UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF NEW YORK

In re:

ROBERT W. KEPLINGER and
EVELYN M. KEPLINGER, f/d/b/a
KEPLINGER FAMILY DRY CLEANERS, INC.,

Debtors.

Case No.: 00-12789
Chapter 7

NATHAN M. GOLDBERG, Chapter 7 trustee,

Plaintiff,

vs.

MICHAEL SUCH, d/b/a SECURITY & SUCH,

Defendant.

Adv. Pro. No.: 00-90223

APPEARANCES:

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Attorneys for the Trustee

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Hon. Robert E. Littlefield, Jr., United States Bankruptcy Court Judge

Memorandum, Decision & Order

On September 21, 2000, the Chapter 7 trustee ("Trustee") commenced the above-captioned adversary proceeding by filing a complaint (the "Complaint") to recover an alleged preferential transfer pursuant to 11 U.S.C. § 547(b). By Memorandum, Decision and Order dated November 15, 2001 (the "Decision"), the Complaint was dismissed because the Trustee failed to carry his burden of establishing the fifth element of § 547(b). The Trustee appealed the Decision, and the District Court (Hurd, J.) vacated and remanded this matter for further proceedings in accordance with its October 7, 2002 Memorandum-Decision and Order (the "District Court Order"). Familiarity with the Decision and the District Court Order is presumed. The court issues this decision after consideration of the District Court Order and the bankruptcy case record; for the

reasons that follow, the court concludes that the Trustee has not proven that the transfer constitutes a voidable preference under § 547(b).

Jurisdiction

This matter is a core proceeding pursuant to 28 U.S.C. §§ 157(a) and (b)(2)(F). The court has jurisdiction to hear and determine this matter pursuant to 28 U.S.C. §§ 1334(a) and (b).

Facts

The material facts are derived from the parties' May 17, 2001 Stipulation of Facts ("Stipulation") and memoranda of law. In January 1999, Michael Such (the "Defendant") loaned Robert W. Keplinger and Evelyn M. Keplinger (the "Debtors") money in exchange for their pledge of a 5.1 carat diamond ring. At that time, the Defendant was unaware of any prior security interest in the ring; the Debtors believed that any prior security interest had been paid and fully satisfied. In August 1999, the Debtors delivered to the Defendant two personal checks in the amounts of $2,615 and $1,567.50, to be applied to earned interest. The Debtors, however, requested that the Defendant hold the checks until they could accumulate sufficient funds in their personal account to draw upon. When it became apparent that the Defendant could not sell the ring, it was returned to the Debtors, who then delivered it to Northeastern Fine Jewelry ("Northeastern"). Northeastern purchased the ring, and the Debtors used a portion of the sale proceeds to obtain an Adirondack Trust Company treasurer's check dated October 15, 1999 (the "Check"), made payable to the Defendant in the sum of $4,128.50. The Check was tendered to the Defendant and negotiated by him; the Defendant received $4,128.50, but this amount did not fully satisfy the indebtedness owed to him by the Debtors.

On May 17, 2000, the Debtors filed their Chapter 7 petition (the "Petition"). As set forth in the Complaint, the Trustee seeks to recover $4,182.50 from the Defendant as an alleged preferential payment in violation of § 547(b). The Defendant filed an Answer on October 30, 2000, and the court issued a Scheduling Order on November 1, 2000, setting the following: (1) trial on April 30, 2001; (2) completion of discovery by January 2, 2001; (3) filing of a joint stipulation of facts on or before April 20, 2001; and (4) filing of pretrial statements on or before April 20, 2001. Since a trial was scheduled in a related adversary proceeding

commenced by the Defendant against the Debtor (*Such v. Keplinger*, Adv. Pro. No. 00-90176),[1] and both proceedings involved the same transaction and core facts, the Trustee requested a joint trial and obtained an Amended Scheduling Order. (Goldberg 11/17/00 Letter.) The Amended Scheduling Order set the following: (1) trial on May 1, 2001; (2) completion of discovery by January 2, 2001; (3) filing of a joint stipulation of facts on or before April 20, 2001; and (4) filing of pretrial statements and exhibits on or before April 20, 2001.

