UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF TENNESSEE
WESTERN DIVISION

In re

GEORGE ALLEN HERBISON,	**Case No. 96-28148-K**
Debtor.	**Chapter 7**
GEORGE W. STEVENSON, Chapter 7 Trustee of the estate of the above-named debtor,	
Plaintiff,	
v.	**Adv. Proc. No. 97-0104**
PAT K. SENSING and JOAN A. SENSING,	
Defendants.	

MEMORANDUM AND ORDER RE PLAINTIFF- CHAPTER 7 TRUSTEE'S COMPLAINT TO RECOVER PREFERENTIAL TRANSFER UNDER 11 U.S.C. §§ 547 AND 550

The instant matter before the court arises out of an adversary proceeding filed by the plaintiff, George W. Stevenson, Chapter 7 Trustee of the estate of the above-named debtor ("Trustee"), pursuant to FED. R. BANKR. P. 7001(1), to recover alleged preferential transfers from the defendants, Pat K. Sensing and Joan A. Sensing (the "Sensings" or "Mr. and/or Mrs. Sensing") under 11 U.S.C. §§ 547 and 550.

By virtue of 28 U.S.C. § 157(b)(2)(F), this is a core proceeding. The court has jurisdiction of this action under 28 U.S.C. §§ 1334(a)-(b) and 157(a) and Miscellaneous District Court Order No. 84-30 entered on July 11, 1984. Based on the sworn testimony at the trial, the

trial exhibits thereto, background stipulations of the parties, statements of counsel, and consideration of the case record as a whole, the following shall constitute the court's findings of fact and conclusions of law pursuant to FED. R. BANKR. P. 7052.

Findings of Fact

The relevant background facts are, for the most part, set forth in the parties' original and amended stipulation of facts as follows:

1. George Allen Herbison, the above-named chapter 7 debtor ("Mr. Herbison"), filed this chapter 7 case on July 2, 1996.

2. George W. Stevenson, Esquire, is the duly appointed and qualified Chapter 7 Trustee of the estate of Mr. Herbison.

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6. On or about April 17, 1995, Mr. Herbison executed a promissory note (the "Note") in favor of Mr. and Mrs. Sensing in the principal amount of $89,303.29.

7. Under the terms of the Note, nine equal installments of $10,256.27 were to be made on the first of each month commencing on May 1, 1995, until paid in full.

8. In repayment of the Note, Mr. Sensing began receiving payments from Mr. Herbison's employer, Home Medical Care, Inc. ("HMC"), on or about May 15, 1995, by checks bearing the following dates in the following amounts.

Date	Amount
May 15, 1995	$10,256.27
June 7, 1995	$10,256.27
July 3, 1995	$10,256.27
August 3, 1995	$10,256.27
August 31, 1995	$10,256.27
November 16, 1995	$10,256.27
December, 15, 1995	$10,256.27

March 11, 1996	$10,256.27
May 13, 1996	$5,000.00
June 14, 1996	$5,256.27

9. The source of funds for the payments by Mr. Herbison to Mr. Sensing was a payroll deduction from Mr. Herbison's check at HMC for pay periods ending before the date of the checks.

10. The eight payments beginning from July 3, 1995 through June 14, 1996, totaling $71,537.62, are in dispute (the "Transfer"). It is undisputed that the last seven payments occurred within one year of commencement of this chapter 7 case; the seven payments total $67,793.89. Mr. and Mrs. Sensing dispute that the payment dated July 3, 1995, from HMC was a transfer that occurred within one year of commencement of this case.

11. The Transfer was a transfer of property of Mr. Herbison.

12. The Transfer was for the benefit of a creditor (the Sensings) of the Mr. Herbison.

13. The Transfer was made on account of an antecedent debt owed by Mr. Herbison to the creditor(s) before the Transfer was made.

14. Mr. Herbison was insolvent when he made the Transfer.

15. On April 17, 1995, Mr. Herbison owed the Internal Revenue Service the amount of $89,303.29 for unpaid 1993 income taxes.

16. In April 1995, Mr. Sensing (not Mrs. Sensing) paid the sum of $89,303.29 directly to the Internal Revenue Service for Mr. Herbison's tax obligations and took the Note back from Mr. Herbison, which was payable to both Mr. and Mrs. Sensing.

17. The payments/transfers enabled the creditor(s) (the Sensings) to receive more than they would have received if the case was a case under chapter 7 of title 11; the payments/transfers had not been made; the creditor(s) had received payment of such debt to the extent provided by the provisions of title 11.

