UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

IN RE:	)	
	)	
Pluma, Inc.,	)	Case No. 99-11104C-11G
	)	
Debtor.	)	
	)	
Pluma, Inc.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adversary No. 00-2070
	)	
West Brothers Transfer & Storage, Inc.,	)	
	)	
Defendant.	)	

MEMORANDUM OPINION

This adversary proceeding came before the court for trial on March 20, 2001. C. Edwin Allman, III appeared on behalf of the Debtor. John Walter Bryant appeared on behalf of Defendant West Brothers Transfer & Storage, Inc. (hereinafter "Defendant").

MATTER BEFORE THE COURT

The Debtor seeks to recover payments in the aggregate amount of $5,684.08 made by the Debtor to the Defendant within 90 days prior to the filing of this case as preferential transfers pursuant to §§ 547 and 550 of the Bankruptcy Code.[1] Defendant denies that the payments at issue constitute preferential transfers. Defendant further contends that such payments fall within the § 547(c)(2) "ordinary course of business" exception and the § 547(c)(4) "new value" exception and, therefore, may

[1]All section citations hereinafter refer to sections of the United States Bankruptcy Code.

not be avoided by the Debtor.

FACTS

Debtor filed a voluntary Chapter 11 petition on May 14, 1999. On November 20, 1999, this court entered an order confirming the Debtor's First Modified Plan of Liquidation. On July 6, 2000, the Trustee filed this adversary proceeding.

Prior to declaring bankruptcy and for sometime thereafter, Debtor engaged in the manufacture and sale of textiles. Prior to the petition date, Defendant provided shipping and transit services to the Debtor. Defendant periodically invoiced the Debtor with payment terms as "net 15." This relationship existed between the parties for a number of years. During the preference period,[2] Debtor paid numerous invoices dated between October 14, 1998 and March 5, 1999. Specifically, Debtor made five payments to Defendant by bank checks in the aggregate amount of $16,151.08 during the ninety day preference period. Debtor acknowledges that $10,467.00 of credit extended by Defendant during the ninety days preceding the petition date was not paid by Debtor and should be recognized as "new value" pursuant to § 547(c)(4). Accordingly, Debtor seeks to recover the net amount of $5,684.08 as a preference pursuant to § 547(b).

ANALYSIS

Under § 547(b) the trustee may avoid a debtor's prepetition transfer

[2]The preference period includes transfers made "on or within 90 days before the date of the filing of the petition." § 547(b)(4). In the present case, the preference period includes transfers made on or between February 14, 1999 and May 14, 1999.

to an unsecured creditor if the transfer: (1) was of an interest of the Debtor in property, (2) was to or for the benefit of a creditor, (3) was for an antecedent debt owed by the Debtor before the transfer was made, (4) was made while the debtor was insolvent, (5) was made on or within 90 days of the filing of the petition and (6) enabled such creditor to receive more than such creditor would receive if the case were a case under Chapter 7, the transfer had not been made and such creditor received payment of such debt to the extent provided under Chapter 7. It is not disputed that the transfers in question were of an interest of the Debtor in property, that the transfers were to a creditor, for an antecedent debt, and were made within 90 days of the filing of the petition. Thus, the matters at issue are (1) whether the Debtor was insolvent at the time of the transfers, (2) whether the transfers enabled the Defendant to receive more than it otherwise would receive under Chapter 7, and (3) whether the transfers are protected by § 547(c).

1. Was the Debtor insolvent at the time of the transfer?

The trustee bears the ultimate burden of proving by a preponderance of the evidence that the Debtor was insolvent at the time of the transfer in question. 11 U.S.C. § 547(g). However, under § 547(f) there is a rebuttable presumption that the Debtor was insolvent on and during the 90 days immediately preceding the date of the filing of the petition. While this presumption does not shift the ultimate burden of proof, it does result in the creditor having the burden of going forward with the evidence and places on the creditor the initial obligation of producing some evidence that the Debtor was solvent at the time of the transfer.

If the creditor produces such evidence, then the burden of going forward with the evidence shifts to the trustee to affirmatively demonstrate the Debtor's insolvency. 5 LAWRENCE P. KING, COLLIER ON BANKRUPTCY, ¶ 547.12 (15th rev. ed. 2000).

