UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

INRE:

WILLIAM DUNLAP CANNON, III, **Chapter 7**

Debtor. **Case No. 94-21918-D**

GEORGE W. STEVENSON, TRUSTEE,
for William Dunlap Cannon, III,

Plaintiff,

v. **Adv. Pro. No. 96-0176**

FIRST TENNESSEE BANK, N.A.,

Defendant.

MEMORANDUM OPINION AND ORDER RE CROSS MOTIONS FOR SUMMARY JUDGMENT

George W. Stevenson, chapter 7 trustee for the debtor, William Dunlap Cannon, III ("Debtor"), filed this adversary proceeding on or about February 27, 1996, to recover preferential transfers from the defendant, First Tennessee Bank ("FTB"). On January 17, 1997, both parties, FTB and the chapter 7 trustee, filed motions for summary judgment, pursuant to Rule 56 of the Federal Rules of Civil Procedure and Rule 7056 of the Federal Rules of Bankruptcy Procedure.

Based on the following analysis, this Court denies FTB's motion for summary judgment and grants the chapter 7 trustee's motion for summary judgment. This is a core proceeding. 28 U.S.C. § 157(b)(2)(1). The following shall serve as this Court's findings of fact and conclusions

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of law pursuant to Federal Rule of Bankruptcy Procedure 7052.

I. Findings of Fact

Prior to the filing of the chapter 7 petition, Debtor had a number of bank accounts at First Tennessee Bank in Memphis, Tennessee, including a Real Estate Escrow Account, an Escrow Recording Account, a Trustee for Department of Housing Account, and a Magnolia Federal Mortgage Account. On or about January 7, 1994, Debtor opened an account in his name at Hibernia National Bank ("Hibernia") in New Orleans, Louisiana, with a $7,500 deposit. In order to create a float, Debtor deposited two of the blank temporary checks issued by Hibernia into two of his accounts at FTB on January 10, 1994. Debtor disguised the first Hibernia check by writing the name Magnolia Federal Mortgage Funding Account, a non-existing entity, and disguised his signature. Debtor deposited this check for $8 1,900 into his First Tennessee Real Estate Escrow Account. The second Hibernia check for $81,450 was deposited into his First Tennessee Escrow Recording Account. Debtor also used the name of Magnolia Federal Mortgage Funding Account on the Hibernia check and made it payable to the Law Office of Dunlap Cannon, III.

On January 11, 1994, FTB extended to Debtor unsecured credit for the deposit of the two Hibernia checks drawn on the Magnolia Federal Mortgage account for $8 1,900 and $8 1,450, and allowed Debtor to write checks against the two insufficient checks. On January 13, 1994, the checks were returned to FTB from Hibernia. First Tennessee Bank attempted to post the checks to Debtor's account, but sufficient funds were not available and Debtor did not have an overdraft line of credit. FTB returned the checks to the Hibernia bank a second time for possible collection; the checks were again returned to FTB by Hibernia through the FED; and FTB then forwarded

the checks to a cash item specialist in its Branch Administration.

From September 1993 through January 1994, Debtor had numerous checks deposited into his Real Estate Escrow Account and Escrow Recording Account that were returned for insufficient funds and identified as "Returned Check Charges." According to the deposition of Ms. Pearline Franks, branch manager for the Kirby Woods Office of FTB where Debtor deposited the two Hibemia checks, she contacted Debtor about the returned checks during the period prior to January 24, 1994.

On January 24, 1994, after being notified by FTB about the two returned Hibemia checks, Debtor transferred $8 1,900 from his HUD account at FTB to his Real Estate Escrow Account and deposited $82,950 into his Escrow Recording Account to allow FTB to "charge back" the returned Hibemia checks against the accounts. The $81,900 and $82,950 deposits made by the Debtor to FTB that were used to "charge back" the two Hibemia checks are the transfers for which the chapter 7 trustee seeks to avoid as preferential transfers.

