

UNITED STATES BANKRUPTCY COURT
DISTRICT OF SOUTH DAKOTA
Western Division

In re:)	Bankr. No. 99-50153
)	
LYNDON M. FRANZEN)	Chapter 7
d/b/a Franzen Freightways)	
Soc. Sec. No. 468-56-4105)	
Tax I.D. No. 46-0430827)	
Debtor.)	
)	
DENNIS C. WHETZAL, TRUSTEE)	Adv. No. 01-5008
Plaintiff,)	
)	DECISION RE: PLAINTIFF-
-vs-)	TRUSTEE'S MOTION FOR SUMMARY
)	JUDGMENT AND DEFENDANT'S MOTION
FIRST INTERNATIONAL BANK)	FOR PARTIAL SUMMARY JUDGMENT
AND TRUST)	
Defendant.)	

The matter before the Court is Defendant First International Bank and Trust's motion for summary judgment as to count one of the complaint and Plaintiff-Trustee's Dennis C. Whetzal's motion for summary judgment regarding all counts. This is a core proceeding under 28 U.S.C. § 157(b)(2). This Decision and accompanying Order shall constitute the Court's interim findings and conclusions under Fed.R.Bankr.P. 7052. As set forth below, the Court concludes that Plaintiff-Trustee's motion will be granted to the extent that all subject post-petition transfers will be avoided under 11 U.S.C. § 549. Further, Plaintiff-Trustee's Motion will be granted and Defendant-Bank's motion will be denied, both to the extent that Defendant-Bank may not maintain an ordinary course of business defense regarding alleged preferential payments made on March 4, 16, and 17, 1999, on loans 68098 and 69485. Reserved for trial (or another round of motions and briefs) will be two issues: whether

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all pre-petition payments were preferential in light of Defendant-Bank's alleged right of setoff and whether Defendant-Bank may maintain an ordinary course of business defense for pre-petition payments made between January 1, 1999, and March 3, 1999, on loans 68098 and 69485.

I.

An involuntary Chapter 7 petition was commenced against Lyndon M. Franzen ("Debtor") on March 31, 1999. Debtor consented to relief and requested conversion to Chapter 11. An order for relief was entered and Debtor's case was converted to Chapter 11 on April 23, 1999. A plan was never confirmed. The case was reconverted to a Chapter 7 on March 8, 2000. Dennis C. Whetzal was appointed to serve as the Chapter 7 case trustee.

On March 27, 2001, Trustee Whetzal commenced an adversary proceeding under 11 U.S.C. § 547 against First International Bank and Trust of Harvey, North Dakota ("Bank"), claiming the Bank had received preferential payments during the 90-day preference period beginning January 1, 1999, and ending with Debtor's involuntary petition on March 31, 1999. Under 11 U.S.C. §§ 542 and 549, Trustee Whetzal also challenged the validity of some collateral the Bank had taken post-petition to secure some pre-petition debts and the validity of some post-petition payments on pre-petition debts.

In its answer, the Bank stated all subject transfers were made

in good faith in the ordinary course of business and that the transfers "were subject to the right of setoff possessed by [the Bank] as a result of the outstanding indebtedness owed to [the Bank] by Debtor at the time of the transfers."

On July 27, 2001, the Bank filed a motion for partial summary judgment seeking a declaration that the pre-petition transfers addressed in the Trustee's complaint regarding loan 69485 were an exception to the preferential transfer rule under § 547(c)(2) because they were made in the ordinary course of business. In support of its ordinary course of business defense, the Bank provided statements by four area bankers regarding customary practices.

In addition to its ordinary course of business defense, the Bank also maintained that Trustee Whetzal could not prevail in his preference action because he was not able to show that the subject debt payments were not proceeds from the Bank's collateral. With the exception of some non evidentiary statements by Trustee Whetzal's attorney at a deposition, the Bank did not identify any evidence in the present record that supported this conclusion.

