In the United States Bankruptcy Court

for the Northern District of Iowa

DENNIS R. WEYMILLER *Debtor(s).*	Bankruptcy No. 94-20350KD Chapter 7
ERIC W. LAM TRUSTEE *Plaintiff(s)* vs. EDWIN L. WEYMILLER and SHARON WEYMILLER *Defendant(s)*	Adversary No. 94-2055KD

ORDER

On August 24, 1994, the above-captioned matter came on for trial pursuant to assignment. Plaintiff appeared by Attorney James O'Brien. Defendant Edwin L. Weymiller appeared in person with Defendants' Attorney, Paul Fitzsimmons. Evidence was presented after which the Court took the matter under advisement.

STATEMENT OF THE FACTS

Plaintiff, the Trustee in this Chapter 7 case, filed the pending complaint to avoid and recover certain transfers of property. Plaintiff alleges Debtor gave Defendants a second mortgage and made six payments of $735 each which constitute fraudulent conveyances under § 548 as well as voidable preferences under § 547 of the Code. Defendants deny the allegations.

Debtor is a farmer who grew up in a farming operation with his father and brothers. When Debtor was a fairly young man, the family members entered into a partnership in which all had some interest in the Weymiller farming operation. Debtor, one of the sons of Defendants Edwin and Sharon Weymiller, eventually purchased a farm in Allamakee County in the fall of 1987. He took possession of this farm in 1988 with the intent of running a Holstein dairy operation. This farm consisted of 280 acres and while marginal for crops, it was suitable for a dairy herd operation if run efficiently.

Debtor purchased the farm for $150,000 on contract from a Mr. Bowman. In order to purchase the property, it was necessary to make a substantial down payment. Debtor did not have cash available and obtained what he categorized as a loan from his father in the amount of $25,000 in 1987. However, subsequent testimony established that Debtor and his father went to a bank and obtained the $25,000 loan. Debtor was the primary signer and his father was the co-signer on the note. Debtor's father did not make payments on this note to the Bank on behalf of Debtor.

At about the same time, the farm partnership involving Defendant Edwin Weymiller and his sons was divided up. Debtor owed his father and brothers because he took Holstein cows and other property when he left the partnership. He signed a promissory note to his parents in the amount of $16,000. This was the amount which he owed the partnership for partnership property he personally retained.

The monthly payment on the real estate contract to the seller, Mr. Bowman, was $1,265.72. Contract payments were made on the basis of an assignment of milk proceeds from Debtor to the contract seller. The milking operation did not go particularly well.

Eventually, on February 23, 1994, the land was leased to Mr. Greg Bossom for $2,000 per month. From that time forward, Debtor applied the lease payment in part to pay the monthly contract payments of $1,265 to the contract seller, Mr. Bowman. Debtor paid the remainder amount of $735.00 to his father. Six of these payments were made from January until June of 1994. The petition for bankruptcy was filed March 8, 1994. At present, these differential payments are going into what is categorized as a farm account and are not being disbursed. It is the six payments paid by Debtor to his father which the Trustee categorizes as a preferential transfer.

On June 1, 1993, Debtor signed a mortgage to his father and mother, the Defendants, in the amount of $39,105. This was a second mortgage on the farm which he purchased on contract from Mr. Bowman. It is not abundantly clear how the parties arrived at the sum of $39,105. It is the position of Debtor and his father, that Debtor owed his father money and that this was a consolidation of all those obligations. Debtor's original loan from the Bank was in the amount of $25,000 which was co-signed by his father. This loan was paid down by Debtor over a period of time. Eventually when Edwin was refinancing his farm operation, he paid off the first note on behalf of his son along with his own refinancing. The remaining balance at the time of that payoff was $22,000. Also, Debtor still owed his father the $16,000 from the break-up of the farm partnership. These two numbers total approximately $39,000, which is the amount of the real estate mortgage. Edwin Weymiller testified that in June of 1993, when this mortgage was executed, his son was having financial problems and he told his son that if he would give him a second mortgage, he would not have to make any payments under that mortgage until "we get this straightened out".

