

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
BEALE'S TIRE CO.-MINDEN, INC.,	)	CASE NO. BK91-40624
)	
DEBTOR	)	A93-4042
)	
JOHN WOLF, TRUSTEE,)	
	)	CH. 7
Plaintiff)	
vs.)	
)	
T.O. HAAS TIRE COMPANY, INC.,)	
)	
Defendant)	
)	
BEALE'S TIRE CO.-HOLDREGE, INC.,	)	CASE NO. BK91-40625
)	
DEBTOR	)	A93-4045
)	
JOHN WOLF, TRUSTEE,)	
	)	CH. 7
Plaintiff)	
vs.)	
)	
T.O. HAAS TIRE COMPANY, INC.,)	
)	
Defendant)	

MEMORANDUM

Hearing was held on May 12, 1994. Appearing on behalf of plaintiff/trustee was John Guthery of Perry, Guthery, Haase & Gessford, P.C., Lincoln, Nebraska. Appearing on behalf of defendant was William Olson of DeMars, Gordon, Olson, Recknor and Shively, Lincoln, Nebraska. This memorandum contains findings of fact and conclusions of law required by Fed. Bankr. R. 7052 and Fed. R. Civ. P. 52. This is a core proceeding as defined by 28 U.S.C. § 157(b)(2)(F).

Background

Beale's Tire Co. - Minden, Inc. and Beale's Tire Co. - Holdrege, Inc. (the Companies) filed for Chapter 11 bankruptcy

relief on April 22, 1991. The Companies sold tires, fuel and related auto supplies. The Companies cases were converted to cases under Chapter 7 on January 28, 1992. John A. Wolf was appointed as the acting trustee of the Companies Chapter 7 bankruptcies. The parties have agreed to treat the Companies as one entity for the adversary proceeding [hereinafter "the debtor" shall refer to "the Companies"].

The defendant, T.O. Haas Tire Co., Inc. (T.O. Haas) and the former Oldfather's O.K. Tire Co., Inc. (O.K. Tire), supplied tires and other inventory to the debtor on an open account basis.

Sometime between February 8, 1991 and February 22, 1991, Bernie Robbins, the owner of the debtor, convened a meeting with representatives of the debtor's major creditors to discuss the increasingly dire financial condition of the debtor. The following persons attended the meeting: Mr. Robbins; Randy Haas, the president of T.O. Haas and the secretary of O.K. Tire; Daryl McMahon, the Vice-President of O.K. tire; Wilbur Oldfather, the Chairman of the Board of O.K. Tire; Tom Beale, the former owner of the debtor who sold the debtor to Mr. Robbins on contract; and Mark Perry, the son-in-law of Tom Beale and an attorney.

By the time the meeting was held, the debtor was approximately sixty to ninety days delinquent on its accounts payable to T.O. Haas and O.K. Tire. Both T.O. Haas and O.K. Tire were ready to stop supplying goods to the debtor on open account because of the debtor's delinquency in paying past due debts. In addition, another significant creditor, Bosselman's, which supplied the debtor's retail fuel, threatened to stop supplying fuel if the debtor did not reduce its past due account.

The parties present at the meeting believed that the debtor could survive if working capital were injected into the debtor so operating expenses could be paid. The parties discussed selling the debtor, but neither T.O. Haas nor O.K. Tire was capable of purchasing the debtor. The debtor was not solvent at this time.

During the meeting, Wilbur Oldfather agreed to loan \$47,000 and Tom Beale agreed to loan \$125,000 to the debtor to resolve its cash flow crisis. The parties agreed that the debtor should pay a portion of this money directly to Bosselman's to preserve the debtor's fuel supply. At the meeting, the debtor issued additional checks to other creditors. O.K. Tire received \$56,000, T.O. Haas received \$9,000, other creditors were paid, and all remaining proceeds were used for general operating expenses.

The loan proceeds were deposited into the debtor's bank account on February 22, 1991. The balance of the debt owed to T.O.

Haas and to O.K. Tire was approximately \$80,000 after the loan proceeds were paid out. No loan documents were executed at this meeting.

In addition to the transfer discussed above, the debtor made several other payments to T.O. Haas and O.K. Tire on past due accounts within ninety days of the bankruptcy petition. The payments, including those resulting from the meeting, according to the stipulation, are as follows:

	<u>T.O. Haas</u>	
2/21/91		\$ 9,000.00
4/11/91		<u>\$ 5,493.91</u>
Total		\$14,493.91

	<u>O.K. Tire</u>	
1/31/91		\$ 1,957.14
2/8/91		\$ 1,392.64
2/15/91		\$ 619.27
2/18/91		\$ 433.52
2/22/91		\$56,000.00
4/12/91		<u>\$ 5,000.00</u>
Total		\$64,402.57

