

**In the United States Bankruptcy Court
for the
Southern District of Georgia
Brunswick Division**

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|-----------------------------------|---|-----------------------|
| In the matter of: |) | |
| |) | Consolidated |
| CLARK A. HOUSTON |) | Adversary Proceedings |
| SAUNDRA D. HOUSTON |) | |
| (Chapter 7 Case <u>01-20268</u>) |) | Number <u>01-2017</u> |
| |) | and |
| |) | Number <u>01-2036</u> |
| <i>Debtors</i> |) | |
| |) | |
| |) | |
| R. MICHAEL SOUTHER, |) | |
| TRUSTEE |) | |
| |) | |
| <i>Plaintiff</i> |) | |
| |) | |
| v. |) | |
| |) | |
| ANN CARTER |) | |
| |) | |
| <i>Defendant</i> |) | |

**MEMORANDUM AND ORDER
ON TRUSTEE’S MOTION TO AVOID TRANSFER**

Debtors Clark A. Houston and Sandra D. Houston (“Debtors”) filed their Chapter 7 bankruptcy case on February 22, 2001. The Trustee moves the Court to avoid two transfers made by Debtor Clark Houston (“Son”) to an insider within the preference period prior to Debtors’ filing.

The insider transferee in both transfers was Defendant Ann Carter, Son’s mother (“Defendant”). The first transfer was for the purpose of repaying Defendant the sum of \$50,000.00

which Son had borrowed in order to fund the construction of a “spec house.” On January 22, 2001, one month prior to their Chapter 7 filing, Debtors sold 0.50 acres of land located in McIntosh County, Georgia, for which they received a sum of \$89,000.00 and netted approximately \$55,259.80 at closing. From the net proceeds of the sale, Debtors paid \$50,000.00 to Defendant.¹ Debtors did not disclose the fact or amount of the transfer in their schedules at filing.

On January 25, 2001, Debtors transferred to Defendant their interest in a commercial building containing approximately 3,000 square feet and two acres of land (“commercial property”) located on Georgia Highway 99 in McIntosh County, Georgia.² As consideration for this transfer, Defendant paid Debtors \$46,374.71, which sum represented the payoff on the first mortgage on the subject property held by First Georgia Bank, and retained \$3,625.29. These funds presumably originated in the \$50,000.00 paid by Son in the first transaction. The deed granted Debtors a right of first refusal in the event Defendant decided to sell the property. Defendant believed the commercial property was worth more than the amount she paid and testified that the “first refusal” clause had no significance for her. Debtors did not disclose the fact of the second transfer in their schedules at filing.

Subsequently, two appraisals were conducted for purposes of determining the value of the commercial property. An appraisal prepared at the request of the Chapter 7 Trustee (“Plaintiff”) concluded that as of September 14, 2001, the property had a total market value of \$181,000.00. An appraisal prepared for Defendant concluded that as of October 2, 2001, the property had an estimated market value of \$96,000.00.

¹ The \$50,000.00 transfer is hereinafter referred to as “first transaction.”

² The transfer of the commercial property from Debtors to Defendant is hereinafter referred to as “second transaction.”

On April 18, 2001 and on June 20, 2001, Plaintiff filed adversary complaints against Defendant which were consolidated and set for trial. At trial on December 7, 2001, Plaintiff and Counsel for Defendant presented testimony and oral arguments, after which the Court took the matter under advisement.

The positions of the parties are as follows. In order to preserve the sums transferred in the first and second transactions for the benefit of the bankruptcy estate pursuant to 11 U.S.C. § 551, Plaintiff seeks to avoid the transfer to Defendant in the first transaction as a preferential transfer pursuant to 11 U.S.C. § 547 and to avoid the transfer to Defendant in the second transaction as a transfer voidable pursuant either to § 548(a)(1)(A) or § 548(a)(1)(B). Defendant contends that the transfers are not avoidable because the first transaction falls within an exception to avoidability provided in § 547(c) and the second transaction does not meet the requirements for avoidability under § 548(1)(A) or (B).

FINDINGS OF FACT and CONCLUSIONS OF LAW

This Court has jurisdiction over these matters pursuant to 28 U.S.C. §§ 1334 and 157 as a core proceeding within the meaning of §§ 157(b)(2)(F) and (H).

1. First Transaction

11 U.S.C. § 547(b) provides for avoidance of a debtor's transfer of a property interest

(1) for the benefit of a creditor; (2) for the payment or satisfaction of a debt owed by the debtor to or for the benefit of a creditor; (3) made while the debtor was insolvent; (4) made on or within 90 days before the date of the filing of the petition . . . and (5) that enables such creditor to receive more than such creditor would receive if the case were a case under chapter 7 of this title[,] the transfer had not been made[,] and such creditor received payment of such debt to the extent provided by the provisions of this title.

Plaintiff bears the burden to establish each of the elements of § 547 (b). § 547 (g). At trial, Plaintiff presented evidence in support of each element, and none of the elements was disputed. The only question is whether a defense was established as permitted under § 547(c).

Section 547(c)(2) provides:

The trustee may not avoid under this section a transfer to the extent that such transfer was (A) in payment of a debt incurred by the debtor in the ordinary course of . . . financial affairs of the debtor and the transferee; (B) made in the ordinary course of . . . financial affairs of the debtor and the transferee; and (C) made according to ordinary business terms.

Defendant, as the asserter of the defense, bears the burden to establish each of the elements of § 547 (c) (2). § 547 (g).

