

**United States Bankruptcy Court
District of New Mexico**

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UNITED STATES BANKRUPTCY COURT
FOR THE DISTRICT OF NEW MEXICO

In re:

GALLUP AUTO SALES,
Debtor.

No. 7-99-12361 SF

ROBERT L. FINCH, Trustee,
Plaintiff,

v.

Adv. No. 99-1197 S

DESERT MOBILE HOMES, et al.,
Defendants.

MEMORANDUM OPINION AND DECISION

This matter came before the Court for trial on the merits of the Trustee's Complaint to Avoid Preferential and Fraudulent Transfer and for Turnover of Property. The Trustee appeared through his attorney Robert Finch. Defendant Jerry Egeland, who was sued personally but also acknowledged being in effect the successor to Desert Mobile Homes¹, appeared through his attorney Mark Brad Perry. This is a core proceeding. 28 U.S.C. § 157(b)(2)(F) and (H). The Court finds that the transfer in this case is an avoidable preference. Therefore, the Court's decision will not discuss the Trustee's alternative theory of fraudulent transfer.

¹Egeland testified that defendant Desert Mobile Homes was originally a corporation, then it became a partnership. The partners were Egeland, Bill Herni and Dick Clark. The partnership terminated and now Egeland claims to own its assets, and admits liability for its debts. Egeland claims the other partners had nothing to do with the \$35,000 that is the subject matter of this lawsuit. In his amended answer Egeland states that "Desert Mobile Homes operated as a corporate entity in Phoenix, Arizona and was incorporated under the laws of that state. It is now dissolved."

FACTS

Montana Mining Company ("MMC") filed its chapter 7 proceeding on April 20, 1999. The subject matter of this adversary proceeding is check #7719 dated March 9, 1999, in the amount of \$35,000 paid to Desert Mobile Homes, which cleared the bank on March 10, 1999. See Exhibit 17.

MMC originally was an offshoot of Gallup Auto Sales ("GAS"), a corporation that is a debtor in another pending chapter 7 case. It was a jewelry business until 1977, when it closed. After 1977 it was a "checkbook corporation" until 1990 when it became a financial corporation that financed car sales for GAS. When cars were sold the retail installment contracts would be made out in the name of MMC; sometimes MMC would purchase the car from GAS, sometimes MMC would purchase the contract. Egeland is the 100% owner of both MMC and GAS.

Egeland testified that in November, 1998, Desert Mobile Homes loaned \$35,000 to MMC. MMC used it to pay legal and other expenses. No documents were put into evidence regarding this loan.

Egeland testified that in February, 1998 GAS and MMC were solvent. He did not testify as to his opinion of MMC's solvency on March 10, 1999. Solga testified that, although he could not remember when the various lawsuits against MMC were filed, he did recall MMC's liquidity during the time the lawsuits were pending.

He claimed that, "in the past" MMC could have sustained a \$250,000 liability on lawsuits and remained solvent, but did not have current enough numbers to give an opinion if it currently could sustain such a loss and remain solvent.

Defendant's Exhibit B (and Trustee's exhibit 16) includes a MMC balance sheet dated October 15, 1998. This balance sheet showed \$804,152 of assets and \$58,607 of liabilities. A note to the balance sheet states that the collectibility of \$666,259 of accounts receivable included in the asset total "is questionable", and that the fair market value would be "substantially less." Solga, MMC's accountant and the preparer of the balance sheet, testified that this balance sheet did not include 1) any tax liabilities because the 1996, 1997, and 1998 returns had not yet been prepared, and 2) any liability for pending lawsuits. He testified that a correct balance sheet would have included these items.

Trustee's exhibit 4 contains MMC's federal income tax returns for the fiscal years ending September 30, 1996, 1997 and 1998. These returns were prepared by Solga, but had not been signed by Egalund or filed. Solga testified that they were accurate returns as far as he knew, however he had a question whether the account receivables number was correct. The September 30, 1998 return's Schedule L is a balance sheet for fiscal years ending 1997 and 1998. The 1998 figures show assets

of \$774,639 and liabilities of \$256,831. The assets include \$652,934 of accounts receivables, a number very close to the October 15, 1998 balance sheet (\$666,259 fifteen days later) that states the real value of receivables is "substantially less". The tax return's 1998 liabilities section includes income taxes of only about \$68,000; Schedule E in the bankruptcy shows taxes due of \$300,000.