Also during this period of time, T.O. Haas and O.K. Tire decided they would no longer supply tires to the debtor except on a secured basis. On March 26, 1991, T.O. Haas and O.K. Tire entered into a security agreement with the debtor. The security agreement granted T.O. Haas and O.K. Tire a security interest in all property owned and acquired by the debtor, including inventory, accounts receivable and equipment. The security agreement secures "all indebtedness now existing, as well as indebtedness which may provide continuing security for such indebtedness until discharged in writing." (Exhibits 4 & 5) The security agreement was duly perfected on April 8, 1991. (Exhibits 4 & 5)

On December 27, 1991, O.K. Tire merged into T.O. Haas, and T.O. Haas assumed all of O.K. Tire liabilities under the terms of the merger. For this reason, the companies are treated in the adversary proceeding as one company [hereinafter "the defendant" shall refer to the merged company, but T.O. Haas and O.K. Tire shall be used if a distinction is necessary].

Tom Beale, the former owner of the debtor who loaned the debtor money at the February meeting, passed away on June 29, 1991.

Position of the Parties

The trustee filed a preference action, pursuant to 11 U.S.C. § 547(b), to recover the payments made by the debtor to T.O. Haas and O.K. Tire within ninety (90) days of the debtor's petition for bankruptcy, which was filed on April 22, 1991. The defendant argues that the payments received from the debtor were not preferential payments because the money paid from the loan proceeds was earmarked for the defendants and thus, was not part of the debtor's estate. Even if the transfers were preferences, it is the position of defendant that the trustee may not void the transfer because the transfers are excepted from Section 547(b) by Sections 547(c)(1), (c)(2) & (c)(4).

This case was submitted on a written stipulation of facts and testimony by deposition on the contested issues.

To void a transfer as a preference pursuant to 11 U.S.C. § 547(b), the following requirements must be satisfied: (1) there must be a transfer of an interest of the debtor in property; (2) on account of an antecedent debt; (3) to or for the benefit of a creditor; (4) made while the debtor was insolvent; (5) within ninety days prior to the commencement of the bankruptcy case; (6) that left the creditor better off than it would have been if the transfer had not been made and the creditor had asserted its claim in 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 has the burden of proving each and every element of a preferential transfer. Brown v. First Nat'l Bank of Little Rock, 748 F.2d 490, 491 (8th Cir. 1984) (citing First Nat'l Bank of Clinton v. Julian, 383 F.2d 329, 333 (8th Cir. 1967); Craig v. Minden Exchange Bank and Trust Co., Neb. Bkr. 90:161, 166 (D. Neb. 1990)). The defendant does not dispute that the trustee has proven that all transfers made by the debtor to T.O. Haas and O.K. Tire ninety days before the petition date are voidable preferences under Section 547(b), except with regard to the transfers made at the February meeting. The defendant believes that the trustee has failed to show that the first element -- the property transferred was property of the bankrupt's estate -- applies to those transfers. The defendant also takes the position that all of the transfers, even if found to be voidable under Section 547(b), are immune from such avoidance under 11 U.S.C. § 547(c).

A. Earmarking Doctrine

With regard to the February transfers, the first dispute between the parties is whether the transferred funds were estate property. To determine whether the property transferred was property of the debtor's estate, a court must find that the transfer resulted in the diminution of the bankruptcy estate.

Jeld-Wen, 986 F.2d at 231; Brown, 748 F.2d at 491. The courts in this circuit resolve this issue by following the earmarking doctrine. The earmarking doctrine is a judicially-created interpretation of the language of Section 547(b), which states that a voidable preference must involve a "transfer of an interest of the debtor in property." McCuskey v. Nat'l Bank of Waterloo (In re Bohlen Enters., Ltd.), 859 F.2d 561, 565 (8th Cir. 1988) [hereinafter Bohlen].

In the earmarking situation, there are three general parties: the old creditor, the creditor who is paid off within ninety days of the petition; the new creditor, the party who supplies the money to pay off the old creditor; and the debtor. Id. "When new funds are provided by the new creditor to or for the benefit of the debtor for the purpose of paying the obligation owed to the old creditor, the funds are said to be "earmarked" and the payment is held not to be a voidable preference." Id. (footnote omitted).

The earmarking doctrine first occurred in cases where the new creditor was the guarantor, e.g. surety, subsequent endorser or straight contract guarantor, of the debtor and paid the old creditor directly. Bohlen, 859 F.2d at 565 (citing Nat'l. Bank of Newport v. Nat'l Herkimer County Bank, 225 U.S. 178, 32 S. Ct. 633, 56 L. Ed. 1042 (1912)). Courts reasoned that property of the debtor was not transferred in this exchange and that, therefore, no diminution of the debtor's estate occurred "since the new funds and new debt were equal to the preexisting debt and the amount available for general creditors thus remained the same as it was before the payment was made." Id. Courts next extended the earmarking doctrine to the situation where the guarantor gave the money to the debtor with instructions to use the funds to pay the old creditor. Id.; see also Brown v. First Nat'l Bank of Little Rock, 748 F.2d 490, 491-92 (8th Cir. 1984).