The “ordinary course” exception requires a two-step analysis. The first step incorporates a subjective test necessitating examination of customary financial dealings between Debtors and Defendant. Here, Defendant had made loans to Son on several past occasions. On each occasion, although there were no written agreements, both Defendant and Son had intended that repayment would occur. On each occasion, Son repaid Defendant as intended. Defendant testified that she made the \$50,000.00 loan to Son with the understanding that he would repay her. I find that Son did, in fact, repay Defendant pursuant to their loosely structured agreement in accordance with their usual course of handling repayment for loans. Pursuant to § 547(c), the subjective test is met.

The second step in the analysis under § 547(c) incorporates an objective test necessitating examination of what constitutes “ordinary business terms” in such financial transactions. *See Walker v. Waycross Paint and Wall Coverings (In re Scott Housing Sys., Inc.)*, Adv. No. 88-5066, Ch. 7 Case No. 86-50123, slip op. at 8-9 (Bankr. S.D. Ga. 1991) (Davis, J.) (discussing need “to determine what the ordinary course of business or financial affairs between the debtor and transferee in fact was” and to consider terms “in the context of the business in which the parties are engaged”). Because terms which may be ordinary in the course of one type of course of financial transactions may not be ordinary in other kinds of financial transactions, *see id.* at 9, “the court is to apply an objective standard, which requires proof of practices common to businesses similarly situated to the debtor and transferee,” *Ganis Credit Corp. v. Anderson (In re Weilert R.V., Inc.)*, 258 B.R. 1, 6 (B.A.P. 9th Cir. 2001) (internal quotations omitted); *see also In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993) (“[Showing] that the payment [the creditor] received was made in accordance with the ordinary business terms . . . does not mean that the creditor must establish the existence of some single, uniform set of business terms.”).

Defendant has failed to show that the first transaction was conducted according to ordinary business terms. Almost universally, lenders who finance the construction of spec homes require written promissory notes and security deeds. Here, however, there was no writing to memorialize the terms of the agreement between Defendant and Son, no perfection of Defendant’s alleged interest in the spec house, and no specific terms other than Son’s thin promise to repay when and if the spec house was sold. I conclude that the dealings between Defendant and Son with respect to the first transaction failed to meet the objective standard set out in § 547(c). Therefore, the exception provided in § 547(c) does not apply to except the first transaction from avoidability under § 547(b), and Plaintiff may avoid the first transfer.

2. Second Transaction

11 USCA § 548(a) provides alternative means for avoidance of a debtor's transfer of an interest in property made within one year before the date of filing. The first means is to show that a debtor made such transfer with actual intent to defraud a creditor of the debtor, and the second is to prove that an insolvent debtor "received less than a reasonably equivalent value in exchange for such transfer." § 548 (a)(1) (A), (B). Thus, with respect to the second transaction, the provisions for avoidance of § 548(a)(1) require Plaintiff to show either that Debtors transferred their interest in the commercial property "with actual intent to hinder, delay, or defraud" Debtors' creditors or that Debtors, who were insolvent at the time of the second transaction, received "less than a reasonably equivalent value" in exchange for the commercial property which was the subject matter of the transaction.

The evidence suggests that Debtors intended to defraud their creditors. Debtors transferred their interest in the commercial property to Defendant, thereby removing that property from the bankruptcy estate prior to filing, and failed to reveal the transfer. At the same time, Debtors preserved an interest for themselves in the property by reserving a right of first refusal to re-purchase the property in the future, giving rise to the inference that Son believed the exchange was not for equivalent value.

A final determination that Debtors actually intended to defraud their creditors is not necessary, however, because the evidence even more persuasively shows that Debtors received less than the reasonable equivalent value in exchange for the property while they were insolvent. The two appraisals show that the value of the property eight to nine months after the transfer was between \$96,000 and \$181,000. It is clear, therefore, that Defendant paid Debtors substantially less for the commercial property than it was worth. Moreover, Defendant's testimony

indicated that at the time Son transferred the property to her, she expected to realize a profit from the property at some point and that she believed that the property was worth more than the amount she paid Debtors. Significantly, Defendant also testified that Son told her that purchasing the property was a good idea. Therefore, I conclude that the commercial property conveyed by Debtors to Defendant on January 25, 2001, had a fair market value which significantly exceeded the sum paid by Defendant in consideration for such transfer.³

I conclude that because the transfer of the commercial property to Defendant diminished the fund available to Debtors' other creditors and was not supported by payment of reasonable equivalent value, Plaintiff may avoid the second transfer pursuant to § 548(a)(1)(B).

ORDER

Pursuant to the foregoing, IT IS THE ORDER OF THIS COURT that:

- 1) Plaintiff shall recover the commercial property and administer it as an asset in this case; and
- 2) Plaintiff shall recover on behalf of the estate that portion of the \$50,000.00 transfer that was not paid to First Georgia Bank to pay off the mortgage indebtedness.

Defendant IS ORDERED to execute a Quitclaim Deed to Plaintiff conveying her interest in and to the subject property. Defendant is FURTHER ORDERED to pay to Plaintiff the sum of \$3,625.29.

Lamar W. Davis, Jr.

³ The discrepancy between the two appraisal estimations is not relevant to this case, in that both appraisals indicate that the property was worth considerably more than the amount paid by Defendant. The precise current market value is similarly irrelevant, because "this element focuses on the real value of a debtor's assets at the point of filing in bankruptcy." Knopfler v. Schraiber (In re Schraiber) 1992 WL 280801, 16 (Bankr. N. D. Ill. 1991) (unpublished).

Dated at Savannah, Georgia

This ____ day of January, 2002.