In the present case, the court finds that the Debtor was insolvent at the time the Debtor made the transfers in question. Apart from the presumption of insolvency, Martin Borders, who was Vice President and Treasurer of Debtor prior to the Debtor filing bankruptcy and who is now the Chief Liquidation Officer of Debtor, testified that the Debtor's assets did not exceed its liabilities when the case was filed. Moreover, Debtor's confirmed First Modified Plan of Liquidation reveals that Debtor's assets were not even sufficient to pay secured claims in full. Although the Defendant denied in its answer that Debtor was insolvent at the time the transfer was made, Defendant produced no evidence at trial that the Debtor was solvent at the time of the transfers.

2. Did the transfer enable the Defendant to receive more than it otherwise would receive under Chapter 7?

The burden is on the trustee to prove that the creditor received more than it would if the case were a Chapter 7 liquidation case, the transfer had not been made, and the creditor received payment of the debt to the extent provided by the provisions of the Bankruptcy Code. 11 U.S.C. § 547(b)(5); In re Powerine Oil Co., 59 F.3d 969, 972 (9th Cir. 1995) (transfer is preferential if creditor receives a "greater percentage of his claim" than if the transfer had not been made and the creditor participated in the distribution of estate assets). Whenever

"the distribution in bankruptcy [to unsecured creditors] is less than one-hundred percent, any payment 'on account' to an unsecured creditor during the preference period will enable that creditor to receive more than he would have received in liquidation had the payment not been made." Elliott v. Frontier Properties/LP (In re Lewis W. Shurtleff, Inc.), 778 F.2d 1416, 1417 (9th Cir. 1985). See also COLLIER ON BANKRUPTCY ¶ 547.03[7] ("[A]ny payment to a general unsecured creditor within the ninety-day period preceding the filing of the petition would be preferential if other creditors in the same class would not receive the same payment in a Chapter 7 liquidation, i.e., the Chapter 7 distribution plus the payment received.") (emphasis in original).

In the present case, Defendant provided services to the Debtor "on account," thereby becoming an unsecured creditor. Since the Debtor was insolvent when the case was filed, unsecured creditors were faced with receiving less than one-hundred percent of their claims upon liquidation of the Debtor. In fact, under Debtor's confirmed Modified Plan of Liquidation, unsecured creditors likely will receive a dividend of between 5% and 15% of their respective allowed claims. Debtor's Modified Plan of Liquidation, p.2. Therefore, the court concludes that the payments to Defendant during the preference period enabled Defendant to receive more than it would have received in liquidation had the payment not been made.

3. Is the preferential transfer to Defendant saved by § 547(c)?

As a result of the foregoing conclusion that all elements of § 547(b) have been shown, the transfer to Defendant is avoidable by the

Debtor unless the transfer falls within one of the exceptions contained in subsection (c) of § 547. Defendant asserts in its answer that two of the § 547(c) defenses apply. Defendant first argues that the transfers were made in the ordinary course of business of the Debtor and the Defendant and made according to ordinary business terms, and therefore are saved by § 547(c)(2). Section 547(c)(2) provides that the trustee[3] may not avoid a transfer:

> 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.

Defendant has the burden of proving by a preponderance of the evidence that each payment satisfies each of § 547(c)(2)'s three subsections. 11 U.S.C. § 547(g). The Debtor does not dispute that the debts were incurred by the Debtor in the ordinary course of business of the Debtor and the transferee and therefore Defendant has satisfied subsection A. Whether Defendant has made its case under subsections B and C is disputed.

The Bankruptcy Code does not define any of the phrases in § 547(c)(2). Moreover, the legislative history of § 547(c)(2) says simply that the "purpose of this exception is to leave undisturbed normal financial relations, because [the ordinary course of business exception]

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[3]Pursuant to § 1107, a Chapter 11 debtor-in-possession, in general, has the same rights, powers and duties as the trustee.

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." S.Rep. No. 989, 95th Cong., 2d Sess. 88 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5874. Given the absence of statutory definitions and dearth of legislative history, resort must be had to the case law for guidance.