Some courts have taken the earmarking doctrine beyond the context of the guarantor-debtor relationship and have held that it applies to situations where the non-guarantor new creditor loans money to the debtor and instructs the debtor to pay the old creditor. Bohlen, 859 F.2d at 566 (citing In re Sun Railings Inc., 5 B.R. 538 (Bankr. S.D. Fla. 1980); 4 **Collier on Bankruptcy** ¶ 547.03, at 547.25 (15th ed. 1993)). The Eighth Circuit, however, "[a]s a matter of first impression," has questioned whether the doctrine should apply to situations where the new creditor is not a guarantor. Id. at 566. The Eighth Circuit stated in Bohlen:

Where there is no guarantor, the earmarking doctrine does not help either the new creditor or the debtor. In fact the new creditor is harmed.

He is a general creditor whose recovery must come from a debtor's estate which is diminished to the extent that the payment made to the old creditor cannot be recovered as a preference. The only person aided by the doctrine is the old creditor, who had nothing to do with earmarking the funds, and who, in equity, deserves no such benefit. We can see no basis for preferring this old creditor to another who was paid with non-earmarked funds.

859 F.2d at 566;

Despite this language in Bohlen and despite the fact that the new creditor was not a guarantor, the Eighth Circuit ultimately decided not to determine whether the earmarking doctrine applied to a situation where the new creditor was not a guarantor. 859 F.2d at 566. Instead, the Court opined, without regard to whether the new creditor is a guarantor or not, that the earmarking doctrine applies when the following requirements are satisfied:

(1) the existence of an agreement between the new lender and the debtor that the new funds will be used to pay a specified antecedent debt, (2) performance of that agreement according to its terms, and (3) the transaction viewed as a whole (including the transfer in of the new funds and the transfer out to the old creditor) does not result in any diminution of the estate.

Id. at 566. The Court held in Bohlen that the earmarking doctrine did not apply because the debtor did not pay the old creditor according to the terms of its agreement with the non-guarantor new creditor. 859 F.2d at 567.

The Eighth Circuit revisited its position on the earmarking doctrine in Buckley v. Jeld-Wen, Inc. (In re Interior Wood Products Co.), 986 F.2d 228 (8th Cir. 1993). In this case, the debtor sold its assets to a buyer within ninety days of the filing of an involuntary bankruptcy petition. Id. at 230. As part of the purchase price, the buyer agreed to assume the debt that the debtor owed to the old creditor, who happened to be owned by the buyer. Id. The trustee filed a preference action alleging that the money paid by the buyer to the old creditor was a voidable preference because the purchase price money used to pay the debt was property of the debtor. Id.

The Jeld-Wen Court characterized the earmarking doctrine as one where "a new creditor is substituted for an old creditor." 986 F.2d at 231. Since this key element was absent in the case because

the debtor was not obligated to pay the buyer back, the Eighth Circuit did not consider whether the earmarking doctrine applied, and the Court did not discuss the distinction made in Bohlen between a new creditor who was a guarantor and one who was not. Id. at 231-32. Therefore, the Court left the Bohlen analysis intact. The Court also held that the intent of a party to the transaction is not a relevant consideration when deciding whether funds are earmarked or not. Id. at 232.

The three requirements listed in Bohlen are controlling. Even though Jeld-Wen did not address the requirements, the case acknowledged Bohlen and did not overrule the requirements set forth therein. To determine whether the transfer of funds constituted earmarked funds, the following must be found: (1) that an agreement existed between Tom Beale, Wilbur Oldfather, and the debtor that specifically directed the debtor to pay O.K. Tire and T.O. Haas; (2) that the agreement was followed by the parties according to its terms; and (3) that the payment to O.K. Tire and T.O. Haas did not constitute a diminution of the estate.

There is a dispute regarding whether an agreement existed and whether the agreement specifically directed the debtor to pay O.K. Tire and T.O. Haas. The trustee takes the position that the debtor controlled the funds and that Mr. Robbins, the president of the debtor, ultimately decided how to apply the loan proceeds. (Haas Deposition (Dep.) 40:3-25, 41:1-20; Robbins Dep. 26:22-24; McMahon Dep. 15: 1-11) Wilbur Oldfather, one of the lenders, also stated that his loan for \$47,000 was for operating expenses in general and that the loan was not directed toward paying any specific creditors. (Oldfather Dep. 20:7-20, 31:19-25, 32:1-2) Mr. Oldfather further testified that he did not direct the Mr. Robbins to apply the funds towards any specific creditor and left that determination to the discretion of Mr. Robbins. (Oldfather Dep. 32:20-25) Since Tom Beale passed away, it is impossible to determine whether he entered into an agreement or not, but the trustee thinks that the testimony of Mr. Robbins and Mr. Oldfather, which states that the debtor controlled the disposition of the funds, is adequate proof that an agreement between Mr. Beale, Mr. Oldfather and the debtor to pay specific creditors as considerations for the loans did not exist.

