UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF GEORGIA
ATLANTA DIVISION

IN RE:	:	CASE NO. 02-91845
Healing Touch, Inc.,	:	CHAPTER 7
Debtor.	:	JUDGE MASSEY
Tamara Miles Ogier, as Chapter 7 Trustee,	:	
Plaintiff,	:	ADVERSARY NO. 04-6051
v.	:	
Synedra Smith Johnson,	:	
Defendant.	:	

ORDER GRANTING MOTION FOR SUMMARY JUDGMENT

The only disputed issue in this adversary proceeding brought by Tamara Miles Ogier, as the Chapter 7 Trustee, is whether Defendant Synedra Smith Johnson was an insider of Healing Touch, Inc., the Debtor, when it repaid a short-term loan to her. The repayment occurred more than 90 days but less than one year before Debtor filed its Chapter 7 petition. If Defendant was an insider at the time of the repayment, the transfer is avoidable as a preference. Plaintiff moves for summary judgment.

Pursuant to Fed. R. Civ. P. 56(c), made applicable by Fed. R. Bankr. P. 7056, a party moving for summary judgment is entitled to prevail if "the pleadings, depositions, answers to

interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 322 (1986). The moving party carries the initial burden of proof and must establish that no genuine factual issue exists. *Celotex*, 477 U.S. at 323; *Clark v. Coats & Clark, Inc.*, 929 F.2d 604, 608 (11th Cir. 1991). The moving party must point to the pleadings, discovery responses or supporting affidavits which tend to show the absence of a genuine issue of material fact. *Celotex*, 477 U.S. at 323. The court will construe the evidence in the light most favorable to the non-moving party. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249 (1986); *Rollins v. TechSouth, Inc.*, 833 F.2d 1525, 1528 (11th Cir. 1987).

The following facts are undisputed. On June 18, 2001, Defendant wired to Debtor the sum of $30,000 as a short-term loan to help it meet its payroll obligations. Eleven days later, Debtor paid off that loan with check no. 1088 dated June 29, 2001 in the amount of $33,000. The additional $3,000 represented interest on the short-term loan.

On July 27, 2001, Defendant again wired $30,000 to Debtor. Seven days later, Debtor repaid the loan with check no. 1144 in an amount of $30,000 and check no. 1146 in an amount of $4,500. Both checks were dated August 3, 2001. Check no. 1146 represented interest on the short-term loan.

At the time of the transfers, Defendant was married to Dr. Nathaniel Johnson III, the Chief Executive Officer and President of Debtor. Dr. Johnson solicited the loans from Defendant for Debtor.

On February 20, 2002, more than 90 days but less than one year after the loan repayment, Healing Touch, Inc. filed a petition under Chapter 7 of the Bankruptcy Code. Plaintiff brought this

adversary proceeding to avoid and recover as a preferential transfer the funds transferred in the second loan repayment and to recover the interest from both loans as usurious.

Plaintiff made demand on Defendant on October 29, 2003 for payment of both loans and the interest paid in the total amount of $67,500.00. Nothing prevented Defendant from paying at that time the sum of $37,500.00, which is the principal amount of the judgment Plaintiff seeks in her motion for summary judgment. Plaintiff seeks prejudgment interest on her revised demand but has abandoned her contention in the complaint that the initial loan was a preference. Defendant no longer contests that she is liable to repay the usurious interest. The only issue in dispute regarding the preference is whether Defendant was an insider on August 3, 2001.

A trustee may avoid a preferential transfer pursuant to section 547 of the Bankruptcy Code and recover the amount of the avoided transfer from the transferee pursuant to section 550 of the Bankruptcy Code. Section 547(b) provides in relevant part:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property-
>
> (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 ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; 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.

Plaintiff, as movant, bears the burden of establishing the absence of an issue of material fact with regard to the six required elements of a preference. Although there were two repayments by

Debtor, Plaintiff seeks to avoid only the second one, consisting of the two checks on August 3, 2001 for a total of $34,500. Plaintiff also seeks to recover the interest payments for usury. (Had Plaintiff sought to recover both repayment transfers, Defendant would have had a defense with respect to the first one for new value given under section 547(c)(4).)