On February 15, 2001, well beyond expiration of the discovery deadline, the Trustee served the Defendant with a Notice to Admit (the "Notice"), to which the Defendant did not respond. On the date of trial, the Trustee filed an untimely pretrial statement, which included as the sole exhibit a copy of the Check. Importantly, because the Trustee did not comply with the Amended Scheduling Order, he was precluded from introducing § 547(b) matters into evidence pursuant to Fed. R. Civ. P. 16(f), made applicable to this proceeding by Fed. R. Bankr. P. 7016.[2] Thus, this matter is considered on submission only.

Arguments

The parties agree that the Stipulation supports findings that the requirements of §§ 547(b)(1) (transfer to or for the benefit of a creditor), (b)(2) (for an antecedent debt), and (b)(3) (made while the debtor was insolvent) are satisfied. It is highly disputed, however, that the temporal requirement of § 547(b)(5) is met by the facts at hand. The parties agree that the Check was delivered to the Defendant within the 90 day reachback period of the bankruptcy filing (Stip. ¶ 6), but their positions diverge with respect to the significance of the Check: does it constitute a "transfer of an interest of the debtor in property," as claimed by the Trustee, or is the Defendant correct that it serves merely to effectuate the August 1999 transfer because it is a replacement for the two personal checks that were not honored by the Debtors' bank upon presentment

[1] The Defendant commenced the adversary proceeding by filing a Complaint on July 24, 2000, objecting to the Debtor's discharge pursuant to § 727. By Memorandum, Decision and Order dated May 1, 2002, the Complaint was dismissed, and the adversary case closed on October 2, 2002.

[2] *See* discussion of Fed. R. Civ. P. 16 and Fed. R. Bankr. P. 7016 at pp. 5-6 *infra.*

by the Defendant? The Trustee relies on *Barnhill v. Johnson*, 503 U.S. 393 (1992), for the proposition that the requisite transfer occurred when the Debtors presented the Defendant with the Check, which was within 90 days of the Debtors' bankruptcy filing, because the date of honor rule applies to this transaction. The Defendant, however, argues that the requisite transfer occurred outside the preference period in August 1999 when the Debtors presented the original checks to the Defendant because the New York State Uniform Commercial Code governs for purposes of a § 547(b) determination. The Defendant suggests the Trustee's reliance on *Barnhill* is misplaced because of the Debtors' express instructions to the Defendant to withhold presentment of the personal checks for an indefinite length of time, which inevitably extended into the preference period. Thus, defining the "transfer" for purposes of § 547(b)(4) is the proverbial bone of contention in this matter.

The secondary issue concerns whether the Trustee has proven § 547(b)(5), requiring that the creditor receive more than he would have received under a Chapter 7 distribution, assuming the subject payment had not been made and the creditor was paid according to the provisions of the Bankruptcy Code. In the Complaint, the Trustee conclusively asserts that this requirement is met. On remand, the Trustee adopts the district court's reasoning that "there is sufficient evidence in the record that could support a finding that the pre-petition payment enabled [the Defendant] to receive a disproportionate share in a Chapter 7 distribution." (Trustee's Mem. on Remand at 2.) The Trustee relies upon the facts cited in the District Court Order and the contents of the Petition to carry his burden of proof. The Defendant's opposition on this point is twofold: first, the Defendant argues that the Trustee cannot establish that he is an unsecured creditor, which is fundamental to this analysis; second, he challenges the Trustee's liquidation analysis on the basis that it is "immaterial" because "core facts" are missing from the record. The Defendant's argument is summarized as follows:

> This matter was presented to the Court on papers, without aid of direct testimony offered by the Trustee in support of his case. Without question, the Trustee's claim began its procedural life from the filing of the debtor[s'] petition. Yet, the proof that the Trustee

> presented was limited to a *Stipulation of Facts* adopted by counsel to give shape to the outstanding legal issues. That Stipulation simply could not carry the day to establish: (1) a preferential transfer, or (2) refute Mr. Such's [affirmative defense] that he enjoyed status as a secured creditor. Therefore, Trustee's recovery claim must fail for lack of specific proof.