The Court of Appeals for the Fourth Circuit has made clear that subsection B of § 547(c)(2) is governed by a subjective test. Advo System Incorporated v. Maxway Corporation, 37 F.3d 1044, 1048 (1994). See also Harman v. First Am. Bank of Md., 956 F.2d 479, 486-88 (4th Cir. 1992). Therefore, determination of whether a payment was made in the ordinary course of business of the Debtor and the transferee requires "an analysis of the business practices which were unique to the particular parties under consideration." Harman, 956 F.2d at 486 (quoting Waldschmidt v. Ranier, 872 F.2d 739, 743 (6th Cir. 1989)). This inquiry is "peculiarly factual." Id. (quoting In re First Software Corp., 81 B.R. 211, 213 (Bankr. D. Mass. 1988)).

In determining whether debtor's payments to a creditor were made within the "ordinary course of business" between the parties, the factors the court should consider include "the history of the parties' dealings with each other, timing, amount at issue, and the circumstances of the transaction." In re Tennessee Chemical, 112 F.3d 234, 237 (6th Cir. 1997). Even late payments may be categorized as within the "ordinary course of business" where evidence shows a regular and consistent pattern of late payments by the debtor, acceptance of those payments by the

supplier, followed by supplier's additional sales on credit to the debtor. In re Classic Drywall, Inc., 127 B.R. 874, 878 (D. Kan. 1991). See e.g., In re Tennessee Chemical, 112 F.3d at 237; In re White, 64 B.R. 843, 850 (Bankr. E.D. Tenn. 1986). However, "in analyzing subsection B 'a narrow band of difference is acceptable.'" In re Air South Airlines, Inc., 247 B.R. 153, 161 (Bankr. D.S.C. 2000) (quoting Huffman v. New Jersey Steel Corp. (In re Valley Steel Corp.), 182 B.R. 728, 737 (Bankr. W.D. Va. 1995)). See also Sprowl v. Miami Valley Broadcasting Corp. (In re Federated Marketing, Inc.), 123 B.R. 265 (Bankr. S.D. Ohio 1991) (payments during preference period made 79 to 101 days after invoice not in ordinary course when compared to pre-preference period payments made 33 to 46 days after invoice); In re Fonda Group, Inc., 108 B.R. 956, 960 (Bankr. D.N.J. 1989) (where travel agency accounts were usually paid within 30 days of invoice date, transfers by Chapter 11 debtor to travel agent more than 30 days after the invoice date were not in "ordinary course of business" so as to preclude avoidance of the transfers as preferences).

A creditor relying upon § 547(c)(2) must establish a "baseline of dealings" so that the court may compare the practice of late payments during the preference period with the prior course of dealing between the parties. In re T.B. Home Sewing Enterprises, Inc., 173 B.R. 790, 795-96 (Bankr. N.D. Ga. 1993). Ordinarily, such baseline should take into account the entire course of dealing between the parties. In re Tennessee Chemical Co., 112 F.3d 234, 237 (6th Cir. 1997). "[T]he entire length of the relationship, or at least a material segment of it, should

be examined to determine the 'baseline' course of dealings." In re Hancock-Nelson Mercantile Co., Inc., 122 B.R. 1006, 1013 (Bankr. D. Minn. 1991). It also is important that the baseline period "extend back into the time before the debtor became financially distressed . . . [when] the debtor's dealings were 'ordinary' in the layman's sense of the word." Id.

Defendant's evidence in the present case failed to establish the requisite baseline and hence was insufficient to establish the applicability of § 547(c)(2). The course of dealing between the Debtor and the Defendant extended over a period of several years preceding the bankruptcy case. However, the evidence regarding Debtor's payment history extended back only to January of 1998. In that regard, Mr. Borders testified that from January through September of 1998, the Debtor paid Defendant's invoices within 15 days. Mr. Jim Wetmore, Defendant's Vice President of Administration, testified that the Debtor was slower than 15 days in paying Defendant's invoices. However, he did not specify when or over what period of time this occurred, and admitted that he could not dispute Mr. Borders' testimony that payments were made within 15 days during most of 1998. The only evidence offered by the Defendant, other than Mr. Wetmore's testimony, consisted of printouts showing the timing of certain payments made by the Debtor. While these records did show that payments were made more than 15 days after the dates of some invoices, the records covered a period of only four and one half months extending from October of 1998 until the middle of February of 1999. In addition to being abbreviated, the period covered by the records was the

four and one half months immediately preceding the preference period. "There is real doubt whether a preference defendant can properly rely upon experience of no more than two months in duration prior to the commencement of the preference period to establish the 'ordinary course' of the parties' past dealings." In re Hancock-Nelson Mercantile Co., Inc., 122 B.R. at 1013. While Defendant's exhibits covered a period of some four months, they nonetheless were not adequate to establish a sufficient course of dealing baseline, taking into account that the period covered by the exhibits did not represent a material segment of the parties' course of dealing and such period immediately preceded the preference period. Additionally, the undisputed testimony revealed that during the nine months immediately preceding the period covered by the exhibits, the Debtor paid the Defendant within 15 days in accordance with the terms of Defendant's invoices, while the payments at issue were made between thirty-four and one-hundred forty-one days after the date of the invoices being paid.[4] Thus, the evidence, taken as a whole, was

