

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:)	CHAPTER 11
)	
SAMY SANTA FLOORING DEPOT, INC.,)	CASE NO. 09-81413 - MHM
)	
Debtor.)	
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SAMY SANTA FLOORING DEPOT, INC.,)	
)	
Plaintiff,)	
v.)	ADVERSARY PROCEEDING
)	NO. 09-6571
KENNEBEC LUMBER COMPANY,)	
)	
Defendant.)	

ORDER DENYING PLAINTIFF'S MOTION FOR SUMMARY JUDGMENT

Debtor filed this adversary proceeding seeking to avoid transfers made by Debtor to Defendant as preferential pursuant to 11 U.S.C. §547(b); and after conversion of the main bankruptcy case and appointment of the Chapter 7 Trustee ("Trustee" or "Plaintiff"), Trustee was substituted for Debtor as plaintiff.¹

Statement of Facts

On or about December 15, 2008, Debtor opened an account with Defendant so that Debtor could act as a broker of Defendant's lumber products to Show Industries ("Shaw"), a customer of Debtor. The payment terms between Debtor and Defendant

¹ The main bankruptcy case commenced August 17, 2009, as a Chapter 11 case, with Debtor acting as debtor in possession. On April 17, 2010, the main bankruptcy case was converted to a Chapter 7 case (Doc. No. 54) and Robert Silliman was appointed as Trustee (Doc. No. 55). Trustee was substituted as Plaintiff in this adversary proceeding by order entered April 30, 2010 (Doc. No. 30). Although motion for summary judgment had been filed before the main bankruptcy case was converted, Trustee ratified the motion when eh filed his reply brief (Doc. No. 37).

provided for payment due 30 days after the invoice date and Defendant reserved the right to charge interest at 1.5 percent per month on invoice balances older than 30 days (the “Payment Terms”). Both Debtor and Defendant understood, however, that Debtor would pay Defendant only after Debtor’s receipt of payment from Shaw. Defendant began shipping materials to Shaw December 19, 2009, pursuant to the Payment Terms. Similar shipments continued until April 13, 2009.

Between January 30, 2009 and June 19, 2009, Defendant received twelve checks from Plaintiff in payment of 13 invoices. During that same period Plaintiff received 13 payments from Shaw in payment for eleven invoices. Trustee’s summary of the payments between the Defendant, Debtor and Shaw is attached as Exhibit “A.”

On August 17, 2009, Debtor filed its chapter 11 bankruptcy petition. The complaint in this adversary proceeding alleges that the payment of \$31,940.48 by check dated May 15, 2009 (“Payment 1”), the payment of \$25,178.80 by check dated May 22, 2009 (“Payment 2”) and the payment of \$25,178.80 by check dated June 19, 2009 (“Payment 3”) are each avoidable preferential transfers. Payments 2 and 3 were made by Debtor to Defendant after Debtor received payment from Shaw.

Legal Analysis

To prevail in a motion for summary judgment, the moving party must show that the record, viewed in light most favorable to nonmovant, demonstrates no material facts in dispute and that the movant is entitled to judgment as a matter of law. FED. R. CIV. P. 56(c); FED. R. BANKR. P. 7056(c); *Clark v. Coats & Clark, Inc.*, 929 F.2d 604, 608 (11th Cir. 1991) The moving party has the initial burden of demonstrating the absence of a genuine issue of material fact. If this burden is met, the burden shifts to the nonmovant

who must produce evidence of the existence of a material fact necessitating further proceedings. FED. R. CIV. P. 56(c); FED. R. BANKR. P. 7056(e); *Hammer v. Slater*, 20 F.3d 1137, 1141 (11th Cir. 1994).

Section 547(b) provides that to recover a preferential transfer, Trustee must show the transfer was made:

- (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
- (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.

11 U.S.C. § 547(b). Trustee has the burden of proving the transfer was preferential and the standard of proof required is a preponderance of the evidence. 11 U.S.C. §547(g); *In re Lucasa Int'l, Ltd.*, 13 B.R. 596, 598 (Bankr. S.D.N.Y. 1981).