(Brignola 10/6/03 Letter at 1.) Because of the insufficiency of evidence, the Defendant argues that the Trustee failed to satisfy every element of § 547 and "those elements may not otherwise be implied or inferred by anything in the record facts." (Defendant's Mem. on Remand at 2.)

Finally, the Trustee submits that § 547(b)(5) is inapplicable to a filing under Chapter 7 "because one cannot compare this section with itself." (Trustee's Mem. on Remand at 3.) Therefore, the Trustee argues he does not have to meet the requirements of § 547(b)(5) in order to prevail in this proceeding.

Discussion

I. Violation of the Amended Scheduling Order

The District Court Order states that it is "instructive to ascertain: (1) whether [the Defendant] was a secured creditor; and (2) if so, whether there would have been a less than 100% payout to unsecured creditors in a Chapter 7 distribution." (District Court Order at 5.) It was unclear to the District Court whether this court considered all the facts and evidence to rule on §§ 547(b)(4) and (b)(5). Based on the procedural history of this case, however, the court cannot ever reach the pivotal state and federal law questions of when the transfer occurred, whether the Defendant received more than his liquidation share, or whether the Defendant should be classified as either a secured or unsecured creditor.

Fed. R. Civ. P. 16, made applicable to this proceeding by Fed. R. Bankr. P. 7016, provides in part:

> **(e) Pretrial Orders.** After any conference held pursuant to this rule, an order shall be entered reciting the action taken. This order shall control the subsequent course of the action unless modified by a subsequent order. The order following a final pretrial conference shall be modified only to prevent manifest injustice.
>
> **(f) Sanctions.** If a party or party's attorney fails to obey a scheduling or pretrial order . . . or if a party or party's attorney is substantially unprepared to participate in the conference . . . the judge, upon motion or the judge's own initiative, may make such orders with regard thereto as are just, and among others any of the orders provided in Rule 37(b)(2)(B),(C), (D).

The court must turn its attention to Fed. R. Civ. P. 37, which provides in part:

> **(b) Failure to Comply with Order.**
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> . . . .
>
> **(2) Sanctions by Court in Which Action is Pending.** If a party . . . fails to obey an order entered under Rule 26(f) [Conference of Parties; Planning for Discovery], the court in which the action is pending may make such orders in regard to the failure as are just, and among others the following:
>
> . . . .
>
> **(B)** An order refusing to allow the disobedient party to support or oppose designated claims or defenses, or prohibiting that party from introducing designated matters into evidence[.]

Accordingly, the Amended Scheduling Order contained the following notice: "Failure to comply with any of the terms of this Order may result in dismissal or the appropriate sanctions, preclusion, the striking of pleadings, and the entry of an order of judgment accordingly." Such was the fate of the Trustee in this matter. Because the Trustee violated multiple terms of the Amended Scheduling Order, the Trustee's sole evidence in support of his claim is the Stipulation of Facts, which does not satisfy the requirements of §§ 547(b)(4) and (5). This matter cannot be decided as a matter of law; questions of fact exist which prevent the court from granting the relief requested.

II. Section 547

Section 547 provides in part:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest in the debtor in property . . .
>
> (4) made –
>
> (A) on or within 90 days before the date of filing of the petition; or . . .
>
> (5) that enables such creditor to receive more than such creditor would receive if –
>
> (A) the case were a case under chapter 7 of this title; and
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

The parties' relative burdens of proof in a preference action are statutorily determined by §§ 547(f) and (g) as follows:

> (f) For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of filing of the petition.

> (g) For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the nonavoidability of the transfer under subsection (c) of this section.

It is quite clear that the Trustee must prove every element of this section before he can avoid any transfer of property as a preference. *In re Lease-A-Fleet, Inc.*, 151 B.R. 341, 347 (E.D. Pa. 1993); *In re Tire Kings of America, Inc.*, 164 B.R. 40, 42 (M.D. Pa. 1993). The threshold issue on remand is whether the Trustee has in fact proven the fifth element of § 547(b). Here, the Defendant denies that: (1) the transfer took place within the 90 day reachback period; (2) the debt is unsecured because the loan to the Debtors was secured by virtue of a collateral pledge; and (3) he received a disproportionate share. For reasons discussed *infra*, the Trustee cannot prove the same. Because the Trustee has failed to carry his burden of establishing that the Defendant received a disproportionate share, the court need not address the merits of § 547(b)(4). No matter how the date of transfer is decided, the Trustee has not made the requisite § 547(b)(5) showing.