The Court feels Debtor and his father testified candidly. However, it appears that through debt consolidation, Edwin paid off the first bank loan in the amount of $22,000 which he was not legally obligated to pay. He was merely a co-signor and the payments were current. Nevertheless, Edwin liquidated that debt, thereby substituting himself as direct creditor in place of the bank. Edwin essentially bought up this loan which now forms a substantial part of the second mortgage of $39,000.

The remaining $16,000 arose out of the breakup of the partnership which went back to 1987. That was originally a promissory note which was unsecured. This obligation became the second part of the debt which was incorporated into the mortgage in 1993. From this consolidation, Defendants put themselves in a more secure position because of the mortgage than they were previously. While the Court feels the parties did not intend anything fraudulent, the result is that Defendants, under these circumstances, end up being treated much more favorably than other unsecured creditors.

The bankruptcy petition was filed on March 8, 1994. Debtor testified that the value of the farm at the time of the filing of the petition remained approximately $150,000. An appraiser, Ray Sweeney, gave a written appraisal offered into evidence as Plaintiff's Exhibit A. Mr. Sweeney's written appraisal states that he felt the farm, as of June 28, 1994, was worth approximately $147,000. Edwin Weymiller testified that, in his opinion, the land was not worth $147,000 or $150,000. He testified that, based on the quality of the ground, the value to him would be approximately $130,000.

As of the time of execution of the mortgage, Debtor owed approximately $200,000 in total debt. The farm was worth between $130,000 and $150,000. The only additional assets revealed in the record are Holstein cattle which were sold for $5,800 soon after the mortgage was executed. These proceeds were applied toward one of Debtor's obligations. The evidence does not reveal any additional assets. From a straight balance sheet analysis, Debtor clearly had more debts than assets.

CONCLUSIONS OF LAW

Plaintiff asserts that both the second mortgage which Debtor granted to Defendants and the six monthly payments of $735 Debtor made to Defendants in 1994 are voidable as preferences under § 547(b) or as fraudulent transfers under § 548(a)(2) (constructive fraud). In their defense, Defendants assert that the mortgage and monthly payments were made in the ordinary course of business, that Debtor was not insolvent at the time of the transfers, and that Defendants did not have reasonable cause to believe that Debtor was insolvent.

In order to set aside a transfer as a fraudulent conveyance under § 548(a)(2), Plaintiff must prove the following five elements: (1) that an interest of the debtor in property; (2) was voluntarily or involuntarily transferred; (3) within one year of the date of filing the petition; (4) that the debtor received less than a reasonably equivalent value; and (5) that the debtor was insolvent at the time of the transfer or became insolvent as a result thereof. In re Cormack, No. L88-01506D, Adv. No. L88-0285D, slip op. at 5-6 (Bankr. N.D. Iowa Jul. 7, 1989). The burden of proof is on Plaintiff to establish each of the five elements by a preponderance of evidence. Id. at 6.

In order for a transfer to be subject to avoidance as a preference under § 547(b),

> (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 [one year] prior to the commencement of the bankruptcy case [where the creditor is an insider], (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.

In re Interior Wood Products Co., 986 F.2d 228, 230 (8th Cir. 1993). The amendments to § 547 effective in 1984 eliminated the previous requirement in actions against insiders that the transferee have reasonable cause to believe the debtor was insolvent. 4 Collier Bankruptcy Practice Guide § 64.07(10) (1994).

Thus, both § 548(a)(2) and § 547(b) require proof that Debtor was insolvent at the time of the transfer or became insolvent as a result thereof. The question of Debtor's insolvency is one of fact for the Court. Cormack, slip op. at 8. Under Bankruptcy law, balance-sheet solvency determines whether payments to creditors are avoidable. In re Taxman Clothing Co., 905 F.2d 166, 170 (7th Cir. 1990). A traditional balance sheet test of insolvency is set out in § 101(32)(A) which requires a determination of whether debts are greater than assets, at fair valuation, exclusive of exempted property. In re Koubourlis, 869 F.2d 1319, 1321 (9th Cir. 1989).