Plaintiff has established five of the six elements needed to avoid the second transfer. There is no dispute that the loan repayment to Defendant by Debtor was a transfer of an interest of Debtor in its property, that Debtor was insolvent at the time of the transfer, and that the transfer paid an antecedent debt owed by Debtor to Defendant. In the Statement of Material Undisputed Facts, submitted with the Motion, Plaintiff states in paragraph 14:

> Transfer 2 enabled the Defendant to receive more that (sic) she would under chapter 7 of the Bankruptcy Code, if the transfer had not been made and if such creditor received payment of such debt to the extent provided by the provisions of title 11 of the United States Code. See Affidavit of the Trustee filed contemporaneously herewith.

In an affidavit filed in support of her motion, Plaintiff states: "The anticipated distribution in the above-referenced bankruptcy case will not be 100% of claims. I see no possibility of payment of all claims." Defendant has not disputed the facts set forth in paragraph 14 of Plaintiff's Statement of Material Undisputed Facts.

The only issue in dispute is whether Defendant was an insider of Debtor at the time of the transfer. The term "insider" is partially defined in section 101(31) of the Bankruptcy Code, 11 U.S.C. § 101(31). The partial definition consists of a list of entities, including individuals, conclusively presumed to be insiders by virtue of their relationships to the debtor or to another insider of the debtor. This section begins with the words "'insider' includes." In Title 11, the word "includes" is not limiting. 11 U.S.C. § 102(3). Therefore, the set of entities that may be insiders is

larger than the set of entities and relationships listed in section 101(31). The Bankruptcy Code left it to the courts to determine the criteria for determining whether an entity not described in section 101(31) is nonetheless an insider.

Section 101(31)(B)(vi) of the Bankruptcy Code provides:

> (31) "insider" includes-
>
> . . .
>
> (B) if the debtor is a corporation-
>
> . . .
>
> (vi) relative of a general partner, director, officer, or person in control of the debtor[.]

Defendant is not related to Mr. Johnson by consanguinity. The issue under this subsection is whether one spouse is related to the other spouse by affinity. Cases have gone both ways on the issue of whether the word "affinity" as used in section 101(45) includes a spouse. *Compare Miller v. Schuman (In re Schuman)*, 81 B.R. 583, 585 (B.A.P. 9th Cir. 1987) (holding that the word "affinity" includes the spouse) *with Barnhill v. Vaudreuil (In re Busconi)*, 177 B.R. 153 (Bankr. D. Mass. 1995) (concluding, based on Massachusetts' statutes of descent, that spouses there are not related by affinity). Because it is clear that Defendant is a non-statutory insider, it is not necessary for the Court to resolve this issue.

To determine whether an entity is an insider without regard to the relationships set forth in section101(31), a court needs a definition of "insider." Courts have generally concluded that an insider, other than one described in section 101(31), may be identified by the presence of two key elements. First, a close relationship must exist between either the debtor or an insider of the debtor and the defendant. Second, the transactions between the debtor and transferee must not have been conducted at arm's length. *See, e.g., Browning Interests v. Allison (In re Holloway)*, 955 F.2d 1008, 1011 (5th Cir. 1992); *In re Krehl*, 86 F.3d 737, 742 (7th Cir. 1996); *Schreiber v. Stephenson*

(In re Emerson), 235 B.R. 702, 707 (Bankr. D.N.H. 1999); *Hirsch v. Tarricone (In re Tarricone, Inc.)*, 286 B.R. 256, 262-266 (Bankr. S.D.N.Y. 2002).

These criteria focus on the core concern addressed by classifying certain entities as insiders, which is that an insider is likely to receive treatment from the debtor more favored than that afforded to non-insider creditors. Favored treatment of an insider may occur even if the defendant lacks access to non-public information or lacks control over the debtor. Hence, the definition of "insider" as one with a close relationship to the debtor who receives more than what the insider would have received in an arm's length transaction includes those without knowledge that they are being preferred or without actual control over the debtor sufficient to cause the transaction to occur.

This definition of a non-statutory insider comports with the legislative history of section 101(31). "An insider is one who has a sufficiently close relationship with the debtor that his conduct is made subject to closer scrutiny than those dealing at arm's length with the debtor." H.R. REP. NO. 95-595, 312 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6269 (discussing the definition of "insider" in 11 U.S.C. § 101). *See also* S. Rep. No. 95-989, 25 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5810.