The Schedules filed in MMC's bankruptcy stated total assets of \$914,991 and total liabilities of \$300,729. The assets included cash, \$50,138, jewelry \$35,778, and 97 accounts receivable worth \$828,264. The liabilities consisted of \$300,000 priority taxes and \$729 of unsecured claims.

At trial Egeland testified that the jewelry was not a corporate asset and had been included in error. Next, the Court questions the value assigned to the receivables. Egeland testified at trial that in January, 1999 MMC sold 142 of its 309 contracts to Beebe for \$200,000, keeping 167 contracts. He testified that Beebe purchased the "good ones". Egeland also testified that he had arrived at the \$200,000 selling price for the contracts after asking other car dealers for quotes. When asked why there were fewer than 167 contracts reported on the bankruptcy schedules, which lists only 97 accounts, Egeland testified that some had been written off.

The claims register for MMC, and Trustee's summary Exhibit 2, shows \$722,822 of unsecured non-priority claims. This liability is, in large part, from the various pending lawsuits, some of which had gone to judgment before the bankruptcy.

Egeland testified that when Desert Mobile Homes received the \$35,000 in March, 1999, it turned around and immediately wrote a check to one Diane Beebe (who does business as Little Louie's), an employee of MMC, as a loan from Desert Mobile Homes. This check is not in evidence, nor is any written loan agreement.

Egeland believed that Diane Beebe used the \$35,000 toward the purchase of retail installment contracts from MMC. Egeland testified that there was no written agreement for this sale of contracts, it was all in his head. He also testified that at this time MMC needed money.

Trustee filed an adversary proceeding against Diane Beene, Adversary No. 99-1172S, to recover the contracts she had purchased, alleging fraudulent transfers. Trustee claimed that Beebe paid \$130,000 of a \$200,000 purchase price for contracts worth at least \$400,000². Beebe answered in that adversary proceeding, claiming she had paid \$164,000 and denying the value of the contracts was \$400,000. This case never came to trial;

²The Court therefore finds that the value of the remaining contracts was somewhere between \$200,000 and \$400,000 for the purposes of this adversary proceeding.

instead, a stipulated order approving settlement agreement ended the litigation. This settlement agreement stipulated that: 1) MMC transferred 142 contracts to Diane Beebe for inadequate consideration, 2) Beebe agreed to assign the contracts back to the trustee, 3) the Trustee was authorized to pay Beebe the \$8,000³ which she had contributed to purchase the contracts, and 4) the settlement did not waive any additional claims the parties may have had against one another.

There was no evidence presented at the trial of this matter from which the Court can find that the \$35,000 transferred to Desert Mobile Homes passed to Diane Beebe and then back into the estate or the hands of the trustee. Although Beebe claimed to have paid \$164,000, that issue has never been litigated and no findings are of record that would serve as a defense in this adversary.

CONCLUSIONS OF LAW

1. Statutes

Bankruptcy Code Section 547 provides, in relevant part:

³Beebe filed a counterclaim to the adversary complaint, requesting a lien under 11 U.S.C. §548(c). She claimed that she paid \$8,000 of her money for the contracts, and also paid \$83,000 she received from Tom Solga (debtor's accountant), \$5,000 from Maxine Harris, \$28,000 from Maria Cervantes, \$5,000 from Gerald Egeland, and \$35,000 from Desert Mobile Homes. These amounts add up to the \$164,000 she claimed she paid MMC as a down payment for the contracts.

(b) Except as provided in subsection (c) 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
- ...
- (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.
- ...

(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 the filing of the petition.

Bankruptcy Code Section 101(32) defines "insolvent" as:

(A) ... financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation.

2. Discussion

A. The transfer was to a creditor.

Egeland admitted this in his answer. See Complaint ¶ 8 and answer.

B. The transfer was for an antecedent debt owed by the debtor before such transfer was made.

Egeland admitted this in his answer. See Complaint ¶ 8 and answer.

C. The transfer was made while MMC was insolvent.

Egeland denied that MMC was insolvent. Section 547(f) gives plaintiff the presumption that the debtor was insolvent during the ninety days before the bankruptcy. This presumption requires the party against whom the presumption exists, i.e. Egeland, to come forward with some evidence to rebut the presumption. Akers v. Koubourlis (In re Koubourlis), 869 F.2d 1319, 1322 (9th Cir. 1989). To avoid this presumption, Egeland would need to introduce evidence of MMC's solvency. Id. The Court finds that Egeland has not met this burden. Egeland did not provide a balance sheet for any period during the 90 days, or any income statements for any portion of the 90 day period. Egeland testified that he believed MMC was solvent in February, 1998, but did not opine about the 90 day period immediately preceding the filing in April, 1999. He also testified that he could not believe that MMC really had over \$900,000 in claims as of the petition date. However, "the mere assertion that the debtor is solvent will not suffice". Sanyo Electric, Inc. v. Taxel (In re World Financial Services Center, Inc.), 78 B.R. 239, 241 (9th Cir. B.A.P. 1987). See also Pioneer Technology, Inc. v. Eastwood (In re Pioneer Technology), 107 B.R. 698, 701 (9th Cir. B.A.P. 1988)(An affidavit stating defendant's belief that assets exceed liabilities during the preference period, without other

