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U.S. BANKRUPTCY COURT

New Mexico

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**Case Name:** Gonzales v. Conagra Foods, Inc. et al

**Case Number:** [02-01095-s](#)

**Document Number:** [92](#)

**Docket Text:**

Memorandum Opinion in Support of Judgment after Trial (Attachments: # (1) Appendix Memo Exhibit A# (2) Appendix Memo Exhibit B# (3) Appendix Memo Exhibit C) (jeb)

The following document(s) are associated with this transaction:

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**Document description:**Appendix Memo Exhibit A

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**Document description:**Appendix Memo Exhibit B

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**Document description:**Appendix Memo Exhibit C

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UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF NEW MEXICO

In re:

FURRS,  
Debtor.

No. 7-01-10779 SA

YVETTE J. GONZALES,  
Plaintiff,

v.

Adv. No. 02-1095 S

CONAGRA FOODS, INC.,  
Defendant.

**MEMORANDUM OPINION IN SUPPORT  
OF JUDGMENT AFTER TRIAL**

This matter came before the Court for trial on the merits of Plaintiff/Trustee's complaint to recover preferential transfers. Trustee appeared through her counsel Jacobvitz, Thuma & Walker (David Thuma). Defendants appeared through their counsel Moses, Dunn, Farmer & Tuthill, P.C. (Victor Carlin) and McGrath, North, Mullin & Kratz, P.C. (Michael T. Eversden and James Neimeier). This is a core proceeding. 28 U.S.C. § 157(b) (2) (F)<sup>1</sup>.

[T]he preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor. Any creditor that received a greater payment than others of his class is required to disgorge so that all may share equally. The operation of the preference section to deter "the race of diligence" of creditors to dismember the debtor before bankruptcy furthers the second goal of the preference section--that of equality of distribution.

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<sup>1</sup>All statutory references are to the Bankruptcy Code as it existed before the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

INTERNATIONAL HOME FOODS

EXHIBIT C TO MEMO

PREFERENCE BALANCE

DATE	PAYMENTS	RECEIPTS	PAYMENT	RECEIPT	BALANCE	NO CREDIT
11/09/2000						
11/10/2000						
11/11/2000						
11/12/2000						
11/13/2000		35420.58		35420.58		35420.58
11/14/2000						
11/15/2000	106734.79		106734.79		106734.79	
11/16/2000						
11/17/2000						
11/18/2000						
11/19/2000						
11/20/2000						
11/21/2000						
11/22/2000						
11/23/2000						
11/24/2000						
11/25/2000						
11/26/2000						
11/27/2000						
11/28/2000						
11/29/2000						
11/30/2000						
12/01/2000		70310.70		70310.70	36424.09	
12/02/2000						
12/03/2000						
12/04/2000						
12/05/2000						
12/06/2000						
12/07/2000	93691.24		93691.24		130115.33	
12/08/2000						
12/09/2000						
12/10/2000						
12/11/2000						
12/12/2000						
12/13/2000						
12/14/2000						
12/15/2000						
12/16/2000						
12/17/2000						
12/18/2000						
12/19/2000		25486.33		25486.33	104629.00	
12/20/2000						
12/21/2000						
12/22/2000						
12/23/2000						
12/24/2000						
12/25/2000						
12/26/2000						
12/27/2000						

DATE	PAYMENTS	RECEIPTS	PAYMENT	RECEIPT	BALANCE	NO CREDIT
12/28/2000						
12/29/2000						
12/30/2000						
12/31/2000						
01/01/2001						
01/02/2001						
01/03/2001						
01/04/2001						
01/05/2001						
01/06/2001						
01/07/2001						
01/08/2001						
01/09/2001						
01/10/2001						
01/11/2001	42114.14		42114.14		146743.14	
01/12/2001						
01/13/2001						
01/14/2001						
01/15/2001						
01/16/2001						
01/17/2001						
01/18/2001						
01/19/2001						
01/20/2001						
01/21/2001						
01/22/2001						
01/23/2001						
01/24/2001						
01/25/2001						
01/26/2001						
01/27/2001						
01/28/2001						
01/29/2001						
01/30/2001						
01/31/2001						
02/01/2001						
02/02/2001						
02/03/2001						
02/04/2001						
02/05/2001						
02/06/2001						
02/07/2001						
02/08/2001						
TOTALS	242540.17	131217.61	242540.17	131217.61		35420.58

PREFERENCE

146743.14

CONAGRA GROCERY

EXHIBIT B TO MEMO

PREFERENCE BALANCE

DATE	PAYMENTS	RECEIPTS	PAYMENT	RECEIPT	BALANCE	NO CREDIT
11/09/2000						
11/10/2000		40519.45				40519.45
11/11/2000						
11/12/2000						
11/13/2000		69029.79				69029.79
11/14/2000		47116.23				47116.23
11/15/2000		80123.71				80123.71
11/16/2000		24693.92				24693.92
11/17/2000						
11/18/2000						
11/19/2000						
11/20/2000		88621.64				88621.64
11/21/2000		53601.78				53601.78
11/22/2000	6083.51		6083.51		6083.51	
11/23/2000		2712.42		2712.42	3371.09	
11/24/2000						
11/25/2000						
11/26/2000						
11/27/2000		21292.49		3371.09	0.00	17921.40
11/28/2000		31281.57				31281.57
11/29/2000						
11/30/2000						
12/01/2000						
12/02/2000						
12/03/2000						
12/04/2000	241779.54	38214.11	241779.54	38214.11	203565.43	
12/05/2000						
12/06/2000		39466.59		39466.59	164098.84	
12/07/2000						
12/08/2000						
12/09/2000						
12/10/2000						
12/11/2000						
12/12/2000	111086.85		111086.85		275185.69	
12/13/2000						
12/14/2000						
12/15/2000	76622.90		76622.90		351808.59	
12/16/2000						
12/17/2000						
12/18/2000						
12/19/2000						
12/20/2000						
12/21/2000						
12/22/2000	36583.41		36583.41		388392.00	
12/23/2000						
12/24/2000						
12/25/2000						
12/26/2000						
12/27/2000						
12/28/2000						

DATE	PAYMENTS	RECEIPTS	PAYMENT	RECEIPT	BALANCE	NO CREDIT
12/29/2000						
12/30/2000						
12/31/2000						
01/01/2001						
01/02/2001	37729.26		37729.26		426121.26	
01/03/2001						
01/04/2001						
01/05/2001						
01/06/2001						
01/07/2001						
01/08/2001						
01/09/2001						
01/10/2001		58396.25		58396.25	367725.01	
01/11/2001		32570.50		32570.50	335154.51	
01/12/2001						
01/13/2001						
01/14/2001						
01/15/2001		5325.12		5325.12	329829.39	
01/16/2001		38850.22		38850.22	290979.17	
01/17/2001						
01/18/2001						
01/19/2001						
01/20/2001						
01/21/2001						
01/22/2001						
01/23/2001						
01/24/2001						
01/25/2001	88100.36		88100.36		379079.53	
01/26/2001						
01/27/2001						
01/28/2001						
01/29/2001						
01/30/2001						
01/31/2001						
02/01/2001		38521.88		38521.88	340557.65	
02/02/2001		40080.43		40080.43	300477.22	
02/03/2001						
02/04/2001						
02/05/2001						
02/06/2001						
02/07/2001						
02/08/2001						
TOTALS	597985.83	750418.10	597985.83	297508.61		452909.49