Relying on *Butler v. David Shaw, Inc.*, 72 F.3d 437 (4th Cir. 1996), Defendant contends that she could not be an insider because she did not have control over Debtor at the time of the transfer. The facts in Butler reduced to the essential are these: Shaw, Inc., owned by Mr. Shaw, sold the assets of its business to Tatum, Inc., which in turn leased property owned by Shaw, Inc. to continue the business. Mr. Shaw became a 35% shareholder of Tatum, Inc. and a manager in name only, performing services for Tatum, Inc. as a salesman. Tatum Inc.'s business did not prosper, and it fell behind on lease payments to Shaw, Inc. Mr. Tatum found two investors to put new

capital into Tatum, Inc. Mr. Shaw agreed to give up his stock in Tatum, Inc. in exchange for a consulting arrangement with Tatum, Inc. for ten years. The day after Mr. Shaw surrendered his shares in Tatum, Inc., the new investors closed their deal by acquiring 49% of the equity in Tatum, Inc. in exchange for contributing substantial capital. Mr. Shaw was not a party to that transaction. With the funds provided by its new investors, Tatum, Inc. paid its debt to Shaw, Inc. the day after the closing. There was no evidence that Mr. Shaw's surrender of stock was the quid pro quo for the payment to Shaw, Inc. More than 90 days but less than one year later, Tatum, Inc. filed bankruptcy.

Prior to Mr. Shaw's surrender of his stock in Tatum, Inc., he was an insider because he owned more than 20% of its shares and hence was an affiliate, 11 U.S.C. § 101(2), and therefore an insider, 11 U.S.C. § 101(31)(E). Because he owned all of Shaw, Inc., it was also an insider. 11 U.S.C. § 101(31)(E).

The trustee sued Shaw, Inc. to avoid the transfer involving payment of the lease debt as a preference and advanced two theories for holding that it was an insider at the time of the transfer. First, he argued that the transfer in question began while Mr. Shaw was an insider, that "a transfer can span a period of time, and that because Shaw, Inc. was an insider by virtue of Shaw's stock ownership when the challenged transfers began, the transfers are avoidable." *Butler*, 72 F.3d at 441. The Court of Appeals rejected this argument on the basis of the Supreme Court's decision in *Barnhill v. Johnson*, 503 U.S. 393, 118 L.Ed.2d 39, 112 S.Ct. 1386 (1992), which held that a transfer made by check does not occur until the check clears. Mr. Shaw was not an insider when the check cleared because he had previously surrendered his stock in Tatum, Inc.

The trustee's second argument was that Shaw, Inc. was a statutory insider at the time of the transfer because Mr. Shaw was a non-statutory insider based on his "close relationship" to Tatum, Inc. The Fourth Circuit rejected this argument as well, holding that an insider not expressly listed in section 101(31) "must exercise sufficient authority over a debtor so as to unqualifiably dictate corporate policy and the disposition of assets" and that Mr. Shaw had no power to control the debtor. *Butler*, 72 F.3d at 443. The *Butler* opinion cites *Hunter v. Babcock (In re Babcock Dairy Co. of Ohio, Inc.)*, 70 B.R. 662, 666 (Bankr. N.D. Ohio 1986) for that proposition.

Defendant's argument based on *Butler* is without merit because *Butler* misreads the *Babcock* case. Plaintiff in *Babcock* contended that the defendant, Roy Babcock, was an insider because of the relationship his brother, Wayne Babcock, to the debtor and that Wayne controlled the debtor at the time of the transfer. If Wayne was an insider, Roy was too under what is now section 101(31)(B)(vi). Wayne was the former owner of the debtor but had sold his shares in the debtor more than one year prior to the petition date. Wayne remained a director of the debtor after the sale, but his term ended more than a year prior to the petition date. Wayne was not an officer of the debtor during the one-year preference period. The court found that the plaintiff had not shown that Wayne had any meaningful control over the debtor at the time of the transfer.

Babcock dealt with the degree of control over the debtor a person must have to be deemed a statutory insider within the meaning of section 101(25)(B)(vi) [now section 101(31(B)(vi)] and not with whether Roy or Wayne was a non-statutory insider. Therefore, *Babcock* does not support the proposition for which *Butler* cites it.