II. Conclusions of Law

A. Standard for Summary Judgment

Summary judgment under Federal Rule of Civil Procedure 56, made applicable to bankruptcy adversary proceedings by Federal Rule of Bankruptcy Procedure 7056, is appropriate where there is no genuine issue of material fact and the moving party is entitled to judgment as a matter of law. See Celotex Corn. V. Catrett, 477 U.S. 3 17, 322 (1986); Anderson v. Liberty Lobbv. Inc. 477 U.S. 242, 247-48 (1986). Any inferences to be drawn from the underlying facts must be viewed in the light most favorable to the party opposing the motion. Matsushita Elec.

Indus. Co. V. Zenith Radio Corn., 475 U.S. 574, 587 (1986). As both parties agree that there is no genuine issue of material fact, this Court must determine which party is entitled to judgment as a matter of law.

B. Check Kiting Scheme Created An Antecedent Debt

FTB asserts that it is entitled to summary judgment because the Trustee cannot meet his burden to prove (1) the existence of an antecedent debt as required by section 547(b)(Z); (2) that FTB was a transferee of a preferential transfer under section 550; and (3) that FTB improved its position as a result of the alleged preferential transfers. Based on stipulated facts, affidavits, exhibits and depositions, the remaining elements of an avoidable preferential transfer in 11 U.S.C. § 547(b) have been established.

Numerous federal courts have recognized that check kiting is a scheme to defraud banks by creating unauthorized loans. Federman v. United States, 36 F.2d 441 (7th Cir. 1929), cert. denied, 28 1 U.S. 729 (1930); Conrov v. Shott, 363 F.2d 90 (6th Cir.), cert. denied, 385 U.S. 969 (1966); McCuskey v. National Bank of Waterloo (In re Bohlen Enters.. Ltd.), 859 F.2d 561 (8th Cir. 1988); Davis V. Securitv Nat'l Bank of Nevada, 447 F.2d 1094 (9th Cir. 1971). Furthermore, unauthorized loans created through a check kiting scheme constitute "debts" for bankruptcy purposes and arise at the moment of a debtor's fraud. First Fed. Of Michigan v. Barrow, 878 F.2d 912, 917 (6th Cir. 1989). Accordingly, the Sixth Circuit Court of Appeals recently affirmed the lower courts' decisions in Emore v. Third Nat'l Bank (In re Montgomery), 123 B.R. 801 (Bankr. M.D. Term. 1991), aff'd, 136 B.R. 727 (M.D. Term. 1992), aff'd, 983 F.2d 13 89 (6th Cir. 1993), holding that check kiting creates an "antecedent debt" for preference purposes.

Check kiting encompasses a wide-range of fraudulent schemes involving the obtaining of false credit by the exchanging and passing of worthless checks between two or more banks. For example, Black's Law Dictionary defines check kiting as a "practice of writing a check against a bank account where funds are insufficient to cover it and hoping that before it is deposited the necessary funds will have been deposited" or the "transfer of funds between two or more banks to obtain unauthorized credit from a bank during the time it takes the checks to clear." **BLACK'S LAW DICT.,** 6th ed. A leading treatise describes check kiting as follows:

> The kite is a type of fraud by which the malefactor uses at least two accounts at separate banks and covers overdrafts on one bank by writing overdrafts on the other bank. The malefactor takes advantage of the float period between the moment of deposit and the moment of payment by each drawee bank. He also takes advantage of both banks' willingness to pay checks drawn against uncollected funds . . . . A constant flow of worthless checks between the two accounts keeps the kite alive as the numbers grow larger and larger . . . .

Clark and Clark, ***The Law of Bank Deposits, Collections and Credit Cards*** ¶ 9.01 (rev. ed. ***1995).***

The Debtor's activities fall squarely within the definition proffered in Black's Law Dictionary and the Clark & Clark treatise. First, Debtor opened an account at Hibernia Bank on which he proceeded to write bad checks. The Debtor then used the funds in the First Tennessee accounts to create temporary floats to cover overdrafts and checks written on United American Bank accounts. FTB credited the Debtor for the uncollected Hibernia checks, and he made use of these funds by writing checks, which FTB honored against the credit in both accounts even though there were insufficient funds. Debtor admittedly took advantage of both banks and stated that he "was creating a three million dollar float, trying to keep everyone from knowing it , which took being fairly creative from time to time." (Cannon deposition, pp. 44-45, 5 1-52.)