PREFERENCE

300477.22

PREFERENCE BALANCE

DATE	PAYMENTS	RECEIPTS	PAYMENT	RECEIPT	BALANCE	NO CREDIT
11/09/2000						
11/10/2000						
11/11/2000						
11/12/2000						
11/13/2000	68465.79		68465.79		68465.79	
11/14/2000						
11/15/2000	8282.25		8282.25		76748.04	
11/16/2000						
11/17/2000		146481.42		76748.04	0.00	69733.38
11/18/2000						
11/19/2000						
11/20/2000						
11/21/2000		8262.75				8262.75
11/22/2000						
11/23/2000		64439.36				64439.36
11/24/2000						
11/25/2000		70182.48				70182.48
11/26/2000						
11/27/2000						
11/28/2000						
11/29/2000						
11/30/2000	53015.45		53015.45		53015.45	
12/01/2000						
12/02/2000						
12/03/2000						
12/04/2000						
12/05/2000						
12/06/2000						
12/07/2000	73630.53		73630.53		126645.98	
12/08/2000						
12/09/2000						
12/10/2000						
12/11/2000						
12/12/2000						
12/13/2000						
12/14/2000						
12/15/2000						
12/16/2000						
12/17/2000						
12/18/2000	69807.95		69807.95		196453.93	
12/19/2000						
12/20/2000						
12/21/2000						
12/22/2000						
12/23/2000						
12/24/2000						
12/25/2000						
12/26/2000						
12/27/2000						

DATE	PAYMENTS	RECEIPTS	PAYMENT	RECEIPT	BALANCE	NO CREDIT
12/28/2000						
12/29/2000						
12/30/2000						
12/31/2000						
01/01/2001						
01/02/2001						
01/03/2001						
01/04/2001						
01/05/2001						
01/06/2001						
01/07/2001						
01/08/2001						
01/09/2001	8251.10		8251.10		204705.03	
01/10/2001						
01/11/2001						
01/12/2001	3554.88		3554.88		208259.91	
01/13/2001						
01/14/2001						
01/15/2001						
01/16/2001						
01/17/2001						
01/18/2001						
01/19/2001	59899.97	12981.25	59899.97	12981.25	255178.63	
01/20/2001		93438.32		93438.32	161740.31	
01/21/2001		48393.12		48393.12	113347.19	
01/22/2001						
01/23/2001						
01/24/2001						
01/25/2001						
01/26/2001		9122.00		9122.00	104225.19	
01/27/2001						
01/28/2001						
01/29/2001						
01/30/2001						
01/31/2001						
02/01/2001						
02/02/2001						
02/03/2001						
02/04/2001						
02/05/2001						
02/06/2001						
02/07/2001						
02/08/2001						
TOTALS	344907.92	453300.70	344907.92	240682.73		212617.97

PREFERENCE

104225.19



Union Bank v. Wolas, 502 U.S. 151, 161 (1991). See also Johnson v. Barnhill (In re Antweil), 931 F.2d 689, 692 (10th Cir. 1991), aff'd 503 U.S. 393 (1992) ("The most important purpose of section 547(b) is to facilitate equal distribution of the debtor's assets among the creditors.").

The parties stipulated to the following facts (doc 78):

1. Furr's Supermarkets, Inc.<sup>2</sup> ("Furr's") filed a chapter 11 bankruptcy case on February 8, 2001 (the "Petition Date").
2. Between November 10, 2000 and the Petition Date (the "Preference Period"), ConAgra Foods, Inc. ("CF"), International Home Foods ("IHF") and ConAgra Grocery Products Company ("CG") (together, ConAgra Foods, IHF, and ConAgra Grocery are sometimes referred to herein as "ConAgra" or "Defendants") were creditors<sup>3</sup> of Furr's.
3. All payments Furr's made to ConAgra during the Preference Period were made while Furr's was insolvent.
4. All payments Furr's made to ConAgra during the Preference Period were made on account of an antecedent debt owed by Furr's before such payments were made.
5. All payments Furr's made to ConAgra during the Preference Period enabled ConAgra to receive more than ConAgra would

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<sup>2</sup> Furr's was a large retail grocery and supermarket chain based in Albuquerque, New Mexico with stores throughout New Mexico and western Texas.

<sup>3</sup> Specifically, Defendants were suppliers to Furr's.

have received if the case were a case under Chapter 7 of the Bankruptcy Code, the payments had not been made, and ConAgra received payment of its claims to the extent provided by the Bankruptcy Code.

6. Under the Trustee's current estimates, it appears very unlikely there will be sufficient funds to pay pre-petition non-priority unsecured claims. If the trustee's projections are accurate, none of the funds recovered in this case will be distributed to unsecured creditors.
7. The parties also stipulated to the admission of various exhibits and reserved objections to other exhibits, which objections were ruled upon at trial.

The Court finds the following additional facts after trial on the merits of the complaint:

8. On December 19, 2001, the Furr's chapter 11 bankruptcy case converted to a chapter 7 case. The Plaintiff was appointed trustee on that date and continues in that capacity.
9. The Court has jurisdiction over the subject matter herein and the parties to this action. Venue is proper in this Court.
10. After November 9, 2000 Furr's paid to CG, CF and IHF the amounts set forth on Memo Exhibits A, B and C attached hereto. Exhibit A shows total payments to CF of \$344,907.92. Exhibit B shows total payments to CG of

\$597,985.83. Exhibit C shows total payments to IHF of \$242,540.17. All figures on Memo Exhibits A, B and C come from a Joint Stipulation Regarding Payments and Shipments, filed by the parties post-trial. (Doc 90).

11. Memo Exhibits A, B and C also reflect the new value provided by CG, CF and IHF during the Preference Period, which new value reduces the claims against the Defendants from: CF, \$344,907.92 to \$104,225.19 (Memo Exhibit A); CG, \$597,985.83 to \$300,477.22 (Memo Exhibit B); and IHF, \$242,540.17 to \$146,743.14 (Memo Exhibit C).
12. From 1991 to mid-1999 Furr's had sufficient cash to meet its obligations on a timely basis. Tr<sup>4</sup> 596:4-5 and Tr 597:14-24.
13. Starting in 1992 or 1993 Furr's started to maximize its cash flow by holding checks for a few days, usually in the amount of \$2 million. Tr 598:16-599:11.
14. Furr's used an accounting software package called the "Lawson" system. Tr 26:9-19. All accounting data was input into Lawson from both the store locations and warehouse. Tr 26:23-31:4. Lawson was capable of generating a large number of different financial reports. Tr 31:12-36:1. Lawson would automatically generate a check when an invoice's payments terms were reached. Tr 36:20-37:1.

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<sup>4</sup> References to the Trial transcript are: Tr page#:line#.

15. Rachel Kefauver, a former employee of the Furr's accounting department, was employed by the Trustee to analyze financial data and prepare various reports. She compiled Exhibits 4, 5, 6, 7, 8, 9, 10, 11, 12 and 20. Tr 45:12-13. Most of the figures on these exhibits were taken directly from Lawson reports; some of the figures came from discovery provided by the Defendants. See, e.g., Tr 55:18-20, 57:19-20, 58:20-22, 73:12-15.
16. Starting in mid to late 1999, Furr's began experiencing cash flow problems that steadily worsened until the eventual bankruptcy filing. Tr 597:14-19. To deal with the worsening cash flow situation, Furr's held more and more checks; on the Petition Date it held approximately \$40 million in checks. Tr 599:20-600:4. Sandra Dunlap was in charge of storing the held checks. Tr 603:2-4. She testified to the procedures involved in holding, accounting for, voiding and reissuing the checks after a decision was made to send them to vendors. Tr 603:21-604:25.
17. Ken Fine, a former office employee of Furr's, testified as to his role in the check holding process. His memory was that Furr's started holding checks as a routine matter in December, 1998. Tr 565:17-18. At first there were only a few dozen held, which were kept in a small box. Tr 565:19-23. The number of held checks grew slowly through 1999,

2000 and 2001. Tr 566:5-8. By the fall of 1999 there were so many held checks that it became necessary to create a spreadsheet to maintain control over the number of checks held, their amounts and payees. Tr 566:9-21. By this time, the held checks were stored in a filing cabinet. Tr 567:2-3. After 1999 there were several thousands of checks held in several different full filing cabinets. Tr 567:9-17. These checks were all held because Furr's did not have the money to pay the vendors. Tr 567:18-21. The checks were held because Lawson printed them out automatically when they were due, regardless of whether Furr's had the cash to honor them. Tr 567:22-568:22. Mr. Fine described the operation and functions of his spreadsheet. Tr 569:7-579:14. In the spreadsheet system vendors were assigned a priority code from zero (indicating a must pay) to five (indicating a no-pay) from which management decided which vendors to pay. Tr 577:1-8.