18. The only element of 11 U.S.C. § 547(b) remaining for the Trustee to meet the burden of proof is that the Sensings are "insiders" of Mr. Herbison as defined under the Bankruptcy Code.

19. Mrs. Sensing is Mr. Herbison's blood aunt. Mrs. Sensing's sister is Mr. Herbison's natural mother. Mrs. Sensing is the stepmother of Pat K. Sensing, II, whose natural father is Mr. Sensing. Although Mr. Sensing is not related by blood to Mr. Herbison, Mr. Sensing is Mr. Herbison's uncle by marriage.

20. Mr. Herbison was, until approximately June 1996, an independent contractor of HMC, which at all times relevant here was owned by the Sensings or Pat K. Sensing, II, the natural son of Mr. Sensing. At the time of the loan on April, 17, 1995, Mr. and Mrs. Sensing were the majority shareholders of HMC. After June 1, 1995, Pat K. Sensing, II was the sole shareholder of HMC.

21. Notwithstanding Mr. Sensing's direct payment of $89,303.29 to the Internal Revenue Service in April 1995, the Internal Revenue Service has filed a proof of claim in this case for $14,506.42 as an unsecured nonpriority creditor and $134,761.90 as an unsecured priority creditor for later unpaid taxes owed by Mr. Herbison to the Internal Revenue Service.

The Sensings also assert as an affirmative defense to the Trustee's complaint that the

transfers made by Mr. Herbison to Mr. Sensing were in payment of a debt incurred with Mr. Sensing by Mr. Herbison in the ordinary course of the financial affairs of Mr. Herbison, made in the ordinary course of financial affairs of Mr. Herbison and Mr. Sensing, made according to ordinary course of financial affairs and, therefore, unavoidable under 11 U.S.C. § 547(c)(2). The court notes that at all times relevant here Mr. Herbison made an extremely high income via commissions earned while he worked at HMC.

Conclusions of Law

The Trustee has the burden of proof on each and every technical element under section 547(b). The Sensings have the burden of proof under the exceptions contained in section 547(c). See 11 U.S.C. § 547(g); *Logan v. Basic Distrib. Corp*. (*In re Fred Hawes Org., Inc*.), 957 F.2d 239, 242 (6th Cir. 1992). As the above-mentioned stipulations of the parties provide, the only element under section 547(b) for the Trustee to prove here is that the Sensings are "insiders" of Mr. Herbison. All the other technical elements of section 547(b) admittedly have been met by the Trustee.

I.

The term "insider" is defined in the definitional section of the Bankruptcy Code to include a "relative of the debtor." 11 U.S.C. § 101(31) (1994). The term "relative" also is defined in the Bankruptcy Code in section 101(45) as an "individual related by affinity or consanguinity within the third degree as determined by common law, or individual in a step or adoptive relationship within such third degree." 11 U.S.C. § 101(45) (1994).

A relationship by "affinity" under common law is the connection existing, in

consequence of marriage, between each of the married persons and the kindred of the other. BLACK'S LAW DICTIONARY 59 (6th ed. 1990); 23 AM. JUR. 2D, *Descent and Distribution* § 52 (1983). See also *In re Winn*, 127 B.R. 697 (Bankr. N.D. Fla. 1991) (the doctrine of affinity would regard the debtor's father-in-law as the debtor's father); *In re Ribocke*, 64 B.R. 663 (Bankr. D. Md. 1986) (citing *In re Bordeaux' Estate*, 225 P.2d 433, 436 (Wash. 1950)); *In re Standard Stores, Inc.*, 124 B.R. 318, 323 (the phrase "within the third degree" in section 101(45) makes sense only if "affinity" is defined as a relationship by marriage, which is the meaning of the Latin root of "affinity," i.e., affinis) (citing WEBSTER'S II NEW RIVERSIDE UNIVERSITY DICTIONARY 83 (1984))); State v. Dodd, 871 S.W.2d 496, 497 (Tenn. Ct. Crim. App. 1993) ("Here, the relationship between the defendant and the alleged victim is one of affinity, not consanguinity. That is, the relationship exists only by virtue of the marriage of the defendant to the alleged victim's aunt. There is no kinship by blood."); *State v. Hooper*, 37 P.2d 52 (Kan. 1934) (the husband has the same relation, by affinity, to his wife's blood relatives as she has to them by consanguinity and vice versa).