The trustee criticizes the defendant's evidence because it is primarily based upon the testimony of the defendant's officers, specifically Randy Haas. The trustee takes the position that the opinion of the creditor should not be taken into consideration under the earmarking doctrine because the agreement has to be between the debtor and the lenders, not the creditor. Therefore, if the debtor and at least one lender did not believe that an agreement existed to direct the debtor to specifically pay T.O.

Haas and O.K. Tire, the trustee believes the Court should not create one in the absence of a consensus.

The defendant takes the position that the parties did enter into an agreement that specifically directed the defendant to pay T.O. Haas and O.K. Tire. Randy Haas testified that T.O. Haas and O.K. Tire were prepared to discontinue supplying tires to the debtor on open account because the debtor was so far behind in making payments. (Haas Dep. 92:20-93:6) Mr. Haas testified that once Mr. Beale and Mr. Oldfather decided to make a loan to the debtor, all of the parties present at the meeting discussed what creditors were going to get paid and what amount they were going to receive from the loan proceeds. (Haas 27:25-28:5) After it was decided that T.O. Haas would receive \$9,000, that O.K. Tire would receive \$56,000, and that other creditors, including Bosselman's would receive their own portion of the loan proceeds, the rest of the loan proceeds were to be used for operating expenses and paid out at the debtor's discretion. (Haas Dep. 38:10-24, 97:1-20; Robbins Dep. 27:1-9, 71:8-22, 87:18-23, 88:9-12, 88:18-21, 88:25-89:15; McMahon Dep. 22:2-11, 23:16-22) Mr. Haas also testified that had Mr. Oldfather and Mr. Beale not agreed to loan Beale's Tire the \$172,000 in order to make the \$56,000 payments to T.O. Haas and O.K. Tire, T.O. Haas and O.K. Tire would not have continued to extend credit to the debtor. (Haas Dep. 94:23-95:4)

It is clear from the depositions of all of the parties that some sort of oral consensus was reached at the February meeting to pay some creditors, including T.O. Haas and O.K. Tire. The parties attending the meeting reviewed the debtor's financial statements to determine where money would be most needed. Once Mr. Beale and Mr. Oldfather made the loans to the debtor, the proceeds were applied to the creditors who were the most important to the debtor's business and the most likely to stop doing business with the debtor on open account. The parties all agree to these facts. The issue before the Court is whether a general agreement to pay the most important creditors constitutes a "specific agreement" to pay a specific creditor as contemplated by the Eighth Circuit in Bohlen.

If there was an agreement, it is undisputed that the agreement was performed according to its terms. Since the checks were issued at or about the time of the February meeting and since the debtor did not stop payment on the checks, the agreement, if any, was performed according to its terms.

This Court finds as a fact that there was no agreement between Mr. Oldfather, Mr. Beale, and the debtor to specifically pay T.O. Haas and O.K. Tire. Mr. Oldfather testified that he did not earmark a portion of his loan proceeds to be paid to a specific creditor, and based upon Mr. Beale's actions, it does not appear

that Mr. Beale was concerned with whether the debtor paid T.O. Haas and O.K. Tire or not. First, the decision was made by Mr. Oldfather and Mr. Beale to loan the debtor money. Second and separate from the first decision, a decision was made by the entire group regarding who should be paid proceeds from the loan.

This agreement is not the type of agreement contemplated by the Eighth Circuit in Bohlen because it is not an agreement to pay a specific creditor. It appears that the loan proceeds were used to pay the creditors who were most likely to treat the debtor as in default of its accounts payable. Mr. Oldfather and Mr. Beale did not condition their loans on whether the debtor paid certain proceeds to T.O. Haas and O.K. Tire, nor did they instruct the debtor to specifically pay specific creditors. The type of transaction in this case is nothing more than a general agreement among interested parties, lenders and old creditors, to use the proceeds to pay old creditors.

The bankruptcy estate was diminished in the same manner as was described by the Eighth Circuit in Bohlen. The loan proceeds paid to T.O. Haas and O.K. Tire would have been available to the bankruptcy estate to pay unsecured creditors, and the lenders, Mr. Beale and Mr. Oldfather, who are now also unsecured creditors, are harmed if this transfer is not voidable because the distribution available to unsecured creditors is diminished.

The transfer of the loan proceeds to T.O. Haas and O.K. Tire was a transfer of property of the debtor. The trustee has met his burden of showing that the transfer was a preferential transfer pursuant to Section 547(b).

B. 547(c)(1)

11 U.S.C. § 547(g) provides that the defendant has the burden of proving nonavoidability of a transfer under 11 U.S.C. § 547(c). The defendant's first defense to the trustee's position that a voidable preference exists is that the transfer of funds falls into the exception located at Section 547(c)(1), which provides:

(c) The trustee may not avoid under this section a transfer --

(1) to the extent that such transfer was --

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange."