18. When a held check was to be delivered to a vendor, the held check would be voided and reissued with a current date on it to prevent the vendors from knowing that Furr's was holding checks. Tr 585:1-8. Another reason to void the held check and reissue a new check with a current date was that some of the held checks became stale while sitting in the filing cabinets. Tr 585:7-11.

19. By mid 2000, Furr's cash flow problems caused inventory shortages in the stores. Tr 606:6-607:5.
20. Around mid 2000, Furr's formed an ad hoc committee composed of senior personnel from various departments that met at least weekly, but sometimes daily, to decide which vendors to pay. Tr 609:2-9 and 605:4-17. Sandra Dunlap advised this committee by forecasting how much cash would be available to pay on a given day. Tr 605:18-606:5. The decision of who to pay was based on the need for product. Tr 605:1-5.
21. By late 2000 most vendors had Furr's on credit hold. Tr 607:13-16.
22. The ad hoc committee prioritized payments to get Furr's off credit hold in order to get product shipped. Tr 607:17-19.
23. Daniel Nichols, a former Furr's senior grocery buyer, testified that when he started at Furr's in July 1998 there was no problem getting orders filled. Tr 294:13-295:16. In July, 2000, Furr's started having problems filling orders, Tr 296:19-297:2, when vendors started placing Furr's on credit hold. Tr 297:9-11. Before July, 2000, Furr's had a service level<sup>5</sup> of 96-97%. Tr 297:12-17. After July, 2000,

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<sup>5</sup> "Service level" is the percentage of goods demanded by the stores that are actually in the warehouse available for shipping. A service level of 80% would mean that 80% of goods demanded by the stores were in the warehouse and available to ship.

the service level started falling at a rate of about 10% per month until the bankruptcy filing, when it was at 12%. Tr 298:1-8. See also Tr 411:17-23 (Fickling testimony regarding service levels.) The reason for the sharp decline in service level was credit holds from vendors. Tr 298:14-17.

Mr. Nichols specifically remembered which products Furr's purchased from Defendants, and recalled credit hold problems with them. Tr 299:11-20. "I just remember that orders were held back because we had past due invoices that needed to be paid. Until past due invoices were unpaid [sic], we didn't receive our orders." Tr 299:23-300:1. He routinely spoke to Chris Gunderson at ConAgra, who told him that ConAgra needed payments before she would allow shipment of the order. Tr 300:8-12.

After the credit hold problems started, Furr's started ordering in a different way; the buyers knew that once an order would be released from credit hold the entire order would go into the pipeline to fill the stores, leaving nothing at the warehouse. Tr 301:17-22. Therefore, buyers just kept "ordering and ordering, back-to-back orders, until it got filled." Tr 301:22-24. ConAgra allowed Furr's to continuously place orders. Tr 302:2-3.

Previously, in normal times, it would take 7 days to get an order from ConAgra Frozen and 10 days to get an order from ConAgra Grocery. Tr 302:20-303:02. Before July, 2000, Furr's would order from ConAgra Frozen approximately once every week to 10 days, and from ConAgra Grocery once every week or two, Tr 306:2-13, and there was no delay in filling the orders. Tr 206:19-21.

On cross-examination, when asked if it was business as usual between Furr's and ConAgra between January 2000 and January 2001, Mr. Nichols answered "Business as usual? Not getting our orders wasn't usual. We continued to do business with ConAgra, if that's what you mean." Tr 319:18-23. It was only the credit hold situation that caused a material delay in getting ConAgra products. Tr 321:5-11. Nichols knew that Furr's was on credit hold several times with ConAgra, but did not remember exact dates or dollar amounts delinquent. Tr 322:8-17.

24. Jerry Fickling was the Furr's employee that ran the diverting<sup>6</sup> department. Until mid-1999 Furr's was predominantly a seller in the diverter market. Tr 408:12-

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<sup>6</sup> "Diverting" is purchasing or selling goods through channels other than normal vendors; for example, one might buy a Hunt and Wesson product from a vendor other than Hunt and Wesson. The sellers in the diverter market are usually grocery chains or wholesalers that buy a large amount of product at, usually, a promotional price and then resell the product for a mark-up to other grocery stores.



17. Then, slowly, Furr's started buying more products from the diverter market than it was selling. Tr 409:6-9.
25. Mr. Fickling was on the ad hoc committee. Tr 411:24-412:6. The committee chose which vendors to pay based on service levels of their products, "to fill the holes in the stores." Tr 412:7-9.
26. Mr. Fickling recalls that ConAgra had Furr's on credit hold off and on. Tr 419:7-11.
27. Colleen Johnson was Furr's warehouse accounts payable supervisor. She started at Furr's full time in February, 1999. Tr 625:13-22. At that time, Furr's was paying its vendors on time. Id. In June, 1999, Furr's starting holding all checks for warehouse accounts vendors, and checks would only be released when a vendor called to complain. Tr 626:3-15. Starting at about this time the majority of checks were being sent by Federal Express to get product released from credit hold quicker. Tr 627:3-11. The only time a check would be sent before its due date was when Furr's had to make a payment in order to get a credit hold released. Tr 629:19-630:1.
28. Jose Troncoso was a vendor account representative for Furr's from early 2000. Previously he had been a data entry clerk at Furr's. As part of his job he dealt with all warehouse vendors. Tr 643:25-644:1. In early 2000 he dealt with

about 30 vendors per week regarding late payments. Tr 645:11-23. By late 2000 and early 2001 he was receiving about 100 calls per day regarding late payments. Tr 645:3-9. He recalled speaking to several ConAgra representatives, but was not clear about the dates of the conversations. He did recall, however, that ConAgra had put Furr's on credit hold. Tr 648:2-8. Part of his job was sending checks to vendors by Federal Express. Tr 651:10-18. He estimated that 50% or more of the checks to warehouse vendors were being sent by Federal Express in the fall of 2000. Tr 653:10-14. Checks were sent by Federal Express to get them to the vendors sooner, so product would be released and shipped sooner. Tr 657:4-11.

When asked about credit holds by Conagra from November 2000 to January 2001 he responded "International Home Foods had us on hold. ConAgra Beef had us on hold, ConAgra Frozen had us on hold. ConAgra Grocery had us on hold." Tr 655:14-21. He also testified that if one ConAgra company had a credit hold, Furr's would have to pay down other ConAgra companies before another one would ship. Tr 656:7-17.

On cross-examination Mr. Troncoso stated that he spoke to someone at ConAgra daily during the year before the bankruptcy. Tr 658:18-21. He admitted that the ConAgra

collection practices before the preference period were not substantially different from those of the preference period, except "the whole Federal Express thing." Tr 659:5-661:19. It was not unusual to talk to ConAgra about payments before the preference period, but as the preference period moved on payment became more of an issue. Tr 662:13-18. The number of calls increased in November and December "a whole lot." Tr 672:11-19.

29. The Court took under advisement the admission into evidence of exhibits 21 through 24, the Federal Express bills. Upon reviewing the testimony from the entire trial, the Court finds that they should be admitted.
30. Walter Doyle testified as an expert for Plaintiff. Tr 187-237. Mr. Doyle had over 30 years of grocery store experience, including over 9 years with Furr's. At Furr's his last position was President, which he left in June, 1999. He had a great deal of experience dealing with vendors over prices and terms. He did not have a great deal of experience negotiating credit limits, because they were rarely an issue in his experience. (Only twice did vendors impose credit limits, but upon request they raised them to adequate levels.) Mr. Doyle was offered as an expert witness on ordinary business terms between financially healthy grocery retailers and their vendors. Defendants

objected (both at trial and in a motion in limine), which the Court overruled by separate Order (doc 87).