The court must address two procedural matters raised by the Trustee: (1) the Notice to Admit; and (2) the applicability of § 547(b)(5). With respect to the Notice, the Trustee takes issue with the Defendant's failure to respond despite the fact that the request was untimely. The Notice requested admission of the following: (1) the Check was issued by the Adirondack Trust Company in the sum of $4,182.50, made payable to Michael Such, and was received and negotiated by the Defendant in the ordinary course of business; (2) on the date the Defendant received the Check, the Defendant carried on his books an outstanding balance due from the Debtors in excess of $4,182.50; and (3) on or about March 15, 2000, the Defendant delivered a 5.1 carat diamond ring into the possession of the Debtors. First, the Notice was untimely; therefore, the Defendant was under no obligation to respond to the same. Second, the Trustee's focus on the Notice is misleading because the above facts, with inconsequential modifications, are contained in the Stipulation. (Stip. ¶¶ 1, 2, and 3.) The Trustee's position would not have been advanced by the inclusion of the Notice in the record, even if deemed admitted pursuant to Fed. R. Civ. P. 36, which is made applicable to this proceeding by Fed. R. Bankr. P. 7036.

In support of the Trustee's contention that the fifth element can be divorced from § 547(b) in Chapter 7 cases, the Trustee cites the District Court Order: "This case is somewhat of an anomaly in that the underlying bankruptcy petition is actually a Chapter 7 proceeding." (District Court Order at 4, fn 1.) The Trustee's understanding, however, ignores the plain language of the statute and the plethora of case law, including case law cited by the district court, wherein courts routinely apply § 547(b)(5) to preference actions. It is abundantly clear that a § 547(b)(5) analysis requires construction of a hypothetical distribution of the estate, which certainly can be done in Chapter 7 cases. It is the Trustee's burden to craft this hypothetical distribution and present the same to the court as a central component of his evidence.[3]

Here, the Trustee relies upon the bare assertion that the Defendant received more by way of the alleged preferential transfer than he otherwise would have in a Chapter 7 liquidation: "By receipt of [the Check], Defendant received a sum larger than he otherwise would have if he had to share the same with other unsecured creditors." (Tr. Mem. at 2.) On remand, the Trustee cites the district court's conclusion that "there is sufficient evidence in the record that could support a finding that the pre-petition payment enabled [the Defendant] to receive a disproportionate share in a Chapter 7 distribution." (Tr. Mem. on Remand at 2.) The district court cited three specific factors in support of this conclusion: (1) the § 547(f) presumption of insolvency; (2) the stipulation as to the Debtors' insolvency two months prior to their bankruptcy filing; and (3) the asset to liability ratio reported on the Summary of Schedules. The district court stated, "Together, this could comprise sufficient evidence that, on the date of the Chapter 7 petition was filed, Debtors had

[3] Interestingly, the Trustee acknowledged this burden in the related adversary proceeding captioned *Goldberg v. Northeastern Fine Jewelry, Inc.* (Adv. Pro. No. 01-90179), wherein the Trustee sought to recover an alleged preferential transfer against Northeastern Fine Jewelry, Inc. pursuant to § 547(b). That proceeding also involved the same transaction and core facts underlying this proceeding, and the court issued a Memorandum, Decision and Order on August 19, 2002 ("Northeastern Decision") granting Northeastern's motion for summary judgment. There, the Trustee filed a supplemental affirmation in support of a motion for summary judgment which contained an analysis of the Debtors' assets, exemptions, and liabilities. (Northeastern Decision at 3.) The supplemental affirmation set forth the Trustee's argument that Northeastern recovered more than it would have if the transfer had not occurred when the Debtors filed their Chapter 7 Petition. (*Id.* at 3-4.) Yet, the Trustee provided no factual evidence to show that if he had sold the ring, he would have obtained more than the $25,847 Northeastern paid for it. (*Id.* at 7.) Therefore, he did not meet the requirements of § 547(b). (*Id.*)

insufficient assets to cover their liabilities." (District Court Order at 7-8.) The court does consider these factors, but it nonetheless finds that these factors, without more, do not satisfy § 547(b)(5). When a trustee offers no evidence of claims filed or assets recovered, the trier of fact is unable to determine whether this section has been. *In re Burdick*, 256 B.R. 837, 841 (Bankr. D. Mass. 2001) ("[T]he Summary of Schedules merely states hypothetical liabilities as of the Petition date, not actual creditors' claims.").