In the Eighth Circuit, to establish a defense under Section 547(c)(1), the defendant must show that the parties intended the transfer of funds to be a contemporaneous exchange for new value, that the exchange was in fact contemporaneous, and that the defendant gave the debtor new value for the payments. Tyler v. Swiss Am. Sec., Inc. (In re Lewellyn & Co., Inc.), 929 F.2d 424, 427 (8th Cir. 1991). These considerations are all questions of fact. Id. To determine intent, it is permissible to look at the agreement between the debtor and the creditors to determine if the transfer of money was intended to be contemporaneous with the creditors' offer of additional tires on credit. Id. at 428 (citing Grogan v. Southwest Textiles, Inc. (In re Advance Glove Mfg. Co.), 42 B.R. 489, 493 (Bankr. E.D. Mich. 1984)).

There was no evidence submitted to show that the transfers made by the debtor to T.O. Haas and O.K. Tire were intended to be a contemporaneous exchange for new value, except for the transfers made pursuant to the February meeting. Therefore, only the \$56,000 transfer to O.K. Tire and the \$9,000 transfer to T.O. Haas are eligible to be considered contemporaneous exchanges for new value.

The trustee takes the position that the money transferred pursuant to the February meeting was to satisfy antecedent debt and that the money was applied to the oldest debt first. (Haas Dep. 50:19-23, 51:5-7, 53:14-18) In order for the defendant to show that a contemporaneous exchange was intended by the parties and that one did in fact take place, the defendant would have to establish that the debtor, T.O. Haas and O.K. Tire intended to payments to be in exchange for new goods, rather than applied to antecedent debt. The fact that the defendant did in fact supply more inventory to the debtor as a result of the payment and that the defendant would not have supplied more inventory is dismissed by the trustee. The trustee states that this point is not relevant to Section 547(c)(1) because the evidence establishes that T.O. Haas and O.K. Tire applied the proceeds to antecedent debt, and the trustee supports his position by pointing out that Section 547(c)(4) addresses the position taken by the defendant.

In addition, the trustee points out that T.O. Haas and O.K. Tire did not do what they agreed to do pursuant to the exchange. A representative of the defendant testified that both T.O. Haas and O.K. Tire were going to cease providing credit to the debtor on open account if the debtor did not make a payment and each supplier would force the debtor to operate on a cash basis. After the debtor made payments to T.O. Haas and O.K. Tire, they only extended

credit to the debtor on a secured basis and did not extend credit on open account to the debtor.

The defendant's position is that T.O. Haas and O.K. Tire would have stopped supplying goods to the debtor altogether, but for the February payment, and as a result of the February payment, they continued to supply the debtor. The defendant's position is that the debtor would have gone out of business more quickly had they discontinued supplying the debtor.

The trustee's position is the correct interpretation of Section 547(c)(1). The payments transferred pursuant to the February meeting were not intended to be a contemporaneous exchange for new value. The payments were applied to antecedent debt. The effect of the payment was to lower the debtor's outstanding credit so T.O. Haas and O.K. Tire could advance new supplies at a lower risk to themselves. This situation is distinguishable from a contemporaneous exchange for new value. A contemporaneous exchange for new value is a direct exchange between the debtor and the creditor for new value, which creates a new debt for the new value received.¹

C. Section 547(c)(2)

The defendant next asserts that the transfer was within the ordinary course of business between the debtor and the defendant. The statutory exception for transactions in the ordinary course of business is 11 U.S.C. § 547(c)(2), which states:

(c) The trustee may not avoid under this section a transfer --

(2) 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 ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms.

¹ See, infra pp. 12-13 (discussing Section 547(c)(4) and supporting case authority).

The defendant has the burden of proving each of these statutory elements by a preponderance of evidence. Jones v. United Sav. and Loan Ass'n (In re U.S.A. Inns of Eureka Springs, Ark., Inc.), 9 F.3d 680, 682, reh'g denied, 1993 U.S. App. LEXIS 31626 (8th Cir. 1993). The Eighth Circuit recently defined what the defendant has to prove under Section 547(c)(2) in U.S.A. Inns. Under Section 547(c)(2)(A), the defendant must show that "the debtor made the transfer in the ordinary course of business or financial affairs of the debtor and the transferee." Id. at 682. After the defendant has met this burden, the defendant must meet the subjective and objective components of Section 547(c)(2). Under Section 547(c)(2)(B), the defendant must show "proof that the debt and its payment are ordinary in relation to other business dealings between that creditor and that debtor." Id. at 684 (quoting Logan v. Basic Distribution Corp. (In re Fred Hawes Org., Inc.), 957 F.2d 239, 244 (6th Cir. 1992)). Under Section 547(c)(2)(C), the defendant must show "proof that the payment is ordinary in relation to the standards prevailing in the relevant industry." Id. This inquiry is separate and distinct from examining the practice between the parties. Id.