Mrs. Sensing is the blood aunt of Mr. Herbison, the above-named chapter 7 debtor. She is married to Mr. Sensing. Mr. Sensing is Mr. Herbison's uncle by affinity. The court must now determine whether the relationship of aunt and uncle is in fact a relationship within the third degree. The leading Tennessee common law case on this issue is *Sutherland v. Keene*, 203 S.W.2d 917, 921 (Tenn. Ct. App. 1947), where the court held that the degree of relationship is computed "by counting from one party up to common ancestor and then down to the other, considering common ancestor as a single degree, or not counting one of the parties whose relationship is to be determined." For example, the court stated that brothers and sisters would

be within the second degree of relationship since the parents are the common ancestors within the first degree. *Id*. The child of a sibling (i.e., niece or nephews) would therefore be within the third degree of relationship. See *In re Covey*, 57 B.R. 665 (Bankr. D.S.D. 1986) (creditors relationship to debtors is within the third degree of consanguinity or blood relationship because he is their nephew); *In re Indian River Homes, Inc.*, 108 B.R. 46 (D. Del. 1989).

Mrs. Sensing is Mr. Herbison's aunt by consanguinity within the third degree; and Mr. Sensing is Mr. Herbison's uncle by affinity within the third degree of relationship. Accordingly, both Mr. and Mrs. Sensing are "relatives" as defined by the Bankruptcy Code in section 101(45) and "insiders" as defined by the Bankruptcy Code in section 101(31). Since the Sensings clearly fall within the per se technical definition of "insider," the court need not make a subjective inquiry into the closeness of the parties or the degree of control or influence. See, for example, *In re Winn*, 127 B.R. 697 (Bankr. N.D. Fla. 1991) ("[r]egardless of the fact that [the father-in-law] may not have had control over the debtor's financial determinations, he remained by definition, trapped in the category of insider").

As a result of the Sensings' insider status, the court finds that any transfers made to the Sensings by Mr. Herbison via HMC's employer deductions, within one year before the date of the filing of the bankruptcy petition, were in fact and in law technical preferential transfers under section 547(b). The Sensings, however, dispute that the check transfer dated July 3, 1995, was a transfer that occurred within one year of the bankruptcy case. Since Mr. Herbison filed this chapter 7 case on July 2, 1996, the one year period "before the date of the filing of the petition" under section 547(b) began on July 1, 1995. A transfer made by check is deemed to occur on the date the check is honored for purposes of section 547(b) of the Bankruptcy Code. *Barnhill v.*

Johnson, 503 U.S. 393 (1992). Since the date of the check at issue is July 3, 1995, then the check would have been honored on or after July 3, 1995, and, therefore, within the one year preference period for "insiders." The court finds that the eight installment payments beginning on July 3, 1995, through June 14, 1996, totaling $71,537.62, were transferred within one year before the date of the filing of Mr. Herbison's chapter 7 petition and are technical preferential transfers under section 547(b).

II.

Technical preferences may not be avoided by a bankruptcy trustee if one or more of the affirmative defenses of section 547(c) are met. Since the Trustee here has met the burden of proving each and every technical element under section 547(b), the court will now address the Sensings' asserted affirmative defense and determine whether the payments in question are "unavoidable" under section 547(c)(2). The party asserting a defense under 11 U.S.C. § 547(c) (here the Sensings) bears the burden of proving that a transfer is not avoidable. 11 U.S.C. § 547(g).

Section 547(c)(2) of the Bankruptcy Code provides that a trustee may not avoid transfers

> (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 the ordinary course of business or financial affairs of the debtor and the transferee; and
> > (C) made according to ordinary business terms [.]

11 U.S.C. § 547(c)(2). The Bankruptcy Code does not define "ordinary course of business" or "ordinary business terms;" rather a court must engage in a "peculiarly factual" analysis of "the business practices unique to the particular parties." *Gosch v. Burns (In re Finn)*, 909 F.2d 903, 907 (6th Cir. 1990) (quoting *In re Fulghum Constr.*, 872 F.2d 739 (6th Cir. 1989)). See also

Perks v. Society Corp., 134 B.R. 627,631 (Bankr. S.D. Ohio 1991).