Trustee Whetzal filed a summary judgment motion on July 31, 2001. In support, he submitted his affidavit, the Bank's documentation for the several loans that Debtor obtained from the Bank, the security agreements for these loans, and the Bank's loan

file notes. Therein, Trustee Whetzal broadened the scope of the payments he sought to recover, which now totaled \$92,211.00. Based on some of Debtor's testimony at a 2004 examination taken May 12, 1999,¹ and the Bank's loan documents and file notes, Trustee Whetzal argued that the Bank changed its relationship with Debtor around February 25, 1999, when Debtor said the Bank refused to make any further transfers from the operating lines of credit to Debtor's commercial checking account. Thus, Trustee Whetzal argued, the facts do not support the Bank's ordinary course of business defense after February 26, 1999, when the Bank ceased advancing sums to Debtor. He requested that the Court avoid, under § 547, preferential payments of \$17,500 on loan 69485 on February 26, 1999; \$2,500 on loan 69485 on March 1, 1999; \$25,000 on loan 69485 on March 2, 1999; \$20,000 on loan 69485 on March 4, 1999; \$2,500 on loan 69485 and \$5,955 on loan 68098 on March 16, 1999; and \$5,226 on loan 68098 on March 17, 1999. These pre-petition transfers totaled \$78,681.

In his summary judgment motion and brief, Trustee Whetzal also identified the several post-petition transfers that he wants avoided under § 549.² The first was a \$30 late charge on April 26,

¹ The complete transcript of Debtor's deposition has not yet been made a part of this file.

² There were several other post-petition payments that were made on Debtor's various loans from the Bank. These payments were

1999, on loan 69485. The second was \$7,500 in payments made by Debtor on October 1, 1999, that were divided among loans 68098, 70194, 70195, 69476, and 69478.³ The third was on January 18, 2000, when the Bank received \$4,500 in proceeds from the sale of Debtor's snowmobile trailer. The final post-petition transfer that Trustee Whetzal wants avoided was on November 29, 2000, when the Bank received \$1,500 in proceeds from the sale of Debtor's snowmobile. Trustee Whetzal also contended that the Bank's effort on April 13, 1999, to take a security interest in Debtor's receivables was invalid.

The Bank responded to Trustee Whetzal's summary judgment motion on August 23, 2001. As to the pre-petition transfers about which Trustee Whetzal complained, the Bank continued to assert that the payments were in the ordinary course of business, although the Bank was no longer advancing funds to Debtor's operating account from the line of credit account. It said two of the three checks that the Bank dishonored in early 1999 were because Debtor's

made after the Bank obtained relief from the automatic stay on March 23, 2000, and abandonment of several items of security on April 19, 2000. Trustee Whetzal did not include these payments in the list of post-petition transfers that he wanted the Court to avoid under § 549. Trustee Whetzal also did not challenge \$20,000 in credit that was extended post-petition to Comdata Network, Inc., based on a pre-petition letter of credit under loan 69741.

³ The \$7,500 was divided as follows: \$2,429.63 for loan 68098; \$1,471.96 for loan 70194; \$1,782.60 for loan 70195; \$1,658.70 for loan 69476; and \$157.11 for loan 68478.

available credit under loan 69845 could not cover them, not because the parties' relationship had changed. The Bank also said that Debtor's available credit under loan 68098 could not cover all three checks it had dishonored in early 1999. Further, the Bank said it did not advance additional funds to Debtor from credit line loans 69485 and 68098 after March 3, 1999, because Debtor did not write checks on his operating account thereafter.

As to the subject post-petition transfers, the Bank conceded the estate is entitled to the \$1,500 in proceeds from the sale of Debtor's snowmobile, less the costs of repair and sale, and is entitled to \$4,500 in proceeds from the sale of Debtor's snowmobile trailer. The Bank also agreed that it did not acquire a valid security interest (pre or post-petition) in Debtor's inventory, equipment, accounts receivable, the snowmobile, or the snowmobile trailer.

Finally, the Bank argued that the post-petition payments on several loans on October 1, 1999, were not voidable because they were considered by the Bank to be "regular" payments that were accepted from Debtor in lieu of the Bank filing a relief from stay motion. The Bank also argued that the October 1, 1999, payments were proper in light of Debtor's post-petition use of the trucks and trailers that secured the loans.