In this case, the defendant did not submit any proof as to what is the prevailing practice in the tire industry, if that is in fact the correct industry, and whether the debtor and defendant's conduct was in accordance with that standard. The evidence would have had to have shown that it was in the ordinary course of business in the industry for the debtor to be from 90 to 120 days delinquent on his account before making a payment to T.O. Haas and O.K. Tire. The evidence did not have to show a uniform set of procedures for the industry, but there needed to be some proof that similarly situated members of the industry, who were facing a similar problem, would have acted in the same manner. U.S.A. Inns, 9 F.3d at 685. The defendant did not meet its burden, and therefore, none of the payments made by the debtor to T.O. Haas and O.K. Tire were in the ordinary course of business.

D. Section 547(c)(4)

The final argument of the defendant is that the transfers within ninety days of the petition may not be voided as preferential because they are excepted from the preference section pursuant to 11 U.S.C. 547(c)(4), which states:

(c) The trustee may not avoid under this section a transfer --

(4) to or for the benefit of a creditor, 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.

The purpose of Section 547(c)(4) is to encourage creditors to do business with financially distressed businesses to help foster rehabilitation. Kroh Bros. Dev. Co. v. Continental Constr. Engineers, Inc. (In re Kroh Bros. Dev. Co.), 930 F.2d 648, 651 (8th Cir. 1991; Bergquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft), 850 F.2d 1275, 1280 (8th Cir. 1988) ("Nevertheless, the subsequent advance rule, section 547(c)(4), was not enacted to ensure equitable treatment of creditors, but rather is intended to encourage creditors to deal with troubled businesses." (quotation omitted)).

The Eighth Circuit has not articulated a particular test to determine whether the subsequent advance rule applies. However, the Fifth Circuit has developed a four part test that is based in principle upon the Eighth Circuit's interpretation of the purpose underlying Section 547(c)(4). Laker v. Vallette (In re Toyota of Jefferson, Inc.), 14 F.3d 1088, 1091 (5th Cir. 1994). The Fifth Circuit cited Kroh Bros., 930 F.2d at 652, for the proposition that "Protecting the creditor who extends 'revolving credit ' to the debtor is not unfair to the other creditors of the bankruptcy debtor because the preferential payments are replenished by the preferred creditor's extensions of new value to the debtor." Vallette, 14 F.3d at 1091.

Section 547(c)(4) applies to revolving credit relationships. Vallette, 14 F.3d at 1091 (citation omitted). There are four requirements under Section 547(c)(4). They are: (1) the creditor must have given new value; (2) the new value was given after the preferential transfer; (3) the new value is not secured by "an otherwise unavoidable security interest;" and (4) the debtor must not have made "an otherwise unavoidable transfer to or for the benefit of such creditor" on account of the new value. Id.

T.O. Haas and O.K. Tire gave the debtor new value. From January 22, 1991 through April 21, 1991, T.O. Haas supplied approximately \$37,625 worth of goods on credit to the debtor. From January 22, 1991, through April 21, 1991, O.K. Tire supplied approximately \$139,110 worth of goods, on credit, to the debtor. (Exhibits 2 & 29 and Appendix 1 & 2 of defendant brief). The

trustee does not dispute that T.O. Haas and O.K. Tire extended new value to the debtor.

The second element to consider is whether new value was given by T.O. Haas and O.K. Tire after the preferential transfers. The statement of accounts for T.O. Haas lists the subsequent advances given by T.O. Haas to the debtor. A breakdown of the dates that each transfer from the debtor to T.O. Haas occurred and that each subsequent advance of new value by T.O. Haas to the debtor occurred is listed below.

	<u>T.O. Haas</u>	
	<u>Transfer from Debtor</u>	<u>New Value Given Debtor</u>
2/22/91	9,000	
2/26/91		2,370.15
2/26/91		2,533.01
2/27/91		255.70
2/27/91		28.11
3/05/91		118.02
3/06/91		155.30
3/12/91		96.63
3/13/91		22.96
3/13/91		79.50
3/14/91		650.62
3/20/91		2,069.86
3/26/91		907.70
3/26/91		82.82
3/28/91		3,602.49
3/29/91		385.20
4/02/91		63.39
4/03/91		2,539.57
4/03/91		2,687.04
4/03/91		781.28
4/03/91		120.96
4/04/91		1,643.40
4/04/94	958.58 ²	

² A payment by check occurs on the date that the check is honored by the drawer bank, not on the date that the check is delivered. Barnhill v. Johnson, 503 U.S. ___, 112 S. Ct. 1386, 118 L. Ed. 2d 39 (1992). This payment for \$958.58 was issued on February 9, 1991 (Exhibit 12), but was not honored by the debtor's bank until April 4, 1991 (Exhibit 38). Therefore, pursuant to Barnhill, the payment is deemed to have occurred on April 4, 1991.

