managerial services for the debtor's business, the transfers were not in exchange for new value given. No evidence was introduced that suggests the parties intended for these services to be compensated, and it is impossible for the Court, on the record before it, to assign a value to them for purposes of the § 547(c)(1) exception. Instead, it appears to the Court, and the Court so finds, that the transfers were made in payment of the debtor's existing obligations to the defendant.

Furthermore, the requisite intent has not been sufficiently demonstrated to bring these transactions within the exception. A critical inquiry under Section 547(c)(1) is whether the parties intended the exchange to be contemporaneous. In re Wadsworth Building Components, Inc., 711 F.2d 122, 124, 10 B.C.D. 975, 8 C.B.C.2d 1166, Bankr.L.Rep. (CCH) ¶ 69,307 (9th Cir. 1983). The burden of proof on this issue, as with the other elements of Section 547(c)(1), lies with the defendant. Matter of Fasano/Harriss Pie Co., 43 B.R. 871, 877, Bankr.L.Rep. (CCH) ¶ 70,108, 40 U.C.C.R.S. 538 (Bkrtcy. W.D. Mich. 1984).[6] The

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[6] For cases filed after October 8, 1984, Section 547(g),

evidence is clear that no understanding existed between the parties as to the specific application of the checks. The October checks, therefore, cannot be exempted from avoidance as a preference under Section 547(c)(1).

II.

The Ordinary Course of Business Exception

The exception created by Section 547(c)(2) that is applicable to this proceeding provides:

> 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;

This exception was intended "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), reprinted in 1978 U.S. Code Cong. & Admin. News, pp. 5787, 6329. Professor Countryman has noted that the key terms

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enacted by the Bankruptcy Amendments and Federal Judgeship Act of 1984, codifies this rule.

"ordinary course of financial affairs," "ordinary business terms," and "ordinary course of business" are all undefined and "do not come into the bankruptcy law with a heavy gloss from use in other areas." Countryman, "The Concept of a Voidable Preference in Bankruptcy." 38 Vand.L.Rev. 713, 772 (1985).

Subsections (C) and (D) test the transaction sought to be avoided by the trustee to determine whether, as a whole, it was in the ordinary course of business or financial affairs. The question of whether these provisions encompass a subjective or an objective standard was raised but not answered in a law review article, see Herbert, "The Trustee Versus the Trade Creditor: A Critique of Section 547(c)(1), (2) & (4) of the Bankruptcy Code," 17 U.Rich.L.Rev. 667, 692 (1983), and one bankruptcy treatise. See 2 NORTON BANKRUPTCY LAW AND PRACTICE § 32.19, at pt. 32 - pg. 55 (1981). In this Court's view, subsection (C) is a subjective test: Was the transfer ordinary as between the debtor and the creditor? Subsection (D), on the other hand, is an objective test: Was the transaction made according to ordinary business terms? See In re Production Steel, Inc., Bankr.L.Rep. (CCH) ¶ 70,843, at 88,029 (Bkrtcy. M.D. Tenn. Oct. 23, 1985).

To be subjectively "ordinary" as between the parties implies some consistency with prior transactions. Id. Consequently, it is necessary to view the transfers at issue in the context of the parties' past course of dealing. In re Ewald Brothers, Inc., 45

B.R. 52, 57, Bankr.L.Rep. (CCH) ¶ 70,191 (Bkrtcy. D. Minn. 1984). Defendant does not contend that prior to October, 1981, its agents were in control of the business and financial affairs of the debtor. Rather, defendant argues that despite its effective control of the debtor's checking account, the payments were necessary to the debtor's ongoing business activities, and, therefore, in the ordinary course of business of the parties. This Court disagrees. The defendant took over management of the debtor's business at a time when the business was in serious financial difficulty and the creditor was owed in excess of $20,000.00. It then wrote checks to itself to pay off some of the outstanding indebtedness. These were clearly transactions outside of the ordinary course of business of the parties. Thus, this Court concludes that the defendant has failed to carry its burden of proof under Section 547(c)(2)(C).