Mr. Doyle testified that if a credit limit was too low to adequately stock shelves fully, that would not be an ordinary business term between the vendor and a financially healthy retailer. Tr 215:24-216:7. He also testified that if a vendor repeatedly held orders and did not fill them or ship them, that would not be an ordinary business term between the vendor and a financially healthy retailer. Tr 217:3-217:11. Even if holds were premised on late payments by a healthy retailer, it would not be ordinary. Tr 217:12-17. It is not ordinary course of business for a retailer to pay by Federal Express. Tr 217:18-217:25. Financially healthy retailers pay by check sent through the mail. Tr 218:1-3. If a retailer takes a cash discount for paying early to which it is not entitled, it is not ordinary for the vendor to demand repayment. Tr 218:4-11. It is also not ordinary to place numerous phone calls or send e-mails demanding payment. Tr 218:19-219:1. Healthy retailers do not issue checks, hold them, and reissue them. Tr 219:8-12 and 236:2-7. Financially healthy retailers do not buy large amounts of product from the diverter market. Tr 219:13-220:8. If a vendor's invoice is due in 11 days, it becomes non-ordinary course of business if paid "three or four" days

late. Tr 221:8-11. It is absolutely not ordinary for a healthy retailer's senior management to meet together to decide which vendors to pay. Tr 221:17-21.

Mr. Doyle's expert report appears at Exhibit 3.

Overall, the Court found Mr. Doyle to be entirely credible and thoroughly knowledgeable in his field of expertise.

31. Steven Dove testified as an expert for Defendants. Tr 434-492. He is a senior vice president of a financial reporting and consulting business specializing in the food and drug trade. He has worked in all aspects of the industry for 31 years. The Court qualified him as an expert on normal credit relationships between vendors and retailers in the grocery industry. Tr 443:3-12. Mr. Dove testified that the payments in question in this adversary proceeding were made according to ordinary business terms in the industry. Tr 445:9-15. He qualified this statement by stating that, from the exhibits he reviewed, there did not appear to be a change (over the time period of the exhibits); there was always a contemporaneous exchange of product and payment<sup>7</sup>. Tr 445:23-446:3. He further testified that terms such as 2% 10 net 30 and 2% net 11 were common terms, Tr 447:4-17, but

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<sup>7</sup> Defendants did not assert the contemporaneous exchange for value defense. See 11 U.S.C. § 547(c)(1). And, Facts 40-42 below show that in fact there were no contemporaneous exchanges during the preference period. All relevant checks were late and for invoices ranging up to 286 days old.

that they were not always enforced by vendors. It is common for retailers, even healthy ones, to make late payments<sup>8</sup>. Tr 447:25-448:5. Disputes on delivery, quantity or pricing often cause late payment<sup>9</sup>. Tr 448:13-449:13. It is not unusual for a vendor to call about past due invoices. Tr 460:4-6, or to hold orders over a credit limit. Tr 461:13-15. And, none of these situations necessarily indicates a credit problem. Tr 462:14-19.

It is normal for vendors to pay by check. Tr 463:1-3. It is unusual to send checks by Federal Express. Tr 463:7-17. On cross-examination, Mr. Dove saw no evidence that the Defendants were holding orders<sup>10</sup>. Tr 464:12-16. Mr. Dove admitted that Furr's service levels overall would indicate that Furr's was on credit hold with vendors, not necessarily with the Defendants, however. Tr 466:16-468:4.

If Defendants had put Furr's on periodic credit holds such that Furr's stock of Defendants' products were significantly down, and if the credit holds were for past

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<sup>8</sup> He did not quantify this statement, however. It would have been useful to know the percentage of healthy customers that paid late, how often, by how much, and the original terms for which the payment was late.

<sup>9</sup> There was no evidence at trial that Furr's ever had these kinds of disputes with Defendants.

<sup>10</sup> This is not credible. See Memo Exhibits A, B and C (long periods with no shipments) and Exhibit S page 6 and Exhibit T pages 20 and 21 (invoices for orders held over one month).

due invoices, Mr. Dove believed that payments made under these conditions would not be made on ordinary business terms. Tr 469:17-470:25.

Mr. Dove believed that financially health retailers have high enough credit limits so that they can stock their shelves and not be placed on credit hold for exceeding credit limits. Tr 471:6-11. Mr. Dove reviewed Exhibits 11a, 11b, 11c, and 11d and concluded that Furr's was bumping up on its credit limit in the last days before bankruptcy<sup>11</sup>. Tr 475:3-6.

Mr. Dove opined that it is absolutely not ordinary business terms for a financially healthy retailer to hold checks, or to void them or reissue them. Tr 480:20-25.

It is also not ordinary for retailers to have management meetings over an extended period of time to determine which vendors to pay, due to lack of funds. Tr 481:15-18.

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<sup>11</sup> The Court partially agrees with this observation. Furr's was significantly over its credit limits with ConAgra Frozen in late November, 2000 (about \$105,000) and with ConAgra Grocery in early December, 2000 (about \$108,000). In both instances these companies made no more shipments to Furr's until their accounts receivable balances were completely paid off. International Home Foods credit limit was \$300,000 and Furr's remained significantly under that limit throughout the preference period.

Mr. Dove testified that grocery retailers do the most ordering in the 4<sup>th</sup> calendar quarter, before the holidays. Tr 484:18-25.

Mr. Dove's expert report appears as Exhibit V. Overall, the Court found Mr. Dove to be marginally credible in his analysis of the data in this case, but thoroughly knowledgeable overall in his field of expertise.

32. James Salvadori, Vice President of Credit Services for ConAgra testified for Defendants. Part of his job is establishing credit lines and limits on a global basis for shared customers between two or more operating companies. Tr 112:3 & 112:20-25. Furr's overall credit limit with ConAgra was \$4.8 million. Tr 118:6-24. Steve Mortenson from Furr's decided how to allocate the \$4.8 million among the different companies. Tr 118:25-119:20. Furr's never indicated to Mr. Salvadori, or a trade group of which he was a member, that Furr's was in any kind of financial difficulty. Tr 121:8-129:12. It was not until a few days before the bankruptcy petition that ConAgra found out about Furr's dire financial straights. Tr 132:20-133:9. ConAgra also did not know that Furr's was holding, voiding and reissuing checks, Tr 134:1-4, or having meetings of senior management to decide who to pay, Tr 134:13-16.



Mr. Salvadori testified that, to his knowledge, no one at ConAgra threatened to cut off Furr's supply during the preference period. Tr 134:17-20 and Tr 156:4-6. The Court does not find this credible. Every Furr's employee that testified in this case, the depositions submitted, and the documents discussed below all indicate that ConAgra threatened to and did in fact put Furr's on credit hold, probably several times.

33. Pamela Russavage testified for Defendants. She is employed by ConAgra Retail Foods, but formerly worked at IHF from August 1997 to December 2000 as Director of Customer Financial Services. Tr 246:7-16. Although IHF was being acquired by ConAgra in the summer of 2000, IHF generally operated independently during the preference period. Tr 249:3-20. IHF did not modify Furr's credit limit in 2000 nor did anyone request that it be raised during 2000. Tr 251:21-25. IHF's terms with customers was 2%10 net 30, Tr 252:14-15, which are the terms IHF had with Furr's for the year before bankruptcy, Tr 253:15-24. Ms. Russavage testified that Exhibit 14 contained a portion of IHF's collection note file on Furr's, and that it indicated that on January 12, 2001, IHF was holding 3 orders and that there was a credit hold for Furr's.

Exhibit 4 compared days to ship and days to pay for Furr's for the preference period and the period March, 2000 to the preference period; Ms. Russavage saw no significant difference between them<sup>12</sup>. Tr 265:2-266:2.