Whether a payment by check occurred within 90 days of the date of filing is contingent upon what date controls for the payment. In considering whether a transfer via check occurred within 90 days of the date of filing, the controlling date for when the transfer occurred is the date the check is honored by the debtor's bank, not the date the debtor wrote the check. *See e.g. In re All American of Ashburn, Inc.*, 95 B.R. 251, 252-53 (Bankr. N.D. Ga. 1989); *In re Georgia Steel, Inc.*, 38 B.R. 829, 832-34 (Bankr. M.D. Ga. 1984).

All the requirements for a preferential transfer are satisfied for Payments 2 and 3. With respect to Payment 1, however, 90 days before the petition date was May 19, 2009. Although check for Payment 1 was dated May 15, 2009, which is more than 90 days before the petition date, Plaintiff alleges the check was honored May 21, 2009, less than 90 days before the petition date.

Business Records Exception

To establish the date the Payment 1 check was honored, Plaintiff relies on bank records of Debtor's account at SunTrust Bank (the "Bank Records"). Trustee's reliance upon the Bank Records creates a hearsay issue. "'Hearsay' is a statement,² other than one made by the declarant while testifying at the trial or hearing, offered in evidence to prove the truth of the matter asserted." FED. R. EVID. 801(c). Hearsay is not admissible unless an exception under FED. R. EVID. 802 allows admission.

The applicable exception in this case is the business records exception. FED. R. EVID. 803(6). The business records exception has four requirements: the record must be "[1] made at or near the time [2] by, or from information transmitted by, a person with knowledge, [3] kept in the regularly conducted business activity and [4] it was the regular practice of that business activity to make the [record] shown by the testimony of a custodian ... or by certification." *Id.* Additionally, if the record were admissible under FED. R. EVID. 803(6) and it was accompanied by a written declaration by its custodian, the record could be self-authenticating. FED. R. EVID. 902(11).

"The touchstone of admissibility under the business records exception to the hearsay rule is reliability." *United States v. Bueno-Sierra*, 99 F.3d 375, 378 (11th Cir.

² Statement includes both written and oral assertions. FED. R. EVID. 801(a).

1996). The custodian need not have prepared the record at issue. *Itel Capital Corp. v. Cups Coal Co.*, 707 F.2d 1253, 1259 (11th Cir. 1983). The custodian, however, must be able to testify about the "the origination and compilation of the documents" or "about the initial link in the chain producing the record." *United States v. Petrie*, 302 F.3d 1280, 1288 (11th Cir. 2002).

Courts strictly prohibit a custodian from introducing business records without personal knowledge of how the records were created. See *Chao v. Lexington Healthcare Group, Inc. (In re Lexington Healthcare Group, Inc.)*, 335 B.R. 570, 574 (Bankr. D. Del. 2005).³ In the case of *Lexington Healthcare*, the debtor sought to introduce records from the debtor's payroll company and Nationwide. The debtor provided affidavits of the debtor's receiver, who was the custodian of the debtor's records, and of the third party administrator of the debtor's 401(k) plan. Neither affiant had personal knowledge of the records at issue because neither was a custodian of the records of the payroll company or Nationwide. Therefore, the court did not admit the records under the business records exception and the records could not be authenticated under FED. R. EVID. 902(11).

The Bank Records evidencing that check number 4989 was paid during the preference period are inadmissible hearsay. Plaintiff provides the affidavit of Trustee, who controls Plaintiff's records. Trustee does not, however, have personal knowledge of SunTrust's recordkeeping or records. Therefore, the Bank Records cannot be admitted

³ *U.S. v. Ullrich*, 580 F.2d 765, 771 (5th Cir. 1978) and *U.S. v. Flom*, 558 F.2d 1179, 1182 (5th Cir. 1977) are criminal cases that allow for admission of a record prepared by another entity and then integrated into the business records of the company whose custodian is proffering the record. Neither case is factually analogous to the facts in this adversary proceeding, as the Bank Records were not so integrated into Debtor's business records. See *Bonner v. City of Prichard*, 661 F.2d 1206, 1207 (11th Cir. 1981) (*en banc*) (adopting all decisions of the former Fifth Circuit October 1, 1981 as binding precedent)

under the business records exception and the Bank Records cannot be self-authenticated under FED. R. EVID. 902(11).

