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ADV. NUMBER: 98-1076
JUDGE: M. A. Mahoney
PARTIES: John McCorvey, III, Theodore L. Hall, Elli Weber
CHAPTER: 7
ATTORNEYS: T. L. Hall, M. J. McCormick
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UNITED STATES BANKRUPTCY COURT
SOUTHERN DISTRICT OF ALABAMA

IN RE

JOHN MCCORVEY, III — Case No. 97-12898-MAM-7

Debtor,

THEODORE L. HALL, Trustee,

Plaintiff,

v. — Adv. No. 98-1076

ELLI WEBER,

Defendant.

ORDER PARTIALLY GRANTING PLAINTIFF'S SUMMARY JUDGMENT MOTION

Theodore L. Hall, Mobile, Alabama, for Trustee/Plaintiff.
Michael J. McCormick, Biloxi, Mississippi, for Elli Weber.

This is an adversary proceeding brought by the trustee (plaintiff) seeking to recover an alleged preferential transfer from Elli Weber (defendant). This Court has jurisdiction to hear this matter pursuant to 28 U.S.C. §§ 1334 and 157 and the Order of Reference of the District Court. This is a core proceeding pursuant to 28 U.S.C. § 157(b) and the Court has the authority to enter a final order. For the reasons indicated below, the motion is partially granted.

FACTS

John McCorvey, III (debtor) filed a Chapter 7 bankruptcy case on August 14, 1997. Before filing, he had been the operator and sole stockholder of a business named Aabko Portable Buildings & Structures, Inc. (Aabko).

Defendant does not dispute that between March 6, 1996 and April 11, 1996 debtor received four loans from his mother, the defendant, totaling $33,800 (the loan). Debtor executed

a promissory note as consideration for each loan. On January 7, 1997, debtor made a $20,000 payment on the loan from defendant. On January 13, 1997, debtor made a $5,000 payment on the loan (hereinafter, the $20,000 and $5,000 payments will be referred to as "the transfers").

Defendant denies receiving from debtor a check for $10,650 on February 2, 1997 or for $2,600 on February 14, 1997. This order will not consider these alleged February transfers.

CONCLUSIONS OF LAW

A court shall grant summary judgment to a party when the movant shows that "there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law." Fed. R. Bankr. P. 7056(c). The facts are to be looked upon in the light most favorable to the nonmoving party. *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986).

Plaintiff brought this complaint under 11 U.S.C. § 547 seeking recovery of preferential transfers. The elements of a voidable preference are:

1) a transfer of an interest of the debtor in property,
2) to or for the benefit of the creditor,
3) for or on account of an antecedent debt owed by the debtor before such transfer was made,
4) made while the debtor was insolvent,
5) made on or within 90 days before filing of the petition or between 90 days and one year before the date of filing if such creditor at the time of such transfer was an insider, and
6) that enables the creditor to receive more than such creditor would receive if the case were under Chapter 7 and the transfer had not been made to the creditor.

11 U.S.C. § 547(b). Plaintiff has the burden to prove each element. *In re Matter of Anderson-Smith & Assoc., Inc.*, 188 B.R. 679, 684 (Bankr. N.D.Ala. 1995).

A.

Plaintiff has conclusively established the following five of these elements contained in § 547(b). First, the payments qualify as transfers under 11 U.S.C. § 101(54) since they are a mode of directly "disposing of or parting with property."

Second, the transfers were to a "creditor." Defendant is a creditor under § 101(10) because at the time of the transfers defendant had a claim, as defined in § 101(5), against debtor for $33,800 plus interest.

Third, the loan from defendant to debtor was entered into between January 1, 1996 and April 11, 1996. The transfers occurred on January 7, 1997 and January 13, 1997. Consequently, the transfers were made "on account of an antecedent debt." 11 U.S.C. §547(b)(2).

Fourth, defendant admitted that she is the mother of the debtor. Defendant's admission renders her an insider under 11 U.S.C. § 101(31)(A)(I) and triggers subsection (B) of §547(b)(4). Subsection (b)(4)(B) is satisfied because the transfers occurred within one year of August 14, 1997 or the date of the filing of the petition.

Fifth, § 547(b)(5) is met because the transfer had a preferential effect in favor of defendant. In general, a transfer falls within § 547(b)(5) when an unsecured creditor receives payment during the preference period unless the estate's assets are sufficient to provide a 100% distribution to creditors in a hypothetical Chapter 7 liquidation. *In re Continental Country Club, Inc.*, 108 B.R. 327 (Bankr. M.D. Fla. 1989).

Analyzing the facts in a light most favorable to defendant, this court will exclude debts that are also corporate liabilities in determining debtor's liabilities. Moreover, the debt owed to defendant will be set at $25,000, rather than $36,710 or the amount owed according to the

promissory notes. Based on this and on the schedules filed by the debtor, debtor's unsecured debt would be at least $37,388.31 calculated as follows:

Coleman Spas	$ 250.00
Helmsing, Lyons, Sims	785.00
Igler & Dougherty	525.00
Parisian	500.00
Sherman International	2,805.63
MCI Preferred	522.68
Schedule D unsecured claims	7,000.00
Defendant's claim	25,000.00
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	$37,388.31[1]

Debtor claimed all of his assets exempt. Therefore, debtor's only asset available to pay the $37,388.31 would be the $25,000 transferred to defendant. This results in a 67% distribution to unsecured creditors, as opposed to the 100% distribution the defendant received. Thus, § 547(b)(5) is satisfied.