Furthermore, the holding of *Butler* is illogical. The statute specifically provides that a "person in control of the debtor" is an insider. 11 U.S.C. § 101(31)(B)(iii) and (C)(v). It also

makes control of a corporation a basis for insider status in other contexts. 11 U.S.C. § 101(31)(A)(4) and (E). (As to affiliates under (E), the control reference is in § 101(2)(b).) Hence, an entity in control of a debtor is an insider without regard to close relationships. Requiring that an entity have control over the debtor to be a non-statutory insider makes no sense and would effectively write the word "includes" out of the section. Even the *Butler* court acknowledged that there are non-statutory insiders, 72 F.3d at 443, which would be an impossibility if control is a definitive characteristic of a non-statutory insider because control would make such an entity a statutory insider. This Court respectfully declines to follow the *Butler* opinion.

The Court presumes for purposes of Plaintiff's summary judgment motion that Defendant had no control or insider information when Debtor repaid to her the second loan. For the reasons stated above, that fact does not resolve the insider issue. The first element necessary to classify an entity as a non-statutory insider is the existence of a close relationship between that entity and the debtor or an insider of the debtor at the time of the transfer sought to be avoided as preference. Here, Defendant had a close relationship with Dr. Nathaniel Johnson because she was married to him at the time of the transfer at issue. Dr. Johnson was the Chief Executive Officer and President at the time of the transfer and was therefore a statutory insider.

The second element necessary to classify an entity as a non-statutory insider is a showing that the transaction at issue was not made at arm's length. Here, Dr. Johnson requested Defendant to make the two short-term loans to Debtor for the purpose of making payroll. She agreed to do so without a note or other writing evidencing debt. The loans were made on an unsecured basis, and there is no evidence that Defendant made any inquiry into Debtor's ability to repay the loans. Indeed, Defendant asserts that she "new (sic) absolutely nothing about the affairs

of the corporation." Defendant's Response to Motion for Summary Judgment, p. 2. (document no. 23.) Seven days after Defendant made the second loan of $30,000 to Debtor, it repaid the loan in full with interest in the amount of $4,500. That charge for the use of $30,000 for seven days works out to an annual interest rate of 782%, which would flabbergast even the most avaricious loan shark. Defendant does not dispute that the interest charged was usurious under Georgia law, as developed more fully *infra*. These facts are sufficient to prove that the loan and its repayment did not constitute an arm's length transaction. *Schreiber v. Stephenson (In re Emerson)*, 235 B.R. 702, 707 (Bankr. D.N.H. 1999). Defendant produced no evidence to show otherwise. Consequently, Defendant was at the time of the repayment of the second loan an insider of Debtor.

Defendant's affirmative defenses under section 547(c)(1), (2) and (4) are not viable. Section 547(c)(1) provides a defense where the debtor and transferee intend a contemporaneous exchange and the exchange was in fact substantially contemporaneous. Here, the parties did not intend a contemporaneous exchange. In the context of the section 547(c)(1), "contemporaneous" means occurring at the same time. The making of a loan and its repayment a week later are not contemporaneous events, and there is no evidence to show that Defendant and Debtor intended them to be because such intent was impossible.

Section 547(c)(2) provides a defense to what would otherwise be a voidable preference claim if the defendant shows that the debt was created in the ordinary course of business of the debtor and the transferee, that the repayment was in the ordinary course of the business or financial affairs of the debtor and the transferee and that the transfer was made according to normal business terms. Defendant offered no evidence on any of these three requirements and could not prove the third one because of the usurious interest rate.

Section 547(c)(4) is the new value exception. It provides a defense for the first transfer but not the second. There is no evidence that Defendant provided any value to Debtor after it repaid the second loan.

Plaintiff also moves for summary judgment on her claim for return of all the interest paid by Debtor for both loans, on the ground that the interest Defendant charged was usurious. GA. CODE ANN. § 7-4-18 provides:

> (a) Any person, company, or corporation who shall reserve, charge, or take for any loan or advance of money, or forbearance to enforce the collection of any sum of money, any rate of interest greater than 5 percent per month, either directly or indirectly, by way of commission for advances, discount, exchange, or the purchase of salary or wages; by notarial or other fees; or by any contract, contrivance, or device whatsoever shall be guilty of a misdemeanor; provided, however, that regularly licensed pawnbrokers, as defined in Code Section 44-12-130, are limited in the amount of interest they may charge only by the limitations set forth in Code Section 44-12-131.