Ms. Russavage was unaware of any ConAgra-wide hold during the preference period. Tr 271:16-19. The Court finds this difficult to believe, but possible. IHF was a new subsidiary company and its employees could be unaware of a company-wide policy. However, as noted in Fact 32, the Court finds that there was, in fact, such a hold.

Customers paid IHF by Federal Express delivery less than 5% of the time. Tr 280:11-17.

Ms. Russavage testified that the last shipment to Furr's was in December, 2000. Tr 281:14-17. Although there were orders placed after that time she did not know why there were no corresponding shipments of products.<sup>13</sup> Tr 281:18-282:2. She also could not explain why the amount IHF shipped to Furr's during the preference period was 84% less

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<sup>12</sup> The Court is not convinced how useful this observation is. The uncontradicted testimony is that Furr's started having financial problems and cash flow problems in 1999. Exhibit 4 does not attempt to compare the preference period to a healthy period.

<sup>13</sup> IHF's credit line with Furr's was \$300,000. The account receivable balance from Furr's was only \$131,455 for most of December, 2000 and \$156,944 from December 21, 2000 to January 11, 2001. Furr's had ample credit available to fill IHF orders.

than the amount shipped on average during the first 9 months of 2000. Tr 289:1-6.

34. Marcus Oviatt, current Director of Business Process Improvement for ConAgra, testified for Defendants. Tr 324-404. During the relevant times he was Director of Account Risk Management. Tr 326:8-10. His department served as the credit department for both CF & CG. Tr 327:9-15. IHF had its own credit department, headed by Ms. Russavage, until it transitioned into his department in April, 2001. Tr 328:11-19. The credit limits were \$150,000 for CF, \$150,000 for CG, and \$300,000 for IHF. Tr 333:1-4.

Mr. Oviatt did not recall Furr's being placed on a ConAgra wide credit hold during the preference period; he recalled e-mails that indicated ConAgra was planning on putting Furr's on credit hold, however. Tr 339:20-340:4. He did not recall Furr's paying CG or CF late or going over its credit limit<sup>14</sup>. Tr 340:13-15.

Mr. Oviatt testified about Exhibits W and X, which show that Furr's payment practices and ConAgra's shipping practices during the preference period were substantially

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<sup>14</sup> This is certainly not supported by the documents in evidence that Furr's continuously paid late and was over CF and CG credit limits by over \$100,000. See Exhibits 11b, 11c.

similar to the few months before the preference period.<sup>15</sup>

Tr 343:3-346:9.

No one ever communicated to Mr. Oviatt that Furr's had cash flow problems, couldn't stock its shelves, had financial difficulties, was voiding and reissuing checks, needed a higher credit limit, that the credit limit was too low, or that there were meetings of senior management to decide who to pay. Tr 354:122-355:10.

Mr. Oviatt described the relationship between Furr's and both CF and CG as "normal" during the preference period. Tr 355:14-18.

Mr. Oviatt did not know why there was a 5 week gap in the middle of the preference period when nothing was shipped to Furr's. See Exhibit W. Tr 363:3-6. He admitted that this was unusual. Tr 363:10-12. He also stated that he did not know why certain orders were held during the preference period. Tr 363:16-364:14. See also Exhibit S, page 6, invoice 13802286, ordered December 5, 2000, shipped January 15, 2001; Exhibit T, page 20, invoice 13281955, ordered

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<sup>15</sup> The Court is not convinced how useful these figures or exhibits are. The uncontradicted testimony is that Furr's started having financial problems and cash flow problems in 1999. Exhibits W and X do not compare Furr's to a time when it was healthy. Later, Mr. Oviatt testified that the exhibits could have contained information from prior periods, but just did not. Tr 373:12-18. The Court assumes that if this information had been provided, it would not have been supportive of Defendants.

December 6, 2000, shipped January 19, 2001; Exhibit T, page 21, invoice 13282744, ordered December 5, 2000, shipped January 20, 2001. He testified that if other orders were held and never shipped, no invoices would have been created, so none would have appeared on Defendants' exhibits. Tr 365:2-8. Therefore, no one really knows the extent of orders held and never delivered.

On cross-examination, Mr. Oviatt again testified that he was not personally aware that either CF or CG had put Furr's on credit hold. Tr 373:19-25. He admitted, however, that a credit hold may have been placed and he did not know about it. Tr 374:19-21.

Mr. Oviatt also testified that there was generally a 10 day grace period before a collector would call on a past due invoice. Tr 379:22-24. Exhibit 14, the collection log, shows that someone called Furr's 3 days after one invoice was due in early December, and that there were several calls in November on 2 invoices on their due dates. Tr 379:25-381:21.

35. Dee Dee Sikora, a ConAgra employee, worked as a Key Account Manager in 2000 and 2001. Tr 496:16-23. She was responsible for selling products to specific accounts, preparing promotions, maintaining day-to-day orders, and trying to increase sales of grocery products. Tr 497:2-5.

Defendants' Exhibit K contains promotional contracts she entered on behalf of ConAgra with Furr's. Exhibit E is a summary of Exhibit K. Tr 510:4-6. The Court does not find there materials particularly relevant.

Ms. Sikora testified that her business with Furr's was up 120-130% calendar year over year for 2000 compared to 1999. Tr 519:18-520:9 and Tr 529:19-530:1. The Court does not find this indicative of the overall Furr's-ConAgra relationship; rather, her portion of the business was up. See also Tr 534:2-7 (Her business was CG only, not CF or IHF). Because her business was so good, she was surprised when Furr's filed bankruptcy, and had not seen it coming during the fall of 2000. Tr 532:1-10.

On cross-examination, Ms. Sikora testified about Exhibit 12, which showed that in fact sales for November, 2000 to January, 2001 were down 20.76% for CG. Tr 535:14-536:12.

The following direct quotation from the record discusses the issue of held orders:

Q: Well, you knew they were holding shipments, didn't you?

A: I knew they were - exceeded term credit terms, which would impact that.

Q: The result of exceeding the credit term was that the shipment was held?

A: Yes.

...

Q: But isn't it true that you also got calls from Ms. Dice to tell you that orders were being held?

A: On occasion.  
Q: And this was in Fall of 2000?  
A: Yes.  
Q: Isn't it also true that you had conversations with Furr's employees regarding invoices that needed to be paid to get orders released?  
A: Specifically? Ask me more specifically, please.  
Q: Well, did you ever talk to Furr's employees about the fact that invoices needed to get paid before orders could be released?  
A: When Furr's or - or customer service would tell me that they had exceeded their credit terms, I would relay the message.  
Q: So just give the Court an idea of a typical occurrence of this transaction, someone would call you and tell you that there was an order being held?  
A: Furr's buyer, for example, would say, "I can't pick up my truck because we're past our credit terms, what needs to be done for us to pick it up," so I would call Ms. Dice and she would say, you know, such and such invoice needs to be paid, and so then I would call back the buyer or the category advisor who called me.  
Q: When did this type of event start to occur?  
A: Summer.  
Q: July or August?  
A: Maybe spring. I don't know exact time lengths obviously, I know it was before August.  
Q: Do you recall in your deposition, your testimony was July or August of 2000?  
A: That's probably about right. It could have been a little sooner, but that's probably about right.  
Q: Before it started you hadn't had to have those kinds of conversations with either of the credit department or Furr's, had you?  
A: No.

Tr 545:5-547:3.

36. On or about November 25, 2000, Furr's was approximately \$105,000 over its credit limit with CF. Exhibit 11b. From that date to January 19, 2001, CF made no new shipments to Furr's. Memo Exhibit A. Coincidentally, the amount owed to CF by Furr's was zero when shipments resumed. Exhibit 11b.