In the instant action, the loan in question was evidenced by a promissory note between Mr. Herbison and the Sensings for the sum of $89,303.29 to be paid in nine installments of $10,256.27. In reality the Note was consideration for the $89,303.29 payment made directly to the Internal Revenue Service by Mr. Sensing for Mr. Herbison's unpaid taxes. According to Mr. Sensing's testimony at the trial, Mrs. Sensing strongly opposed the making of this particular loan. Although the form of the Note was between Mr. Herbison and Mr. and Mrs. Sensing, the check payable directly to the Internal Revenue Service was drawn on Mr. Sensing's personal checking account (not Mrs. Sensing's), and the technical preferential payments were made by Mr. Herbison to Mr. Sensing, albeit, by payroll deduction from HMC. Sifting through the circumstances, the court finds that the loan transaction in question was in reality between Mr. Herbison and Mr. Sensing, not between Mr. Herbison and his employer, HMC, nor Mrs. Sensing. The court will therefore look to the circumstances and business practices unique to Mr. Herbison and Mr. Sensing to determine whether the payments the Trustee seeks to avoid were made in the ordinary course of business or financial affairs of those particular parties.

The so-called "ordinary course of business exception" has been found to apply in cases involving business loans as well as consumer loans. For example, the Sixth Circuit in *In re Finn*, 909 F.2d 903 (6th Cir. 1990), held that the incurring of "consumer debt that is a 'normal financial relation' and that is not 'unusual action' undertaken during the 'slide into bankruptcy' will satisfy § 547(c)(2)(A)'s requirement for an exception from the avoidance rules." *Id*. at 907 (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 88 (1978), reprinted in 1978 U.S.C.C.A.N. 5787, 5874). In *Finn*, the debtor entered into a revolving loan agreement with a credit union in which

the proceeds were used to pay off consumer debt that the debtor had incurred. The debtor's brother cosigned the loan and became a creditor of the debtor by virtue of his right to reimbursement and an insider for purposes of section 547(b). Also, in *In re Perks*, 134 B.R. 627 (Bankr. S.D. Ohio 1991), the debtor purchased a car with the proceeds of a loan that was cosigned by her parents. The debtor's parents, in effect, became creditors and insiders of the debtor. In both of these consumer loan transactions, the court found that the ordinary course of business exception was applicable.

In determining whether these payments were made in the "ordinary course" or "normal financial relation," this court will consider the entire history of the parties' dealings with each other, the amount, manner, and timing of the transaction and the related totality of the circumstances under which the transfers were made. See *Brown v. Shell Canada, Ltd. (In re Tennessee Chemical Co.),* 112 F.3d 234 (6th Cir. 1997); *In re Yurika Foods Corp*., 888 F.2d 42 (6th Cir. 1989); *In re Perks*, 134 B.R. at 631; *In re Federated Marketing, Inc.*, 123 B.R 265, 270 (Bankr. S.D. Ohio 1991); *In re White*, 64 B.R. 843 (Bankr. E.D. Tenn. 1986). Compare *Luper v. Columbia Gas of Ohio, Inc. (In re Cavled, Inc.),* 91 F.3d 811 (6th Cir. 1996). Both Mr. and Mrs. Sensing testified at trial and in their depositions that they had made numerous personal loans to Mr. Herbison over the years. In fact, Mr. Sensing estimated that he had made loans to Mr. Herbison about "half a dozen times over a period of years." *Deposition of Pat K. Sensing*, p. 40, lines 13-14. Furthermore, those personal loans were handled the same way each time in that either Mr. Sensing personally or HMC would write a check and then such loan would be repaid by Mr. Herbison via a payroll deduction at HMC. *Id*. at lines 51-53.

The $89,303.29 loan in question was, however, the largest amount that Mr. Sensing had

personally loaned Mr. Herbison. According to the Sixth Circuit in *In re Finn*, "a transaction can be in the ordinary course of financial affairs even if it is the first such transaction undertaken by the customer. This rule holds where the transaction would not be out of the ordinary for a person in the borrower's position." 909 F.2d at 908. For example, the *Finn* court found that since the loan did not increase the borrower's total indebtedness, nor was the loan grossly disproportionate to the borrower's apparent earning power at the time, then the loan was incurred "in the ordinary course of financial affairs." *Id*. Similarly, Mr. Sensing's loan to Mr. Herbison did not increase the latter's total indebtedness since the money borrowed went directly toward the Internal Revenue Service obligation and the loan was proportionate to Mr. Herbison's high earning power, especially since Mr. Herbison successfully repaid the loan.

The court finds considering a totality of the facts and circumstances that neither the loan nor the loan amount is unusual as between these particular parties (i.e., between Mr. Herbison and Mr. Sensing). The court must now determine whether the payments to Mr. Sensing were made in the ordinary course of the financial affairs of the immediate parties. Even if the transactions were irregular, they may be considered "ordinary" for purposes of section 547(c)(2) if those transactions were consistent with the course of dealings between the particular parties. *In re Fulghum Constr. Corp.*, 872 F.2d at 743. See also *In re White*, 58 B.R. 266, 270 (Bankr. E.D. Tenn. 1986) (payments by debtor were "ordinary even if they were made on irregular basis").