The requirement that the transfer be made "according to ordinary business terms" is an objective test which looks to standards existing in the business in which the parties are engaged. In re Production Steel, Inc., supra at ¶ 70,844. Cf. Herbert, "The Trustee Versus the Trade Creditor II: The 1984 Amendment to Section 547(c)(2) of the Bankruptcy Code," 2 Bankr.Dev.J. 201, 211 (1985). Defendant offered no evidence on what "ordinary business terms" are in this business. The testimony presented showed that the debtor did not ordinarily pay

its monthly bills with cashiers' checks, but Anne McDade paid the defendant with cashiers' checks. While payment by cashiers' check does not necessarily preclude a finding that payments were not made according to ordinary business terms, see Matter of Craig Oil Co., 31 B.R. 402, 406, Bankr.L.Rep. (CCH) ¶ 69,286 (Bkrtcy. M.D. Ga. 1983), it is incumbent upon the party asserting a § 547(c)(2) defense to show by competent evidence what "ordinary business terms" are. This Court concludes that the defendant has failed to carry its burden of proof under Section 547(c)(2)(D).[7]

III.

The Subsequent Advance Exception

Section 547(c)(4) establishes a subsequent advance rule whereby a preferential transfer is insulated from the trustee's avoiding powers to the extent that the creditor extends new value, which is unsecured and remains unpaid, to the debtor after the preferential transfer. In re Saco Local Development Corp., 30 B.R. 859, 861, 10 B.C.D. 962 (Bkrtcy. D. Me. 1983). See In re Fulghum Construction Co., 706 F.2d 171, 172, 10 B.C.D. 702, 8 C.B.C.2d 644, Bankr.L.Rep. (CCH) ¶ 69,201 (6th Cir.),

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Having determined that the defendant has not met its burden of proof under Sections 547(c)(2)(C) and (D), the Court shall not address the parties' arguments regarding when the debts were "incurred" for purposes of applying the 45-day rule of Section 547(c)(2)(B).

cert. denied sub nom. Ranier & Associates v. Waldschmidt, 464 U.S. 935, 104 S.Ct. 342, 78 L.Ed.2d 310 (1983).[8] See generally, Countryman, "The Concept of a Voidable Preference in Bankruptcy," supra, 38 Vand.L.Rev. at 784. The purpose of Section 547(c)(4) is to encourage creditors to continue to provide goods or credit to financially troubled businesses. In

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The subsequent advance rule of Section 547(c)(4) is a legislative modification of the "net result rule," a judicially created equitable doctrine which evolved under the Bankruptcy Act. That rule provided as follows:

> [W]hen for goods sold and delivered, payments are made on a running or open account between the parties in the regular course of business within the 90-day period, without the knowledge on the part of the creditor of the debtor's insolvency, and the net result of these transactions is to enrich the debtor's estate by the total sales, less the total payments, such payments or transfers are not preferential, even though no corresponding goods are exchanged for the payments made within 90 days before bankruptcy.

4 COLLIER ON BANKRUPTCY ¶ 547.40, at 547-131 (15th ed. 1985). A true "net result rule" would total all payments and all advances and offset the one against the other. Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137, 93d Cong., 1st Sess., Pt. I, at 210-11 (1973). In contrast, the subsequent advance rule of Section 547(c)(4) does not apply to the 90-day preference period as a whole; rather, the focus of the court's inquiry is on the total amount of preferential transfers received by a creditor before the transfer of "new value," and on the total amount of the new value transfers by the creditor to the debtor after the preferential transfers were made. See Matter of Isis Foods, Inc., slip op., no. 84-0101-CV-W-1 (W.D. Mo. March 30, 1984).

re Gold Coast Seed Co., 30 B.R. 551, 553, 10 B.C.D. 1049, Bankr.L.Rep. (CCH) ¶ 69,305 (Bkrtcy. App. Pan. 9th Cir. 1983).

Applying the formula found in Section 547(c)(4) to the facts of this case, the Court finds that Aztec Copy, Inc. gave new value in the amount of $25,000.00 on October 6, 1981, after the preferential transfer of October 4, 1981, in the amount of $13,892.22. Thus, the defendant qualifies for the Section 547(c)(4) exception in that amount. The difference of $11,107.78 cannot be applied to offset preferential transfers subsequent to October 6. See In re Rustia, 20 B.R. 131, 136, 9 B.C.D. 6, 6 C.B.C.2d 917 (Bkrtcy. S.D. N.Y. 1982).