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[4]Exhibit 1, "Days Paid" column. "Days Paid" is calculated as the number of days between the invoice date and the check date. However, a transfer by check is deemed effective for purposes of the affirmative defenses in § 547(c) on the date when the check is received by the creditor. Durham v. Smith Metal & Iron Co. (In re Continental Commodities, Inc.), 841 F.2d 527, 528 (4th Cir. 1988). See also Barnhill v. Johnson, 503 U.S. 393, 402 n.9, 112 S. Ct. 1386, 118 L.Ed.2d 39 (1992) ("Those Courts of Appeals to have considered the issue are unanimous in concluding that a 'date of delivery' rule should apply to check payments for purposes of § 547(c)."(citations omitted)). This is in contrast to the rule under § 547(b) which holds that the transfer of funds by check is effective when the drawee bank honors the check. Barnhill, 503 U.S. at 395. In all likelihood, it took one or two days for mail delivery of the checks to Defendant. Thus, the number of days between the invoice date and the "transfer" date for purposes of § 547(c) is likely at least a day or two greater than shown on Exhibit 1.

insufficient to show by a preponderance that such payments were made in the ordinary course of business within the meaning of § 547(c)(2)(B) of the Bankruptcy Code.

The remaining element of § 547(c)(2) is subparagraph (C) which requires a showing that payments were made "according to ordinary business terms." In Maxway, the Court of Appeals for the Fourth Circuit held that subsection C of § 547(c)(2) calls for an objective analysis of the norm in the creditor's industry. 37 F.3d at 1048 ("the benchmark for ordinariness is the norm in the creditor's industry."). This view comports with the view of the majority of the federal circuits which have addressed this issue and have held that subsection C requires an objective analysis. Id. at 1048, n.3. However, such inquiry is unnecessary in this proceeding because, as explained above, Defendant was unable to establish subsection B and therefore cannot take advantage of the ordinary course of business exception contained in § 547(c)(2).

Finally, Defendant also asserted as an affirmative defense in its answer the § 547(c)(4) "new value" exception to preference avoidance. Section 547(c)(4) provides that the Trustee may not avoid a transfer:

> 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.

As was the case with the § 547(c)(2) "ordinary course of business" exception, Defendant also bears the burden of proving by a preponderance

of the evidence that the payments at issue satisfy each of § 547(c)(4)'s two subsections. 11 U.S.C. § 547(g). Defendant did not present any evidence to this effect. Accordingly, the Defendant cannot take advantage of the new value exception beyond the new value that was admitted by the Debtor in reducing the preference claim in Exhibit 1 from $16,151.08 to $5,684.08.

Accordingly, a judgment will be entered contemporaneously herewith allowing a recovery from the defendant of $5,684.08, plus interest from the date on which this adversary proceeding was filed at an interest rate determined in accordance with 28 U.S.C. § 1961.

This 11th day of April, 2001.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
MIDDLE DISTRICT OF NORTH CAROLINA
GREENSBORO DIVISION

IN RE:	)	
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Pluma, Inc.,	)	Case No. 99-11104C-11G
	)	
Debtor.	)	
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Pluma, Inc.,	)	
	)	
Plaintiff,	)	
	)	
v.	)	Adversary No. 00-2070
	)	
West Brothers Transfer & Storage, Inc.,	)	
	)	
Defendant.	)	

JUDGMENT

In accordance with the memorandum opinion filed contemporaneously herewith, it is ORDERED, ADJUDGED AND DECREED that the plaintiff have and recover from the defendant the principal sum of $5,684.08, plus interest from July 6, 2000, at an interest rate determined in accordance with 28 U.S.C. § 1961.

This 11th day of April, 2001.

William L. Stocks

WILLIAM L. STOCKS
United States Bankruptcy Judge