On September 12, 2001, Trustee Whetzal advised the Court by

affidavit that documents recently supplied to him indicated that all payments into Debtor's operating account between December 31, 1998, and March 16, 1999, came from Comdata Network, Inc., Debtor's factoring agent. The alleged preferential payments thus did not come from any collateral held by the Bank. Trustee Whetzal also acknowledged that the Bank was entitled to repair and sale costs of \$526.67 on the snowmobile. That left \$973.33 that the Bank agreed to return to the bankruptcy estate for the snowmobile.

II.

Summary judgment. Summary judgment is appropriate when "there is no genuine issue [of] material fact and . . . the moving party is entitled to a judgment as a matter of law." Fed.R.Bankr.P. 7056 and Fed.R.Civ.P. 56(c). An issue of material fact is *genuine* if it has a real basis in the record. *Hartnagel v. Norman*, 953 F.2d 394, 395 (8th Cir. 1992) (quotes therein). A genuine issue of fact is *material* if it might affect the outcome of the case. *Id.* (quotes therein). The matter must be viewed in the light most favorable to the party opposing the motion. *F.D.I.C. v. Bell*, 106 F.3d 258, 263 (8th Cir. 1997); *Amerinet, Inc. v. Xerox Corp.*, 972 F.2d 1483, 1490 (8th Cir. 1992) (quoting therein *Matsushita Elec. Industrial Co. v. Zenith Radio*, 475 U.S. 574, 587-88 (1986), and cites therein). Further,

the plain language of Rule 56(c) mandates the entry of summary judgment, after adequate time for discovery and

upon motion, against a party who fails to make a showing sufficient to establish the existence of an element essential to that party's case, and on which that party will bear the burden at trial.

Amerinet, 972 F.2d at 1490 (quoting *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986)). The movant meets this burden if he shows that the record does not contain a genuine issue of material fact and he points out that part of the record that bears out his assertion. *Handeen v. LeMaire*, 112 F.3d 1339, 1346 (8th Cir. 1997) (quoting therein *City of Mt. Pleasant v. Associated Electric Coop*, 838 F.2d 268, 273 (8th Cir. 1988)). No defense to an insufficient showing is required. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 156 (1970) (cite therein); *Handeen*, 112 F.3d at 1346. If the movant meets his burden, however, the non movant, to defeat the motion, "must advance specific facts to create a genuine issue of material fact for trial." *Bell*, 106 F.3d at 263 (quoting *Rolscreen Co. v. Pella Products of St. Louis, Inc.*, 64 F.3d 1202, 1211 (8th Cir. 1995)). The non movant must do more than show there is some metaphysical doubt; he must show he will be able to put on admissible evidence at trial proving his allegations. *Bell*, 106 F.3d 263 (citing *Kiemele v. Soo Line R.R. Co.*, 93 F.3d 472, 474 (8th Cir. 1996), and *JRT, Inc. v. TCBY System, Inc.*, 52 F.3d 734, 737 (8th Cir. 1995)).

III.

The issue presented under § 547 by these cross-motions for summary judgment is whether certain pre-petition payments from Debtor's checking account to the Bank for application against Debtor's lines of credit were made in the ordinary course of business under the preference exception provided by § 547(c).

Applicable law - preferential transfer. Under 11 U.S.C. § 547(b), a trustee may avoid a transfer to a creditor that occurred within ninety days of the petition date if the transfer was for a debt that preceded the transfer, the debtor was insolvent at the time of the transfer, and the transfer enabled the creditor to receive more than it would have under a Chapter 7 liquidation. *Buckley v. Jeld-Wen, Inc. (In re Interior Wood Products Co.)*, 986 F.2d 228, 230 (8th Cir. 1993). The trustee bears the burden of proof on each element of a preference under § 547(b). 11 U.S.C. § 547(g). The purpose of § 547(b) is to restore the bankruptcy estate to its pre-preferential transfer condition, *Halverson v. Le Sueur State Bank (In re Willaert)*, 944 F.2d 463, 464 (8th Cir. 1991), and prevent the debtor from favoring one creditor over others by transferring property shortly before filing bankruptcy. *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990).