IV.

Summary of § 547(c) Defenses

For the purpose of clarity, the Court sets forth its application of the Section 547(c) defenses to the transactions involved in this proceeding:

Date	Preference	New Value	Net Preference
Oct. 4, 1981	$13,892.22		
Oct. 6, 1981		$25,000.00	-0-
Oct. 21, 1981	$ 4,350.84		$ 4,350.84
Oct. 27, 1981	$ 3,950.00		$ 3,950.00
Oct. 27, 1981	$ 4,533.34		$ 4,533.34
			$12,834.18

V.

Conversion

The tort of conversion requires the wrongful exercise of control over personal property in violation of the owner's rights. Frisco Joes, Inc. v. Peay, 558 P.2d 1327, 1330 (Utah 1977). The limits of the permitted use by one authorized to use another's property are determined by the terms, express or implied, of the agreement between the parties. RESTATEMENT, SECOND, TORTS § 228, Comment c. Based on the above finding that under the agreement between the debtor and the defendant the payments were authorized, there is no liability for conversion.

CONCLUSIONS OF LAW

1. The jurisdiction of this Court is properly invoked pursuant to 28 U.S.C. § 1334 and the General Order of Reference of the United States District Court for the District of Utah dated July 10, 1984, entered pursuant to 28 U.S.C. § 157(a). This is a "core proceeding" within the meaning of 28 U.S.C. § 157(b)(2)(F). Venue is properly laid in the Central Division of the District of Utah.

2. The trustee established that the payment of $13,892.22, represented by check no. 2002, dated October 4, 1981, was on account of antecedent debts owed by the debtor before such payment was made, and that it was made within 90 days before the

date of filing its Chapter 11 petition, when the debtor was insolvent, the result of which was to enable the defendant to receive more than it would have received under the distributive provisions of Chapter 7.

3. The payment of $13,892.22 is excepted under Section 547(c)(4) of the Bankruptcy Code in that after such payment the defendant gave new value to the debtor that was unsecured and on account of which the debtor did not make an otherwise unavoidable transfer to the defendant.

4. The defendant failed to sustain its burden of proof on the affirmative defenses raised under Section 547(c)(1) and (c)(2).

5. The trustee established that the payment of $4,350.04, represented by check no. 2037, was on account of antecedent debts owed by the debtor before such payment was made, and that it was made within 90 days before the date of filing its Chapter 11 petition, when the debtor was insolvent, the result of which was to enable the defendant to receive more than it would have received under the distributive provisions of Chapter 7.

6. The trustee established that the payment of $3,950.00, represented by check no. 1001, was on account of antecedent debts owed by the debtor before such payment was made, and that it was made within 90 days before the date of filing its Chapter 11 petition, when the debtor was insolvent, the result of which was

to enable the defendant to receive more than it would have received under the distributive provisions of Chapter 7.

7. The trustee established that the payment of $4,533.34, represented by check no. 2054, was on account of an antecedent debt owed by the debtor before such payment was made, and that it was made within 90 days before the date of filing its Chapter 11 petition, when the debtor was insolvent, the result of which was to enable the defendant to receive more than it would have received under the distributive provisions of Chapter 7.

8. The trustee is entitled to recover from the defendant the sum of $12,834.18 as a voidable preference under Section 547(b) of the Bankruptcy Code, for which the defendant is not entitled to apply any of the exceptions under Section 547(c), together with prejudgment interest at the legal rate from the date of commencement of this adversary proceeding.

9. The transfers of funds of the debtor to the defendant were not a conversion.

10. The trustee is not entitled to exemplary or punitive damages.

The trustee shall prepare and submit a judgment in conformity with these findings of fact and conclusions of law within 10 days from the date hereof.

DATED this 3rd day of February, 1986.

BY THE COURT:

Glen E. Clark

GLEN E. CLARK
UNITED STATES BANKRUPTCY JUDGE