Many of the deliveries immediately after January 19, 2001, were based on orders that had been placed on December 5, 2000. The Court finds that CF initiated a credit hold on or about November 25, 2000 and refused to ship any new orders until its entire bill was paid, which occurred in mid-January, 2001. See also Tr 310:8-23. All the suspect payments to CF were made during this time period of credit hold. This credit hold impaired Furr's ability to buy product during its peak buying season.

37. On or about December 6, 2000, Furr's was approximately \$108,000 over its credit limit with CG. Exhibit 11c. From that date to January 10, 2001, CG made no new shipments to Furr's. Memo Exhibit B. Coincidentally, the amount owed to CG by Furr's was zero when shipments resumed. Exhibit 11c. The Court finds that CG initiated a credit hold on or about December 6, 2000 and refused to ship any new orders until its entire bill was paid, which occurred in mid-January, 2001. All the suspect payments to CG were made during this time period of credit hold. This credit hold impaired Furr's ability to buy product during its peak buying season.
38. International Home Foods stopped shipping altogether on or about December 19, 2000. Memo Exhibit C. The Court finds that IHF placed Furr's on credit hold on or about December 19, 2000. Because Furr's made only one relatively small



payment after that time, IHF never removed the credit hold. This credit hold impaired Furr's ability to buy product during its peak buying season.

39. Shipments by all Defendants fell significantly in the fourth quarter, traditionally a grocer's busiest time. Ex. 12.

40. Memo Exhibit A documents transactions between Furr's and Conagra Frozen during the preference period. After deducting for all new value, the potential preference balance is \$104,225.19. Although there were 8 checks issued to CF during the preference period, only the last 4 are at issue because the first 4, and part of the 5<sup>th</sup>, were "absorbed" by the new value provided. Therefore, the only checks at issue are:

Check #	Amount	Amount at issue
25134067	\$69,807.95	\$32,519.24
25136683	\$8,251.10	\$8,251.10
25137233	\$3,554.88	\$3,554.88
25138776	\$59,899.97	<u>\$59,899.97</u>
	Total	<u><u>\$104,225.19</u></u>

Check 25134067 was issued on December 13, 2000 to replace an earlier check issued on December 7, 2000 and held. See Exhibit 20. This check paid one invoice that was 12 days late and one invoice that was 229 days late. See Exhibit 5. It was sent by Federal Express to CF. See

Exhibit 22, # 0512. The Court finds that this check was not a payment in the ordinary course of business.

Check 25136683 was issued on January 4, 2001. This check paid invoices that were 48 days late. See Exhibit X. It was sent by Federal Express to CF. See Exhibit 22, # 0612. The Court finds that this check was not a payment in the ordinary course of business.

Check 25137233 was issued on January 9, 2001. Defendants provided no invoice detail on which invoices were paid by this check<sup>16</sup>. It was sent by Federal Express to CF. See Exhibit 22, # 0668. The Court finds that this check was not a payment in the ordinary course of business.

Check 25138776 was issued on January 17, 2001. This check paid invoices that were 46 days late. See Exhibit 5. It was sent by Federal Express to CF. See Exhibit 22, # 0710. The Court finds that this check was not a payment in the ordinary course of business.

41. Memo Exhibit B documents transactions between Furr's and Conagra Grocery during the preference period. After deducting for all new value, the potential preference balance is \$300,477.22. Although there were 8 checks issued

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<sup>16</sup> It was CF's burden to do so. See 11 U.S.C. § 547(g). See also P.R. Mallory & Co., Inc. V. Nat'l Labor Relations Board, 400 F.2d 956, 959 (7<sup>th</sup> Cir. 1968) (A failure to produce evidence which under the circumstances would be expected gives rise to a presumption against the party failing to produce it.)

to CG during the preference period, only the last 6 are at issue because the first 2, and part of the 3rd, were "absorbed" by the new value provided. Therefore, the only checks at issue are:

Check #	Amount	Amount at issue
25132797	\$111,086.85	\$61,441.29
25133319	\$76,622.90	\$76,622.90
25134826	\$36,583.41	\$36,583.41
25135636	\$37,729.26	\$37,729.26
25139382	\$86,504.49	\$86,504.49
25139639	\$1,595.87	<u>\$1,595.87</u>
	Total	<u>\$300,477.22</u>

Check 25132797 was issued on December 6, 2000 to replace an earlier check issued on December 1, 2000 and held. See Exhibit 20. This check paid invoices that were 12 days late. See Exhibit 6. It was sent by Federal Express to CG. See Exhibit 21, # 0481. The Court finds that this check was not a payment in the ordinary course of business.

Check 25133319 was issued on December 11, 2000 to replace an earlier check issued on December 4, 2000 and held. See Exhibit 20. This check paid invoices that were 6 to 13 days late. See Exhibit 6. It was sent by Federal Express to CG. See Exhibit 22, # 0496. The Court finds

that this check was not a payment in the ordinary course of business.

Check 25134826 was issued on December 19, 2000 to replace an earlier check issued on December 15, 2000 and held. See Exhibit 20. This check paid invoices that were 7 days late. See Exhibit 6. It was sent by Federal Express to CF. See Exhibit 22, # 0542. The Court finds that this check was not a payment in the ordinary course of business.

Check 25135636 was issued on December 26, 2000 to replace an earlier check issued on December 18, 2000 and held. See Exhibit 20. This check paid invoices that were 16 days late. See Exhibit 6. It was sent by Federal Express to CG. See Exhibit 21, # 0578. The Court finds that this check was not a payment in the ordinary course of business.

Check 25139382 was issued on January 22, 2001. This check paid invoices that were 4-5 days late. See Exhibit 6. It was sent by Federal Express to CG. See Exhibit 22, # 0731. The Court finds that this check was not a payment in the ordinary course of business.

Check 25139639 was issued on January 24, 2001. This check paid invoices that were 46 days late. See Exhibit 6. It was sent by Federal Express to CG. See Exhibit 22, #

0739. The Court finds that this check was not a payment in the ordinary course of business.

42. Memo Exhibit C documents transactions between Furr's and International Home Foods during the preference period. After deducting for all new value, the potential preference balance is \$146,743.14. There were 4 checks issued to IHF during the preference period, only part of the first one was "absorbed" by the new value provided. Therefore, the checks at issue are:

Check #	Amount	Amount at issue
25127748	\$106,734.79	\$10,934.76
25130771	\$25,079.20	\$25,079.20
25131378	\$68,612.04	\$68,612.04
25135645	\$42,117.14	<u>\$42,117.14</u>
	Total	<u>\$146,743.14</u>

Check 25127748 was issued on November 6, 2000 to replace an earlier check issued on October 17, 2000 and held. See Exhibit 20. This check paid invoices that were 32 to 59 days late. See Exhibit 7. It was sent by Federal Express to IHF. See Exhibit 23, # 0245. The Court finds that this check was not a payment in the ordinary course of business.

Check 25130771 was issued on November 27, 2000. This check paid invoices that were 7 to 13 days late. See Exhibit 7. It was sent by Federal Express to IHF. See

Exhibit 23, # 0396. The Court finds that this check was not a payment in the ordinary course of business.

Check 25131378 was issued on November 28, 2000 to replace an earlier check issued on November 2, 2000 and held. See Exhibit 20. This check paid invoices that were 37 days late. See Exhibit 7. It was sent by Federal Express to IHF. See Exhibit 23, # 0415. The Court finds that this check was not a payment in the ordinary course of business.

Check 25135645 was issued on December 26, 2000. This check paid invoices that were 20 to 286 days late, many over 200 days late. See Exhibit 7. It was sent by Federal Express to IHF. See Exhibit 23, # 0589. The Court finds that this check was not a payment in the ordinary course of business.

43. This adversary proceeding was filed on Monday, May 20, 2002. The calendar week preceding the filing ended on May 17, 2002. The weekly average 1-year constant maturity Treasury yield, as published by the Board of Governors of the Federal Reserve System, for the calendar week preceding the filing was 2.40%<sup>17</sup>. See 28 U.S.C. § 1961(a) (Describing how to calculate interest.)