In *Norris v. Sigler Daisy Corp.*, 260 Ga. 271, 272, 392 S.E.2d 242, 243 (1990), the Supreme Court of Georgia held that GA. CODE ANN. § 7-4-18 permits a civil action by the borrower to recover usurious interest, stating "a loan violative of the criminal usury statute is illegal, with the result that the lender forfeits the interest but may collect the principal." *See also Moore v. Comfed Sav. Bank*, 908 F.2d 834, 840 n.2 (11th Cir. 1990). To determine if interest on a fixed interest loan is usurious, a court calculates the interest per month of a particular loan by taking the total amount of interest charged under the loan and dividing by the number of months in the loan. *Fleet Fin. Inc. of Ga. v. Jones*, 263 Ga. 228, 231-32, 430 S.E.2d 352, 356 (1993).

For the first loan of $30,000, Debtor paid Defendant $3,000 in interest for an eleven day loan. That comes to a monthly rate of interest of 27.6%. For the second loan of $30,000, Debtor paid Defendant $4,500 as interest for a seven day loan. That comes to a monthly rate of interest of 41.45%. Both these monthly interest rates were well beyond the 5% per month interest limitation

set forth in GA. CODE ANN. § 7-4-18. Defendant presented no defense to Plaintiff's usury claim either in her brief or at the hearing.

Finally, Plaintiff seeks an award of prejudgment interest. "The Bankruptcy Code does not specifically provide for an award of prejudgment interest in the recovery of preferential transfers. *In re Investment Bankers, Inc.*, 136 B.R. 1008, 1023 (Bankr. D. Colo. 1989). The decision to award prejudgment interest in a preferential transfer action is therefore left to the sound discretion of the bankruptcy court. *In re Art Shirt Ltd., Inc.*, 93 B.R. 333, 342 (Bankr. E.D. Pa.1988)." *Lowrey v. Mfrs. Hanover Leasing Corp. (In re Robinson Bros. Drilling, Inc.)*, 1992 WL 535954 (W.D. Okla. 1992). In this instance, an award of interest is appropriate because Defendant had no colorable defense to the claim and could have paid it when the demand was made.

"Prejudgment interest is recoverable in a preference action from the date of demand for its return by the trustee or, if there is no demand, from the date of commencement of the adversary proceeding." *Ellenberg v. Mercer (In re The Home Co.)*, 108 B.R. 357, 360 (Bankr. N.D. Ga. 1989) (Cotton, J.). Most courts concur with this conclusion. *See, e.g., Sigmon v. Royal Cake Co. (In re Cybermech, Inc.*), 13 F.3d 818, 822-23 (4th Cir. 1994); *McLemore v. Third Nat'l Bank in Nashville (In re Montgomery)*, 983 F.2d 1389, 1396 (6th Cir. 1993); *Schwinn Plan Comm. v. AFS Cycle & Co. (In re Schwinn Bicycle Co.)*, 205 B.R. 557, 574 (Bankr. N.D. Ill. 1997).

Courts have used several bench marks as the proper interest rate, including the state legal interest rate, the prime rate and the rate under 28 U.S.C. § 1961. This court adopts the approach of Judge Cotton in the *Home Co.* case. "Although section 1961 only provides for postjudgment interest, most courts have concluded that the statute also applies to prejudgment interest in a case involving a federal question in which there is no express statutory provision for such interest." *In*

re Home Co., 108 B.R. at 360. The Court notes that the federal rate (3.33% on April 22, 2005- see http://www.federalreserve.gov/releases/h15/current/) is lower than Georgia's legal rate. GA. CODE ANN. § 7-4-2 ("The legal rate of interest shall be 7 percent per annum simple interest where the rate percent is not established by written contract.")

Accordingly, Plaintiff is entitled to a judgment in the amount of $37,500.00 plus prejudgment interest on that principal amount from November 2, 2003 at the rate under 28 U.S.C. § 1961 and postpetition interest on the same principal amount at the same rate.

For these reasons, it is

ORDERED that Plaintiff's motion for Summary Judgment is GRANTED.

This 6th day of May 2005.

/s

JAMES E. MASSEY
U.S. BANKRUPTCY JUDGE