Applicable law - ordinary course of business exception. A transfer by a debtor must have three characteristics to be

considered one made in the ordinary course of business and thus an exception to a voidable preferential transfer pursuant to § 547(c)(2). *Central Hardware Co. v. Sherwin-Williams Co. (In re Spirit Holding Co.)*, 153 F.3d 902, 904 (8th Cir. 1998). First, the transfer must be for a debt that was incurred in the ordinary course of business. *Id.* The transfer must have been made in the ordinary course of the financial affairs of the debtor and the creditor. *Id.* Finally, the transfer must have been made according to ordinary business terms. *Id.* The goal of this exception at § 547(c)(2) 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.

Id. (quoting S.Rep. No. 95-989 at 88 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5874; H.R.Rep. No. 95-595 at 373 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6329)).

There is no "precise test" to apply when determining whether a transfer is in the "ordinary course of business." *Spirit Holding Co.*, 153 F.3d at 904. Instead, the Court must engage in a factual analysis and determine whether the creditor, who carries the burden to prove this exception, has demonstrated a consistency in the business transactions at hand. *Id.* "The controlling factor is whether the transactions between the debtor and the creditor, both

before and during the ninety-day period, were consistent." *Official Plan Committee v. Expeditors International of Washington, Inc. (In re Gateway Pacific Corp.)*, 153 F.3d 915, 917 (8th Cir. 1998) (citing *Lovett v. St. Johnsbury Trucking*, 931 F.2d 494, 497 (8th Cir. 1991)). Proof of an unusual collection effort has a tendency to show that a transfer occurred outside the ordinary course of business. *Spirit Holding Co.*, 153 F.3d at 905 (citing *In re Braniff, Inc.*, 154 B.R. 773, 781-82 (Bankr. M.D. Fla. 1993)). The absence of an unusual collection effort, however, does not make the transfer an ordinary one. *Id.*

Discussion. The present record establishes that the Bank's relationship with Debtor changed appreciably by no later than March 4, 1999, when the Bank could have extended available credit to Debtor under loan 69485, but did not. Instead, the Bank returned check 1183 unpaid. From that date forward, it is clear that any payments made on Debtor's various loans were the product of atypical collection efforts by the Bank. Further, the pre-petition payments on March 16 and 17, 1999, were specifically generated by the Bank as setoffs. Computer-generated, automatic transfers to and from Debtor's checking account and to and from Debtor's two operating lines of credit had ended. From no later than March 4, 1999, forward, the Bank stopped lending Debtor money as needed to assist him with his cash flow and then taking payments

when possible on the line of credit. From no later than March 4, 1999, forward, the Bank's only actions were to reduce the balance on the lines of credit it had extended to Debtor. Thus, the course of business previously established between the parties ended. Another phase began that lasted until Debtor's petition in bankruptcy. Accordingly, the pre-petition transfers out of Debtor's checking account from March 4, 1999, to the petition date were not transfers in the ordinary course of business. These payments totaled \$11,151 on loan 68098 and \$22,500 on loan 69485.

The present record is not sufficient for the Court to reach a conclusion regarding transfers earlier in the preference period. As noted above, Debtor was seemingly having financial problems by January 15, 1999, when the first check was returned. Whether the Bank's ordinary course of business with Debtor ended that date, however, is difficult to determine since some advances were made thereafter from loan 69485. While the Bank agreed that the relationship changed on March 16, 1999, when the first setoffs occurred, it was Debtor's testimony that the Bank ceased cooperating with him in February 1999. Accordingly, the present record does not favor either party. Since the record must be considered in a light favorable to the Bank on Trustee Whetzal's summary judgment motion, although the Bank bears the burden of proof on its ordinary course of business defense, summary judgment

regarding these earlier payments in the preference period is not appropriate. Instead, a trial is needed to receive more evidence on the Bank and Debtor's relationship from the first of January 1999, through March 4, 1999.