4/05/91		468.00
4/09/91		3,206.91
4/09/91		166.76
4/10/91		1,123.36
4/10/91		2,578.96
4/11/91		48.43
4/12/91	4535.33 ³	
4/16/91		288.67

The statement of account for O.K. Tire lists shows that new value was given to the debtor after each transfer occurred on the following dates.

O.K. Tire

	<u>Transfer from Debtor</u>	<u>New Value Given Debtor</u>
2/01/91	1,957.14 ⁴	
2/04/91		177.37
2/04/91		1,533.17
2/04/91		631.91
2/04/91		1,418.72
2/06/91		2,995.98
2/08/91	1,392.64	
2/11/91		260.35
2/11/91		1,156.64
2/15/91	619.27	
2/18/91		2,292.44
2/18/91		182.82
2/19/91	433.52 ⁵	

The parties combined this payment with another payment in the Stipulation of Facts under April 11, 1991.

³ Pursuant to Barnhill, supra n. 2, the \$4,535.33 payment is deemed to have occurred on April 12, 1991, which is the date that the debtor's bank honored the payment (Exhibit 38). The Stipulation lists the payment as having occurred on April 11, 1991.

⁴ Following Barnhill, supra n. 2, this payment was honored by the debtor's bank on February 1, 1991, and not on January 31, 1991, as the parties stipulated the payment to have occurred (Exhibit 38).

⁵ Following Barnhill, supra n.2, this payment occurred on February 19, 1991, the date that the debtor's bank honored the check, and not on February 18, 1991, as the parties stipulated.

2/20/91		702.10
2/22/91	56,000.00	
2/23/91		119.22
2/23/91		2,213.74
2/23/91		378.00
2/23/91		193.88
3/04/91		57.89
3/04/91		3,177.31
3/04/91		1,489.03
3/04/91		1,762.28
3/04/91		1,797.11
3/06/91		167.44
3/07/91		130.00
3/11/91		691.80
3/11/91		518.81
3/11/91		455.45
3/11/91		128.32
3/11/91		69.38
3/11/91		1,489.03
3/11/91		3,177.31
3/11/91		1,797.11
3/11/91		1,762.28
3/11/91		255.33
3/18/91		1,361.41
3/18/91		3,373.70
3/21/91		897.27
3/25/91		753.04
3/25/91		1,935.16
3/25/91		1,055.29
3/25/91		13.28
3/25/91		47.11
3/30/91		1,006.30
3/30/91		2,233.44
3/30/91		937.84
3/30/91		488.83
4/05/91		800.00
4/08/91		161.41
4/08/91		2,475.19
4/08/91		1,280.38
4/08/91		1,370.84
4/12/91	5,000	
4/15/91		2,220.88
4/15/91		178.72
4/15/91		1,959.24
4/15/91		512.48
4/17/91		1,913.88

Based upon these figures, both T.O. Haas and O.K. Tire extended subsequent advances of new value to the debtor. All of

the preferential payments made to T.O. Haas are offset by the new value provided by T.O. Haas after each preferential payment, except for the April 12, 1991 payment. That payment of \$4,535.33 is offset only by the April 16, 1991 new value because that is the only advance of new value made by T.O. Haas after the transfer and prior to the debtor's bankruptcy. Therefore, \$4,246.66 of the preferential payment was not offset by subsequent advances of new value from T.O. Haas.

The February 1, 1991 payment made by the debtor to O.K. Tire is completely offset by subsequent advances of new value from O.K. Tire, as are the February 8, the February 15, and the February 19 transfers. However, the February 22, 1991 and the April 15, 1991 transfers from the debtor to O.K. Tire are not completely offset by the subsequent advances of new value. The debtor's preferential payment is \$12,158.76 more than the subsequent advance of new value extended by O.K. Tire to the debtor.

The third criteria for the Section 547(c)(4) exception is that the new value extended by the creditor to the debtor is not secured by an unavoidable security interest. Without a doubt, both T.O. Haas and O.K. Tire intended to make these subsequent advances strictly on a secured basis. The security agreement entered into by the debtor, T.O. Haas and O.K. Tire granted the creditors a security interest in all inventory, accounts receivable and equipment currently owned or to be acquired in the future. If the security interest is not avoidable, the defendant is not entitled to the Section 547(c)(4) exception and will owe the estate the full amounts of the preferential payments received.

The avoidability of a security interest is determined by 11 U.S.C. § 547(c)(5), which states:

(c) The trustee may not avoid under this section a transfer (5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of --

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of the section applies, 90 days before the date of the filing of the petition; ...

(B) the date on which new value was first given under the security agreement creating such security interest.