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<sup>17</sup>See <http://www.federalreserve.gov/releases/h15/20020520> (Last visited October 13, 2006).

## DISCUSSION

The stipulated facts (Facts 1-6) establish Plaintiff's prima facie case under 11 U.S.C. § 547(b)<sup>18</sup>. Once the trustee establishes the elements of Section 547(b), the transferee has the burden of establishing any affirmative defenses under Section 547(c)<sup>19</sup> to avoidance of the transfer. 11 U.S.C. § 547(g)<sup>20</sup>;

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<sup>18</sup> Section 547(b) provides, in part:  
Except as provided in subsections (c) and (I) of this section, the trustee may avoid any transfer of an interest of the debtor in property--  
(1) to or for the benefit of a creditor;  
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;  
(3) made while the debtor was insolvent;  
(4) made--  
(A) 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--  
(A) the case were a case under chapter 7 of this title;  
(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.

<sup>19</sup>11 U.S.C. § 547(c) provides in relevant part:  
The trustee may not avoid under this section a transfer--  
...  
(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[.]

<sup>20</sup>11 U.S.C. § 547(g) provides:  
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  
(continued...)

Clark v. Balcor Real Estate Finance, Inc. (In re Meredith Hoffman Partners), 12 F.3d 1549, 1553 (10<sup>th</sup> Cir. 1993), cert. denied, 512 U.S. 1206 (1994); Payne v. Clarendon Nat'l Ins. Co. (In re Sunset Sales), 220 B.R. 1005, 1018 (10<sup>th</sup> Cir. B.A.P. 1998). The creditor asserting the ordinary course of business defense (Section 547(c)(2)) has the burden of proving the defense by a preponderance of the evidence. Jobin v. McKay (In re M&L Business Machine Co., Inc.), 84 F.3d 1330, 1339 (10<sup>th</sup> Cir. 1996) (citing In re Meredith Hoffman Partners, 12 F.3d at 1553).

The purpose of [the ordinary course of business defense] is to leave undisturbed normal financial relations, because doing so does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy. See 11 U.S.C.A. § 547. "This section is intended to protect recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor's transferee." 4 Collier on Bankruptcy, ¶ 547.10 (15th ed. 1991).

Sender v. Nancy Elizabeth R. Heggland Family Trust, 48 F.3d 470, 475 (10th Cir. 1995).

On the one hand the preference rule aims to ensure that creditors are treated equitably, both by deterring the failing debtor from treating preferentially its most obstreperous or demanding creditors in an effort to stave off a hard ride into bankruptcy, and by discouraging the creditors from racing to dismember the debtor. On the other hand, the ordinary course exception to the preference rule is formulated to induce creditors to continue dealing with a distressed

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<sup>20</sup> (...continued)  
nonavoidability of a transfer under subsection ©) of this section.



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

Fiber Lite Corp. v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.), 18 F.3d 217, 219 (3rd Cir. 1994). To be protected, a transfer must be ordinary both from the transferee's perspective and the debtor's perspective. In re Milwaukee Cheese Wisconsin, Inc., 112 F.3d 845, 848 (7th Cir. 1997) (citing Marathon Oil Co. v. Flatau (In re Craig Oil Co.), 785 F.2d 1563 (11th Cir. 1986)) (Even if transactions are ordinary from the transferees' perspective, they still must be ordinary from the debtor's perspective.); In re Tolona Pizza Products Corp., 3 F.3d 1029, 1032 (7th Cir. 1993) ("One condition is that payment be in the ordinary course of both the debtor's and the creditor's business.") See also H.R.Rep. No. 595, 95th Cong., 1st Sess 373 (1977), reprinted in 1978 U.S.C.C.A.N. 5787, 5874, 6329 (legislative history suggests that purpose of this section is to avoid unusual actions by either the debtor or its creditors).

Section 547(c)(2) encourages normal credit transactions and the continuation of short-term credit dealings with troubled debtors to stall rather than hasten bankruptcy. Logan v. Basic Distribution Corp. (In re Fred Hawes Organization, Inc.), 957 F.2d 239, 243 (6th Cir. 1992); Harrah's Tunica Corp. v. Meeks (In re Armstrong), 291 F.3d 517, 527 (8<sup>th</sup> Cir. 2002).

Failure to meet any of the three requirements of § 547(c)(2) results in denial of the defense. Id. The § 547(c)(2) defense is narrowly construed. Payne v. Clarendon Nat'l Ins. Co. (In re Sunset Sales, Inc.), 220 B.R. 1005, 1020 (10th Cir. B.A.P. 1998); Jobin v. McKay (In re M&L Business Machine Company, Inc.), 84 F.3d 1330, 1339 (10<sup>th</sup> Cir. 1996). "Preferences are disfavored, and subsection C makes [terms wholly unknown to the industry] more difficult to prove." Tolona Pizza, 3 F.3d at 1032.

There is generally no disagreement over the first requirement (i.e., § 547(c)(2)(A)) that a debt was incurred in the ordinary course of business of the debtor and the transferee; reported cases under § 547(c)(2) overwhelmingly focus on subsections (B) and (C). Under those sections the creditor must prove that the transfers were ordinary as between the parties (§ 547(c)(2)(B)), which is a "subjective test", and ordinary in the industry (§ 547(c)(2)(C)), which is an "objective test". Id.  
Section 547(c)(2)(B)

Courts consider four primary factors to determine if payments are ordinary between the parties as required under the subjective test set forth in subsection (B): (1) the length of time the parties were engaged in the transaction in issue; (2) whether the amount or form of tender differed from past practices; (3) whether the debtor or creditor engaged in any unusual collection or payment activity; and (4) the circumstances under which the payment was made.<sup>21</sup> These factors are typically

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<sup>21</sup>The Tenth Circuit Court's fourth factor differs from some other courts' test, which is "whether the creditor took advantage (continued...)

considered by comparing pre-preference period transfers with preference period transfers.

Sunset Sales, Inc. 220 B.R. at 1020-21. "[w]hile there may be four factors which may be analyzed, the case authority often focuses upon one of these factors and any significant alteration in any one of the factors may be sufficient to conclude that a payment was made outside the ordinary course of business."

Concast Canada, Inc. V Laclede Steel Co. (In re Laclede Steel Co.), 271 B.R. 127, 132 (8<sup>th</sup> Cir. BAP 2002).

The relations of the debtor and the creditor are placed in a vacuum, and the transfer in question is assessed for its consistency with those relations. What is subjectively ordinary between the parties is answered from comparing and contrasting the timing, amount, manner and circumstances of the transaction against the backdrop of the parties' traditional dealings. The transaction is scrutinized for anything unusual or different.

Morris v. Kansas Drywall Supply Co. (In re Classic Drywall, Inc.), 121 B.R. 69, 75 (D. Kan. 1990) (Citations omitted). In other words, the Court compares the preference period to a prior period. The comparison should be with a period "preferably well before" the preference period, presumably before the Debtor started experiencing financial problems. Tolona Pizza Products, 3 F.3d at 1032. "Generally, the entire course of dealing is considered." Brown v. Shell Canada Ltd. (In re Tennessee

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<sup>21</sup> (...continued)  
of debtor's deteriorating financial condition." See, e.g., Sulmeyer v. Pacific Suzuki (In re Grand Chevrolet, Inc.), 25 F.3d 728, 731 (9th Cir. 1994).

Chemical Co.), 112 F.3d 234, 237 (6th Cir. 1997). See also Iannacone v. Klement Sausage Co. (In re Hancock-Nelson Mercantile Co.), 122 B.R. 1006, 1013 (Bankr. D. Minn. 1991) (Baseline period should extend back into the time before debtor became distressed.) Cf. Meridith Hoffman Partners, 12 F.3d at 1553 (Ordinary business terms under section 547(b)(2)(C) are those "when debtors are healthy.")