Ordinary Course of Business Preference Defenses

Defendant relies upon the two ordinary course of business defenses listed in § 547(c)(2). Once a trustee has proven by preponderance of the evidence that the transfer was a preference, the burden shifts to the transferee to prove by preponderance of the evidence that one of the preference defenses shields their transfer from avoidance.

11 U.S.C. § 547(g); *In re A.W. & Associates, Inc.*, 136 F.3d 1439, 1441 (11th Cir. 1998); *In re McLaughlin*, 183 B.R. 171 (Bankr. W.D. Wis. 1995).

The amendments promulgated by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) changed the bases for ordinary course of business defense, which were previously conjunctive, to disjunctive. To defend against recovery of a preferential transfer, the creditor must show that the transfers were “made in the ordinary course of business or financial affairs of the debtor and the transferee;” *or* “made according to ordinary business terms[.]”

A. Subjective Prong § 547(c)(2)(A)

The “subjective prong” of the ordinary course of business defense allows a transferee to defend a preferential transfer that was made in the ordinary course of business dealings between the debtor and the transferee. 11 U.S.C. § 547 (c)(2)(A). Determining whether the disputed transaction is consistent with the course of dealings between the parties is an inherently factual analysis. *Cassirer v. Herskowitz (In re Schick)*, 234 B.R. 337, 348 (Bankr. S.D.N.Y. 1999). Courts, however, have a number of factors insightful in deciding this issue. The lateness of payments is one of the most

illuminating factors and the most applicable factor in this case. *Marathon Oil Co. v. Flatau (In re Craig Oil Co.)*, 785 F.2d 1563, 1566 (11th Cir. 1986). Late payments, however, may be considered ordinary upon a showing that late payments were the normal course of business between the parties. *Logan v. Basic Distribution Corp. (In re Fred Hawes Org., Inc.)* 957 F.2d 239, 243 (6th Cir. 1992), *Braniff, Inc. v. Sundstrand Data Control, Inc. (In re Braniff, Inc.)*, 154 B.R. 773, 780-81 (Bankr. M.D. Fla. 1993).

When considering late payments, Plaintiff must establish a “baseline of dealings” between the two parties to allow comparison of the timing of payments made prior to the preference period with the timing of the payments during the preference period. *Id.* at 1567. If possible, the baseline should extend to a time when the debtor was not financially distressed. *Iannacone v. Klement Sausage Co., Inc. (In re Hancock-Nelson Mercantile Co., Inc.)* 122 B.R. 1006, 1013 (Bankr. D. Minn. 1991).

According to the affidavit of David Mittelstadt, the representative and general manager of Defendant, Defendant was paid by Debtor after Debtor received payment from Shaw. Prior to the preference period, Defendant issued thirteen invoices to Plaintiff. Because the ordinary course of business between Defendant and Debtor was contingent upon a third party, Shaw, the lateness of payments analysis should also consider the timing in reference to Shaw’s payments. Three times, Debtor paid Defendant after receiving payment from Shaw. Ten times, Debtor paid Defendant before receiving payment from Shaw. Therefore, Defendant failed to show the course of dealing between Debtor and Defendant established a usual practice of payments by Debtor to Defendant after Debtor received payments from Shaw.

B. Objective Prong § 547(c)(2)(B)

The objective prong of the ordinary course of business exception provides a defense for a preferential transfer “made according to ordinary business terms.” 11 U.S.C. §547(c)(2)(B). Ordinary business terms “refers to the *range* of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage, and that only dealings so idiosyncratic as to fall outside the broad range should be deemed extraordinary and therefore outside the scope of subsection [b].” *Miller v. Fla. Mining & Materials (In re A.W. & Assocs.), Inc.*, 136 F.3d 1439, 1443 (11th Cir. 1998) (quoting *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993)). Two rationales underlie this exception:

(1) comparison to industry standards serves the evidentiary function of providing a basis to evaluate the parties' self-serving testimony that an extraordinary transaction which was in fact intended as a preference towards a particular creditor was instead part of a series of transactions within a business relationship; and (2) reference to industry standards reassures other creditors that deals have not been worked out favoring a particular creditor, which would permit a preference to slide under the 547 fence.