"Section 547(c)(5) prevents a secured creditor from improving its position at the expense of an unsecured creditor during the 90 days prior to filing the bankruptcy petition." Samson v. Alton Banking & Trust Co. (In re Ebbler Furniture and Appliances Inc.), 804 F.2d 87, 89 (7th Cir. 1986); See Swanson v. First Wisconsin Fin. Corp., 163 B.R. 528, 533 (E.D. Wis. 1993); Century Glove, Inc. v. Iselin (In re Century Glove, Inc.), 151 B.R. 327, 340 (Bankr. D. Del. 1993). The Seventh Circuit applies Section 547(c)(5) in the following manner:

[D]etermine the amount of the loan outstanding 90 days prior to filing and the "value" of the collateral on that day. The difference between these figures is then computed. Next, the same determinations are made as of the date of filing the petition. A comparison is made, and, if there is a reduction during the 90 day period of the amount by which the initially existing debt exceeded the security, then a preference for section 547(c)(5) purposes exists. The effect of 547(c)(5) is to make the security interest voidable to the extent of the preference.

Ebbler Furniture, 804 F.2d at 89-90 (citations omitted).

In this case, the security interest was perfected on April 8, 1991. When the security interest is acquired within the ninety days of the petition, the date that the security interest was first obtained is substituted for the date ninety days prior to the petition. 4 **Collier on Bankruptcy** ¶ 547.13, at 547-60 n. 6 (15th ed. 1994). Since T.O. Haas and O.K. Tire did not have any security interests in the collateral prior to April 8, 1991, their improvement of position at the expense of unsecured creditors gives them more in a liquidation than they would have received without the security interest. The transfer of the security interest in accounts receivable and inventory is avoidable.

In regard to the lien on the equipment, T.O. Haas and O.K. Tire are unsecured by virtue of the fact that Tom Beale and First Security Bank hold prior perfected security interests in the debtor's equipment which eliminates any value in the equipment for the lien of the defendant. (See BK91-40625, filing no. 34). Under Section 547(c)(4), an unsecured or partially secured creditor is entitled to the exception for new value to the extent that the creditor is unsecured. 4 **Colliers on Bankruptcy** ¶ 547.12, at 547-56.2 n. 4 (15th ed. 1994).

The new value advanced by T.O. Haas and O.K. Tire was secured by an avoidable security interest, and therefore, the claim defendant has for goods supplied to the debtor is a general unsecured claim. As such, the defendant's claim satisfies the Section 547(c)(4) exception that the new value not be subject to an unavoidable security interest. Pursuant to Section 547(c)(4), the trustee may not avoid the transfers made by the debtor to T.O. Haas and O.K. Tire except to the extent discussed above.

Conclusion

The trustee has met the burden of showing that the transfers made by the debtor to T.O. Haas and O.K. Tire, who are now merged into the defendant, are preferential. The defendant failed to show that the transfer was contemporaneous with an exchange for new value from T.O. Haas and O.K. Tire pursuant to Section 547(c)(1), and the defendant did not show that the transaction occurred in the ordinary course of business between the parties pursuant to Section 547(c)(2). The defendant did show that partial new value was given to the debtor subsequent to each transfer in accordance with Section 547(c)(4). To the extent new value was not subsequently advanced to cover transfers from the debtor, the trustee may void those portions of the transfers as a preferential payments and recover those amounts from the defendant. The amount the trustee may recover based upon the preference received by T.O. Haas is \$4,246.66, and the amount the trustee may recover based upon the preferential payment received by O.K. Tire is \$12,158.76.

Separate journal entry to be entered.

DATED: July 18, 1994.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge

Copies mailed by the Court to:
John Guthery, 1400 FirstTier Bank Building, Lincoln, NE 68508
William E. Olson, P.O. Box 81607, Lincoln, NE 68501
U.S. Trustee

UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEBRASKA

IN THE MATTER OF)	
)	
BEALE'S TIRE CO.-MINDEN, INC.,	)	CASE NO. BK91-40624
	)	A93-4042
<u>DEBTOR(S)</u>)	
	)	CH. 7
JOHN WOLF, TRUSTEE,)	
Plaintiff(s))	
vs.)	
)	
T.O. HAAS TIRE COMPANY, INC.,)	
)	
<u>Defendant(s)</u>)	
)	
BEALE'S TIRE CO.-HOLDREGE, INC.,	)	CASE NO. BK91-40625
	)	A93-4045
Debtor)	
)	
JOHN WOLF, TRUSTEE,	)	CH. 7
)	
Plaintiff)	
vs.)	
	)	DATE: July 18, 1994
T.O. HAAS TIRE COMPANY, INC.,)	
)	
<u>Defendant</u>	)	HEARING DATE: May 12, 1994

JOURNAL ENTRY

Before a United States Bankruptcy Judge for the District of Nebraska regarding adversary proceedings.

APPEARANCES

John Guthery, 1400 FirstTier Bank Building, Lincoln, NE 68508
William E. Olson, P.O. Box 81607, Lincoln, NE 68501

IT IS ORDERED:

Judgment is entered in favor of the plaintiff and against the defendant. The transfer of the amount of \$4,246.66 and the transfer of the amount of \$12,158.76 are voidable preferences and recoverable by the trustee. See memorandum this date.

BY THE COURT:

/s/ Timothy J. Mahoney
Timothy J. Mahoney
Chief Judge