As between Mr. Herbison and Mr. Sensing, irregular payments were the ordinary. For example, the first payment was fifteen days late. In his deposition, Mr. Sensing explains that "the reason for some of these dates not being exactly right is that he would sometimes ask us not

to take it out because he was in a bind or something and we would let him go a little longer or something of that nature." *Deposition of Pat K. Sensing*, p. 36, lines 11-15. Also, Mr. Herbison stated the following in his deposition:

> It says on there the payment plan but it didn't work that way. Several months I wouldn't have them take anything out and that's why there were several delayed payments. I couldn't point out which ones, and I just begged and pleaded for them not to take everything I had. But they were pretty lenient with it. They didn't make me pay it like that thing says.

Deposition of George A. Herbison, p. 55, lines 3-11.

Based on the entire course of dealing between Mr. Herbison and Mr. Sensing and the circumstances surrounding the transaction in question, it would have actually been unusual and "out of the ordinary" for Mr. Herbison to pay Mr. Sensing on time. Therefore, the court finds that the payments were consistent with the entire course of dealings between the parties and thus "ordinary" under the circumstances. Only substantial deviations take transactions out of the ordinary course. See, for example, *In re Molded Acoustical Products, Inc.*, 18 F.3d 217 (3rd Cir. 1984). Only unusual practices are out of range. *In re Tolona Pizza Products Corp.*, 2 F3d 1029 (7th Cir. 1993).

The court also notes that the primary purpose of the ordinary course of business exception is to encourage "dealing[s] with troubled debtors in order to forestall bankruptcy." *In re Fulgham*, 872 F.2d at 74. See also *O'Neill v. Nestle Libby's P.R., Inc.*, 729 F.2d 35, 37 (1st Cir. 1984) (§547(c)(2) exception is designed to encourage creditors to conduct business with a struggling enterprise so that debtors can rehabilitate themselves); *Fiber-Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.)*, 18 F.3d 217, 219-20 (3d Cir. 1994) ("the ordinary course exception to the preference rule is formulated to induce creditors to

continue dealing with a distressed debtor so as to kindle its chances of survival without a costly detour through, or a humbling ending in, the sticky web of bankruptcy").

In the instant action, the sole purpose of Mr. Sensing's making the personal loan to Mr. Herbison was to allow Mr. Herbison to avoid bankruptcy at the time. Mr. Sensing explained in his deposition that they "did try to help him, he was in quite a bind." *Deposition of Pat K. Sensing*, p. 35, line 13-14. Furthermore the sole purpose of Mr. Sensing's loan was to pay the debt that Mr. Herbison owed to the Internal Revenue Service. See *Deposition of George A. Herbison*, p. 86, lines 17-22 ("Q. So there is no question that this loan was negotiated and made in order to pay your income tax liability? A. Yes, sir, no question."). Under these circumstances, this court declines to discourage transactions where the primary purpose is not prebankruptcy planning, but instead is to avoid bankruptcy altogether. See *In re Fulgham*, 872 F.2d at 744. If Mr. Herbison had filed a bankruptcy case as a first resort and thereafter Mr. Sensing had paid the Internal Revenue Service for Mr. Herbison's now dischargeable taxes, no questions would be asked about preferences or the like.[1]

Based on the foregoing factual analysis of the business and personal practices unique to these particular parties, the court concludes after carefully considering a totality of the particular facts and circumstances and applicable law that the payments to Mr. Sensing during the one year preference period indeed were consistent with the entire course of financial and personal dealings between the parties and thus "ordinary" for purposes of section 547(c)(2) and Sixth Circuit case law. The preferential payments from May 15, 1995 through June 14, 1996, are

[1]It is interesting to note here that if the Trustee is successful in this complaint, the Internal Revenue Service arguably will receive, less bankruptcy administrative expenses, all the monies the Sensings will have to pay the Trustee; the Sensings and other creditors would, in this event, receive no distribution.

therefore not avoidable by the Trustee -- they are exceptions to the preference rule.

In accordance and consistent with the foregoing, IT IS SO ORDERED.

BY THE COURT

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David S. Kennedy
Chief United States Bankruptcy Judge

Date: March 24, 1998

cc: George W. Stevenson, Esq.
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