In this adversary proceeding, the Court finds that Defendants have failed to meet the subjective test of 11 U.S.C. § 547(c)(2)(B). The Court will apply the four Sunset Sales factors. First, the evidence did not reveal how long Furr's was engaged in business with each of the Defendants. The Court is to compare preference period transactions with a prior periods', from a time preferably before the financial problems started. The only comparative data provided by Defendants derived from a few months immediately before the preference period. The uncontroverted testimony was that Furr's was already in trouble during the time covered by all of Defendants' exhibits. It was Defendants' burden to compare preference period transactions with those from a time when Debtor was healthy; they did not meet this burden.

Regarding the second Sunset Sales factor, Furr's started using Federal Express for half of all of its payments to vendors in July, 1999. Fact 27. In this adversary proceeding every

single check was sent by Federal Express. See Facts 40, 41 and 42.

Regarding the third Sunset Sales factor, the Court finds that ConAgra engaged in unusual collection activities. It repeatedly threatened to and in fact did put Furr's on credit hold. It refused to ship product even when Furr's was under a credit limit. It constantly contacted Furr's through its agents for payment of specific invoices. Furr's also engaged in unusual payment activities. Furr's ranked vendors on a scale that was based on how desperately it needed product, then favored those vendors whose product was needed most. It also routinely held, voided, and reissued checks as part of its scheme to delay paying creditors. Furr's was secretive about its true condition and took steps to avoid having creditors know its dire financial condition.

Regarding the fourth Sunset Sales factor, the Court finds that the circumstances under which the payments were made were as far from ordinary as possible. It appears to the Court that Furr's was barely holding on, ordering product that it was not sure it could pay for, placing as many orders as possible in the hope that some would be filled so stores could be stocked, and picking which vendors to pay and putting off all the others.

Section 547(c)(2)(C)

Although the Court finds that Defendants did not satisfy § 547(c)(1), it will also rule on § 547(c)(2). Under § 547(c)(2)(C) "[t]he court here compares and contrasts the particular transaction against the 'practices' or 'standards' of the industry. A transaction is objectively ordinary if it does not deviate from industry norm but does conform to industry custom." Classic Drywall, Inc., 121 B.R. at 75.

Ordinary business terms, as used in paragraph (C), is thought of as an objective test. Courts consider whether the payment is ordinary in relation to the standards prevailing in the relevant industry. The circuit courts are currently divided about how to determine whether a particular transaction falls within the confines of ordinary business terms. Three prevalent views have emerged. One view, espoused by the Second, Sixth, Seventh and Eighth Circuits, emphasizes the range of terms used by firms that are similar to the creditor. The Tenth Circuit follows a narrower definition of ordinary business terms, excluding extraordinary circumstances from consideration, such as collection practices that may be used when the debtor is financially unhealthy. The Third and Fourth Circuits take a middle ground, defining ordinary business terms on a "sliding-scale" approach that is based on the length of the relationship between the debtor and the creditor.

Ann van Bever, Current Preference Issues, 1 J. Small & Emerging Bus. L. 297, 306 (1997) (footnotes omitted).

In Meridith Hoffman Partners the Tenth Circuit discussed the term "ordinary business terms" used in § 547(c)(2)(C). 12 F.3d at 1553. The Court stated that "ordinary business terms" could mean either 1) terms that creditors in similar situations would commonly use, even if the situation itself is extraordinary, or

2) terms that are used in usual or ordinary situations. Id. It adopted the latter meaning, and further elaborated that "[o]rdinary business terms therefore are those used in 'normal financing relations'; the kinds of terms that creditors and debtors use in ordinary circumstances, when debtors are healthy."<sup>22</sup> Id. (Emphasis added.) This interpretation raises difficulties for defendants because it makes irrelevant evidence of similar businesses' treatment of delinquent customers who are having financial problems.

In this adversary proceeding, the Court also finds that Defendants have failed to meet the objective test of 11 U.S.C. § 547(c)(2)(C). Both experts agreed on several items. First, they both agreed that holding, voiding and reissuing checks were not things in the ordinary course of business. Second, they agreed that if Defendants were holding product because invoices were late, that would not be ordinary course of business. Third, they

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<sup>22</sup> This definition by the Tenth Circuit has been called "unique" because it flatly rejects both the "party-focused view" (court excludes late payments from preference attack when the manner and timing conform to the manner and timing of previous payments made and accepted between the parties) and the "industry-terms view" (court asks whether the manner and timing of the late payments conforms to the general and accepted methods of the parties' industry) adopted by the other circuits. Janet E. Bryne Thabit, Ordinary Business Terms: Setting the Standard for 11 U.S.C. § 547(c)(2)(C), 26 Loy. U. Chi. L.J. 473, 489-90, 496 (1995). In fact, the Tenth Circuit test set out in Meridith Hoffman Partners does accept the "industry-terms" view, although it refines that test by requiring that the behavior of healthy debtors be the measure of behavior. Id. at 1553.

agreed that using Federal Express to send checks to get credit holds lifted were not ordinary course of business. Finally, they agreed that it was not ordinary business for senior management to have meetings to decide which vendors to pay at the expense of others. Mr. Doyle also opined that repeated dunning calls were not ordinary; the Court agrees. He also found that paying invoices late was not an ordinary course of business event for healthy retailers; again, the Court agrees.

### **PREJUDGMENT INTEREST**

"In bankruptcy proceedings, the courts have traditionally awarded prejudgment interest to a trustee who successfully avoids a preferential or fraudulent transfer from the time demand is made or an adversary proceeding is instituted unless the amount of the contested payment was undetermined prior to the bankruptcy court's judgment." Turner v. Davis, Gillenwater & Lynch (In re Investment Bankers, Inc.), 4 F.3d 1556, 1566 (10<sup>th</sup> Cir. 1993), cert. denied, 510 U.S. 1114 (1994). See also Sigmon v. Royal Cake Co., Inc. (In re Cybermech, Inc.), 13 F.3d 818, 822 (4<sup>th</sup> Cir. 1994) ("It is well-settled that bankruptcy courts have discretion to award prejudgment interest in § 547 preferential transfer actions, and to compute that interest from the date of demand for the return of the transferred funds.") Prejudgment interest is generally awarded if 1) the award would serve to compensate the injured party, and 2) the award is otherwise



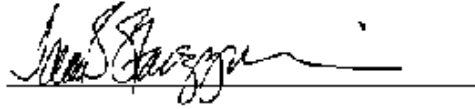
equitable. Investment Bankers, 4 F.3d at 1566. The award of prejudgment interest in a preference case "unquestionably" serves a compensatory purpose: to compensate the estate from the creditor's use of the funds that were wrongfully withheld from the estate during the pendency of the adversary proceeding. Id.; see also In re: Milwaukee Cheese Wisconsin, 112 F.3d 845, 849 (7<sup>th</sup> Cir. 1997) ("[P]rejudgment interest is an ingredient of full compensation.") It is equitable to award the interest when there was no dispute as to the amount of the preferential payments. Investment Bankers, 4 F.3d at 1566.

In this case, the Plaintiff has consistently asked for a judgment for the amount of the payments set out in the complaint, less new value that could be established by the Defendants. The amount has always been ascertainable. There is no evidence in the record that Plaintiff demanded a return of the funds before filing the adversary proceeding. Therefore, the Court will award prejudgment interest from May 20, 2002 at the rate of 2.40% to the date of the entry of the judgment in this case. The judgment will then accrue interest at the statutory rate.

#### **CONCLUSION**

The Plaintiff has met her burden of proving that the Defendants received preferential transfers in the amounts set out in Memo Exhibits A, B and C. Defendants have failed to prove that the transactions meet the ordinary course of business

defense under Section 547(c)(2). An appropriate judgment will enter.



Honorable James S. Starzynski  
United States Bankruptcy Judge

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