Miller v. Fla. Mining & Materials (In re A.W. & Assocs.), Inc., 136 F.3d 1439, 1443 (11th Cir. 1998) (citing *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1032 (7th Cir. 1993)). Expert testimony is unnecessary to establish a defense as long as the testimony of the witness is based on personal experiences. Fed. R. Evid. 702, *Webster v. Fujitsu Consulting, Inc. (In re NETtel Corp.)*, 369 B.R. 50, 64-65 (Bankr. D. Col. 2007).

David Mittelstadt stated in his affidavit that standard industry practice was to “drop ship” products. Drop shipping occurs when a supplier ships product to a third party based upon orders placed by the third party with a broker, who then places the order with

the supplier. The ordinary business practice is that the broker does not pay the supplier until the broker receives payment from the third party. During the preference period, payments followed this system, as Debtor did not pay Defendant until it received payment from Shaw for the order.

Conclusion

Plaintiff has not met his evidentiary burden as to Payment 1 because Plaintiff relies upon inadmissible hearsay to prove the date the check was honored. Plaintiff has met the burden of proving both Payments 2 and 3 were preferences. With David Mittelstadt's affidavit, however, Defendant creates an issue of material fact about whether the both Payment 1 and Payment 2 were made according to ordinary business terms. Accordingly, it is hereby

ORDERED Plaintiff's Motion for Summary Judgment is *denied*.

IT IS SO ORDERED, this the 24th day of February, 2011.



MARGARET V. MURPHY
UNITED STATES BANKRUPTCY JUDGE

EXHIBIT A
SUMMARY OF TRANSACTIONS BETWEEN KENNEBEC, DEBTOR, AND SHAW

Kennebec Invoice Number	Kennebec Invoice Date	Kennebec Invoice Amount	Date of Debtor Check Paying Invoice	Check #	Amount Paid by Debtor	Kennebec/Debtor Payment Interval	Amount of Invoice Issued to Shaw by Debtor		Date Debtor Paid by Shaw	Interval Between Date Kennebec Paid by Debtor and Date Debtor Paid by Shaw
							Corresponding Invoice No. from Debtor to Shaw	Invoice Issued to Shaw by Debtor		
F3423	12/19/2008	33,546.84	01/30/2009	4417	65,231.04	42	32508	35,990.24	01/23/2009	7
F3423B	12/19/2008	31,684.20	01/30/2009	4417	65,231.04	42	32510	39,262.08	01/23/2009	7
F3467	01/21/2009	41,675.92	02/20/2009	4534	41,675.92	30	33486	47,693.36	02/26/2009	(6)
F3468	01/29/2009	39,311.36	02/27/2009	4559	39,311.36	29	33630	45,408.88	03/03/2009	(4)
F3584	02/11/2009	33,546.84	03/20/2009	4616	33,546.84	37	34355	38,758.72	03/18/2009	2
F3645	03/12/2009	39,925.60	03/31/2009	4699	55,895.84	19	35415	59,899.84	04/17/2009	(17)
F3647	03/12/2009	15,970.24	03/31/2009	4699	55,895.44	19	Included in Invoice No. 35415 to Shaw			
F3647B	03/19/2009	19,962.80	04/03/2009	4747	41,480.84	15	35673	22,822.80	04/22/2009	(19)
F3742A	03/19/2009	21,518.04	04/03/2009	4747	41,480.84	15	35665	24,916.32	04/22/2009	(19)
F3740	03/27/2009	50,278.80	04/22/2009	4749	8,519.16	7	35942	54,740.40	04/29/2009	(26)
F3741	03/31/2009	50,278.80	04/22/2009	4846	41,759.64	26	36069	54,740.40	04/29/2009	(7)
F3646	04/03/2009	31,940.48	05/19/2009	5036	25,100.00	52	36183	33,313.28	05/06/2009	16
F3647C	04/03/2009	15,970.24	05/15/2009	5165	25,178.80	80	36185	18,258.24	05/06/2009	44
			05/08/2009	4989	31,940.48	42			06/04/2009	9
				4946	15,970.24	35				(27)

Indicates Preference Payment

Payment Terms Net 30
Average Interval for Non-Preference Payments 26.33
Preference Payments 42, 52, and 80