FTB argues that the Debtor's attempt at check kiting failed due to the lack of a circular or continuous pattern of activity. FTB relies upon the United States Supreme Court's description of a check kiting scheme in Williams v. United States, 458 U.S. 279 (1982), in which the writing of fraudulent checks is circular and continuous so as to maintain the kite for an extended period. This example, however, was presented in the Williams decision to show how "a check kiting scheme *typically* works." Williams, 458 U.S. at 28 1 n. 1 (emphasis added). Neither the Supreme Court nor the leading treatise indicates that circular, continuous check writing and/or maintaining a float for an extended period, is a prerequisite to check kiting. This court, therefore, finds that the Debtor's fraudulent activities constituted check kiting thereby creating an antecedent debt.

C. FTB's Claim Arose Prior to the Transfer Creating an Antecedent Debt

Even assuming, arguendo, that Debtor's activities did not constitute check kiting, the transfers in question were clearly on account of an antecedent debt. To determine the existence of a debt for preference purposes, this Court turns to the familiar statutory construction summarized in First Fed. Of Michigan v. Barrow, 878 F.2d 912, 917 (6th Cir. 1989):

> (1) "debt" means a liability on a claim. 11 U.S.C. § 101(11).
> (2) "claim" means-- (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured or unsecured . , . . 11 U.S.C. § 1 01(5).
> (3) "creditor" means-- (A) entity that has a claim against the debtor that arose at the time of or before the order of relief concerning the debtor . . . . 11 U.S.C. § -101(9)(A). The legislative history of the Bankruptcy Code evidences Congress' desire to provide the broadest possible definition of "claim" when it enacted section 101(4) (footnote omitted) (citations omitted).

See also In re Montgomery, 123 B.R. at 808: "'debt' and 'claim' are coextensive. When a claim exists, so does a debt. In re Cybermech, 13 F.3d 818, 822 (4th Cir. 1994).

In the case at hand, FTB had a "claim" against the Debtor when it granted provisional,

unsecured credit in the amounts of $81,900 and $8 1,450 to the Debtor based upon the deposit of the Hibernia checks. FTB had a claim and the Debtor had a liability on that claim thereby constituting a "debt." An antecedent debt simply means a pre-existing or prior debt, which requires an inquiry into the point in time at which the debt arose. See In re Gold Coast Seed Co, 751 F.2d 1118, 1119 (9th Cir. 1985); Barash v, Public Fin. Corn., 658 F.2d 504 511 (7th Cir. 1981). The debt in this case was created during a period immediately following January 10, 1994. The charge back of the two checks, which is the transfer at issue, occurred on January 24, 1994. The debt clearly arose prior to the transfer and was, therefore, an antecedent debt for preference purposes under 11 U.S.C. § 547(b).

D. Section 547(b)(5) is Met

The trustee also met his burden of proving section 547(b)(5). As a result of the transfers, First Tennessee Bank received $81,900 and $81,450, totaling $163,350.00, on account of the antecedent debt owed to it by the Debtor. This allowed FTB to receive more than it would have received had the transfer not been made. Since the total unsecured claims asserted against the estate exceed $6 million, the assets of the bankruptcy estate are inadequate to repay the claims in full. Therefore, FTB also received more than it would have received in a distribution under chapter 7 liquidation. This Court further finds that FTB was a transferee of a preferential transfer under section 550.

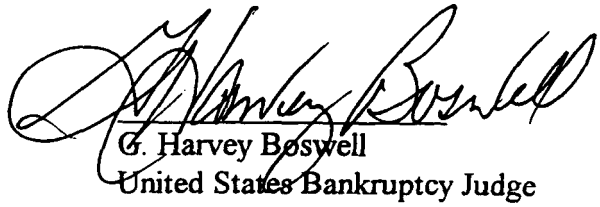
Accordingly, this court holds that the trustee has met his burden of proof as to all elements set forth in 11 U.S.C. § 547(b) and that the avoidable preferential transfers totaled $163,350.00 plus prejudgment interest.

III. Order

It is therefore **ORDERED** that First Tennessee Bank's motion for summary judgment is **DENIED** and that the chapter **7** trustee's motion for summary judgment is **GRANTED.**

IT IS SO ORDERED.

By the Court,



G. Harvey Boswell
United States Bankruptcy Judge

Date: April 22, 1997