The evidence indicates that, at the time the mortgage was executed, Debtor had approximate debts of between $184,000 and $200,000. The value of Debtor's real estate was between $130,000 and $150,000. Debtor also had cattle valued at approximately $6,000 which were sold and the proceeds turned over to a creditor. It is evident that debts exceeded assets. Plaintiff has met its burden of proof on this issue as to the avoidability of the mortgage.

As to the monthly payments of $735 Debtor made to Defendants in 1994, § 547(f) provides that Debtor is presumed to have been insolvent during the 90 days immediately preceding the date of the filing of the petition. Six such payments were made between January and June of 1994. Debtor filed his petition on March 8, 1994. Defendants have not rebutted the presumption of insolvency under § 547(f) as to payments made within 90 days prior to the petition. As to postpetition payments, Plaintiff is entitled to recovery under § 549(a).

Section 547 contains an exception to avoidability for transfers made in the ordinary course of business. 11 U.S.C. § 547(c)(2). A trustee may not avoid under § 547(b) a transfer that was (1) in payment of a debt incurred in the ordinary course of business of both parties, (2) made in the ordinary course of business of both parties and (3) made according to ordinary business terms. Id. The creditor has the burden of proving the nonavoidability of a transfer under § 547(c). 11 U.S.C. § 547(g).

The "ordinary course of business" determination requires a peculiarly factual analysis. Lovett v. St. Johnsbury Trucking, 931 F.2d 494, 497 (8th Cir. 1991). The "cornerstone" of this defense is that the creditor needs to demonstrate some consistency with other business transactions between the debtor and the creditor. Id. This exception to avoidability is intended to protect recurring, customary credit transactions. In re Keller Tool Corp., 151 B.R. 912, 914 (Bankr. E.D. Mo. 1993).

Defendants have not established that they had the type of business relationship with Debtor that is contemplated by § 547(c)(2). Granting a second mortgage to secure prior debt to Defendants is not an ordinary business transaction for Debtor. Defendants were not in the business of loaning money although they had helped Debtor financially in the past. Granting the second mortgage to secure the previous debt was not consistent with the parties' previous transactions. The record also does not reveal a history of Debtor making monthly payments of $735 to pay off his debt to Defendants. Defendants have not met their burden of proof regarding the ordinary course of business exception.

Defendants do not seriously dispute the existence of the other elements of §§ 547(b) and 548(a)(2). The mortgage and the monthly payments of $735 constitute transfers of an interest of Debtor in property to a creditor. Defendants are insiders subject to the one year reach-back period of § 547(b)(4)(B). See 11 U.S.C. § 101(31)(A)(i) ("insider" includes relative of debtor). Both the mortgage and the monthly payments benefitted Defendants and were made on account of antecedent debt. Defendants were made better off by the mortgage as they became secured, rather than unsecured, creditors. Debtor did not receive anything of value in exchange for granting Defendants a mortgage securing the previously existing debt.

WHEREFORE, the mortgage dated June 1, 1993 from Debtor to Defendants and the six monthly payments of $735 (a total of $4,410) which Debtor made to Defendants in 1994 are voidable as preferences under § 547(b).

FURTHER, these transfers are also voidable as fraudulent transfers under § 548(a)(2).

FURTHER, Plaintiff's complaint is granted.

FURTHER, the mortgage Debtor gave Defendants, recorded June 2, 1993, at Book 106, page 531-532 of the records of Allamakee County, Iowa, is hereby voided.

FURTHER, judgment shall enter for Plaintiff Eric Lam, Trustee, and against Defendants Edwin L. Weymiller and Sharon Weymiller in the amount of $4,410.

SO ORDERED this 14th day of September, 1994.

Paul J. Kilburg
U.S. Bankruptcy Judge