B.

The Bankruptcy Code considers an individual insolvent when the sum of the individual's debts is greater than all of the individual's property, at a fair valuation, exclusive of exempt property. 11 U.S.C. § 101(32). Plaintiff relies on the schedules provided by the debtor upon the filing of the petition as an accurate depiction of debtor's financial condition not only at the time of the petition but also at the time of the transfer. Plaintiff's assertion is based in part on debtor's answer to Question 10 of its Statement of Financial Affairs that no property was transferred within one year immediately proceeding this case.

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[1] Plaintiff included an $18,000 and $5,000 claim of Barnett Bank allegedly found in Schedule F. This court did not include these two debts because of its inability to locate them on Schedule F. Nonetheless, the transfers resulted in a preferential advantage to the defendant even without counting these claims.

Defendant contends that plaintiff's analysis fails to properly account for all of debtor's assets at the time of the transfer, including debtor's interest in various corporations and a note payable by Aabko to debtor. In addition, defendant claims plaintiff neglected to consider a 1995 BMW 318I and a 1995 FORD F350, both of which defendant alleges were repossessed subsequent to the transfer.

Although defendant has not provided sufficient evidence in support of its calculation of debtor's assets at the pertinent time, her response raises a genuine issue of material fact. Moreover, the transfer did not occur within the 90 days immediately preceding the date of filing of the petition and as a result, plaintiff must prove defendant's insolvency without the aid of § 547(f)'s presumption. Therefore, summary judgment on the issue of the debtor's insolvency at the time of the transfer is denied.

C.

Defendant raises the earmarking doctrine in support of its contention that it did not transfer "an interest of the debtor in property." Under the earmarking doctrine a lender of new funds pays a prior creditor of the debtor directly or such funds are entrusted to the debtor with the understanding that the debtor is to use the funds only to pay obligations owed to a specific creditor designated by the new lender. *In re Safe-T-Bake of South Florida, Inc.*, 162 B.R. 359 (Bankr. S.D.Fla. 1993).

Defendant admits that the debtor used its certificate of deposit (CD) at Barnett Bank as collateral for the line of credit. The loan was granted in return for an interest in debtor's CD. Arguably, this renders the loan the property of debtor to the extent of the collateral ($20,000) and therefore, the earmarking doctrine does not apply. *See*, *In re Kelton Motors, Inc.*, 97 F.3d 22,

(2d Cir. 1996) (earmarking defense not available to the extent debtor offered its own property as collateral for the loan which was specifically made so debtor could pay a selected creditor).

However, defendant has issued a subpoena on Barnett Bank in the hope of discovering evidence of the Bank's awareness that the loan proceeds were entrusted to debtor only to repay defendant. Consequently, it would be premature to find the earmarking doctrine inapplicable.

D.

Assuming the transfers were preferences under § 547(b), defendant argues that the transfers fall within the § 547(c)(2) ordinary course exception. Under § 547(c)(2) a preferential transfer cannot be avoided to the extent it satisfies all three of the following requirements: 1) the transfer was made in payment of a debt incurred in the ordinary course of business of the debtor and transferee, 2) the transfer was made in the ordinary course of business of the debtor and transferee, and 3) the transfer was made according to ordinary business terms. In general, "ordinary course of business" involves the prior conduct of the parties, the common industry practice, and whether the payment resulted from any unusual action by either the debtor or creditor. *Matter of Anderson-Smith*, 188 B.R. at 685.

Defendant asserts in its Initial Response at ¶6 that the purpose of the line of credit was to repay his mother because she needed the money to meet her medical bills. This statement indicates that the debt was repaid out of necessity, rather than according to the ordinary course of business between debtor and defendant. Thus, defendant must prove that payments made because of her need to pay medical bills is a payment "made in ordinary course of business of the debtor and the defendant." Moreover, defendant must satisfy the other two prongs of the ordinary course exception. *Advo-System, Inc. v. Maxway Corp.*, 37 F.3d 1044 (4th Cir. 1994)

(transferee has burden of proving that payments received satisfy each subsection of § 547(c)(2)). Presently, defendant has not provided sufficient evidence to meet its burden and she has not sought summary judgment on this defense. However, defendant did use § 547(c)(2) in support of her defense to plaintiff's motion for summary judgment and defendant's use of the ordinary course defense gives rise to an issue of fact. Accordingly, summary judgment is not appropriate.

THEREFORE, IT IS ORDERED:

1. Plaintiff's motion for partial summary judgment is granted on the elements of a preference contained in the opening sentence of § 547(b) and in subsections (1), (2), (4), and (5), and these elements are conclusively established for purposes of the trial in this case.

2. Summary judgment on all other issues is denied.

Dated: September 14, 1998

MARGARET A. MAHONEY
CHIEF BANKRUPTCY JUDGE