In this case, the Trustee fails to provide any evidentiary basis to support a ruling in his favor. He does not offer a hypothetical distribution to show what the Defendant would have received if he was an unsecured creditor compelled to accept the distribution due to him if the Trustee were to liquidate the Debtor's estate. It is the role of the Trustee to administer the case by examining the Debtor, marshaling assets, examining the propriety of claimed exemptions, determining the liquidation value of non-exempt assets, reviewing the schedules, list of creditors, and/or claims register, and verifying the Debtor's debt-asset ratio. All of these factors are within the knowledge of the Trustee and are relevant to a hypothetical distribution for purposes of a § 547(b) determination.

The record is clear that the Trustee has not established a *prima facie* case under § 547(b). Instead, the Trustee's proof is confined to the four corners of the Petition. The Trustee claims he "cannot be expected to produce proof of facts set forth in a Petition submitted by the [Debtors] beyond [their] verification of the document which is part of the court docket." (Tr. Mem. on Remand at 4.) The Trustee, therefore, asks this court to conduct an independent examination of the record in order to make its § 547(b)(5) determination, notwithstanding the court's prior finding that it is "unable to make a determination, from an independent review of the file, that this Defendant has received more than it should." (Decision at 4.)

The court may conduct an independent examination of the official record of the bankruptcy case and adversary proceeding. *See In re Carrozzella & Richardson*, 2003 Bankr. LEXIS 1539, at *2 (Bankr. D. Conn. 2003). Courts faced with § 547(b)(5) determinations have utilized Fed. R. Evid. 201, allowing them to take judicial notice of the bankruptcy case filed. *See, e.g., In re Lan Yik Foods Corp.*, 185 B.R. 103, 109 (Bankr. E.D.N.Y. 1995); *In re Candor Diamond Corp.*, 68 B.R. 588, 595 (Bankr. S.D.N.Y. 1986). These cases,

however, are distinguishable from the case at hand. Specifically, the trustees' positions were bolstered by the courts' review of the schedules and/or judicial notice of relevant information. The decisions were issued after trial, in consideration of the trial testimony, evidence, stipulations of fact, and the bankruptcy case files. This case is markedly different because the court did not conduct a trial and the Trustee's presentation of evidence was precluded due to his violation of the Amended Scheduling Order. Without testimony or additional evidence, the court is unable to confirm that the Debtors' scheduled assets and liabilities are accurate, not overstated or erroneous, or that the Trustee has completed his administration of the case for the benefit of the Debtors and their creditors. The Trustee asks the court to step into his shoes and make the initial § 547(b) showing in satisfaction of his burden by taking judicial notice of the Petition. The Trustee states, "the [D]efendant appears to imply that in the matter of compliance with the rules of evidence, the court must shed its equitable powers, put on blinders, thus ignoring any knowledge of commonly known information or deduction, or the reality of the facts, in *assigning the burden of proof responsibilities on the plaintiff [Trustee].*" (Tr. Response to Mem. on Remand at 2) (emphasis added.) This contention ignores § 547(g), which provides that "the trustee has the burden of proving the avoidability of a transfer . . . ." The Trustee has not done so in this case.

Conclusion

A conclusion that the $4,128.50 Check to the Defendant constitutes a voidable preference under § 547(b) would require the court to find that the Trustee proved the requirement of § 547(b)(5). The evidence does not support such a finding; therefore, the relief requested is denied.

It is SO ORDERED.

Dated:
Albany, New York

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Hon. Robert E. Littlefield, Jr.
United States Bankruptcy Judge