One other issue under § 547 remains to be resolved in this adversary proceeding, one that should have been addressed before the ordinary course of business defense. In its answer, the Bank contended that the subject pre-petition transfers fell within the Bank's right of setoff. If true, then all elements for a preferential transfer required by § 547(b) may not be present since the Bank may not have received more through these transfers than it would have under a Chapter 7 liquidation. See 11 U.S.C. §§ 547(b)(5) and 553. Neither party fully addressed this issue in their respective motions or briefs. Accordingly, the parties should confer and advise the Court by letter within a week if they can resolve this issue, if they did not do so earlier. If the issue is not resolved, the parties may request a scheduling order for a trial date or for a deadline for motions and briefs on that particular issue. Consideration of the Bank's ordinary course of business defense under § 547(c)(2) for the pre-petition transfers between January 1, 1999, and March 4, 1999, will become relevant only if all elements of § 547(b) are first established.

IV.

As noted above, the Bank has acknowledged that the bankruptcy estate is entitled to \$973.33 in proceeds from the post-petition sale of Debtor's snowmobile and \$4,500 in proceeds from the post-petition sale of Debtor's snowmobile trailer. It also agreed that it did not acquire a valid security interest (pre or post-petition) in Debtor's inventory, equipment, and accounts receivable. The only post-petition transfers addressed in Trustee Whetzal's motion that the Bank still argued were valid were the several payments by Debtor to the Bank totaling \$7,500 on October 1, 1999. The Bank attempts to justify receipt of those payments on the grounds that Debtor was using trucks and trailers in which the Bank had a security interest and that the amount received was less than the amount to which the Bank was entitled.

Applicable law - post-petition transfer. Once the automatic stay is in place, a reorganizing debtor is not free to pay pre-petition claims. See *In re Lively*, 266 B.R. 209, 211-16 (Bankr. N.D. Okla. 1998) (a reorganizing debtor cannot choose which pre-petition claims to pay outside a plan without court approval). Such transfers are recoverable under § 549 if they were not approved by the Court. *Id.* at 213. A transfer may be avoided under § 549, if an actual transfer of bankruptcy estate property was made after the case was commenced and the transfer was not

authorized by the Court or the Bankruptcy Code. *Shields v. Duggan (In re Dartco, Inc.)*, 197 B.R. 860, 865 (Bankr. D. Minn. 1996); *Schieffler v. Coleman (In re Beshears)*, 196 B.R. 464, 466 (Bankr. E.D. Ark. 1996); see also *LaBarge v. Vierkant (In re Vierkant)*, 240 B.R. 317, 323-25 (B.A.P. 8th Cir. 1999) (discussion regarding acts that are void because they violate the automatic stay under § 362 and acts that are voidable under § 549). The party asserting the validity of the post-petition transfer bears the burden of proof. Fed.R.Bankr.P. 6001; *Beshears*, 196 B.R. at 466.

Discussion - post-petition transfer. The October 1, 1999, payments are avoidable under § 549(a). The payments occurred after March 31, 1999, the date the case was commenced. There is no evidence that the payments were authorized by the Court or under the Code. Debtor's trucking business never operated "ordinarily" after the bankruptcy was commenced and there is no evidence of the value to the estate of any post-petition use of the Bank's collateral while the Debtor operated the business under Chapter 11. *Lively*, 266 B.R. at 211-16. Thus, the Bank must return the \$7,500 to the Bankruptcy estate.

Trustee Whetzal shall prepare an order for partial summary judgment that grants his motion and denies the Bank's motion to the extent that the Bank may not maintain an ordinary course of business defense under § 547(c)(2) for the pre-petition payments on

March 4, 16, and 17, 1999; that voids under § 549(a) all post-petition transfers (payments or obtaining security) identified by Trustee Whetzal; and that recognizes that the Bank has agreed to turnover the proceeds from the snowmobile, less repair and sale costs, and the proceeds from the snowmobile trailer.

So ordered this 26 day of October, 2001.

BY THE COURT:



Irvin N. Hoyt
Bankruptcy Judge

ATTEST:
Charles L. Nail, Jr., Clerk

By: *Charathy L. Baker*
Deputy Clerk

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

OCT 26 2001

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



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

OCT 26 2001

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

By: *CLN*

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