evidence in support, is insufficient to rebut the § 547(f) presumption.); Pongetti v. Merchants and Farmers Bank (In re Wellington Construction Corporation), 82 B.R. 424, 427 (Bankr. N.D. Miss. 1987)(In-court statements of solvency by former officers, which were not supported by financial statements or records, did not overcome presumption.) Solga testified that "in the past" MMC could have withstood a \$250,000 judgment. (In fact, however, the lawsuit liabilities were three times that figure.) However, cash flow or ability to withstand a judgment is not the test; insolvency is a balance sheet test. 11 U.S.C. § 101(32)(A). See Larimore v. Gulsby (In re Craft Plumbing Service), 53 B.R. 654, 658 (Bankr. M.D. Fl. 1985):

The profit and loss statements which were admitted in evidence, as a general proposition, have only an indirect relevance to the question of insolvency. One may operate at times at a profit, yet be insolvent when the balance sheet test, which is the only valid test, is applied. This is so in spite of a positive cash flow. A possible profit does not negate insolvency and if the liabilities exceed the aggregate value of the assets, the Debtor is still insolvent.

Even if Egeland had successfully overcome the presumption, however, the Court finds ample evidence that MMC was insolvent during the 90 days before the bankruptcy⁴. The Schedules filed

⁴It is instructive to note that, as a starting point, the Court finds the debtor was insolvent on October 15, 1998. The October 15, 1998 balance sheet omitted over \$900,000 of liabilities (see Exhibit 2). This alone would have made MMC insolvent to the extent of about \$150,000 as of that date. This balance sheet also claims to have overstated the assets, by an

in MMC's bankruptcy omitted or understated about \$722,000 of liability. See Plaintiff's Exhibit 2 (Estimating prepetition claims of \$913,991). Assets were overvalued on the schedules. See Plaintiff's Exhibit 19 (Estimating MMC total assets at \$468,734.) Using Exhibits 2 and 19, it appears that MMC was insolvent to the extent of \$445,257 on the filing date. The \$35,000 transfer was made March 10, 1999, roughly 41 days before the petition. Substantially all of the liabilities (e.g., priority taxes and lawsuit liabilities) were outstanding for the entire 90 day period. The MMC's bank statement for April 1 through the filing date shows relatively little activity: one small deposit and 63 deductions totalling \$22,173. See Exhibit 11. Questions 5 and 10 of the Statement of Financial Affairs show no foreclosures or other transfers of assets during the 90 day period other than the Diana Beebe transaction already described. Question 3 shows payments of approximately \$50,000, but no unusual or excessively large payments to creditors between March 10 and April 20, 1999. The Court can therefore "retroject" from the petition date to March 10, 1999 and find that the debtor remained insolvent between March 10, 1999 and the petition date. See Foley v. Briden (In re Arrowhead Gardens, Inc.), 32 B.R. 296, 301 (Bankr. D. Ma. 1983):

unknown amount.

Where a debtor is shown to be insolvent at a date later than the date of the questioned transfer, and it is shown that the debtor's financial condition did not change during the interim period, insolvency at the prior time may be inferred from the actual insolvency at the later date. This method of determining insolvency, termed "retrojection", is frequently employed in bankruptcy cases where a debtor's financial condition as of the relevant date is unascertainable.

(Citations omitted.) See also Gillman v. Scientific Research Products Inc. of Delaware (In re Mama D'Angelo, Inc.), 55 F.3d 552, 554 (10th Cir. 1995):

Courts often utilize the well-established bankruptcy principles of "retrojection" and "projection", which provide for the use of evidence of insolvency on a date before and after the preference date as competent evidence of the debtor's insolvency on the preference date.

(Citations omitted). Therefore, in sum, the Court finds that MMC was insolvent on March 10, 1999.

D. The transfer was within 90 days of the filing of the petition

Egeland admitted this in his answer. See Complaint ¶ 10 and answer.

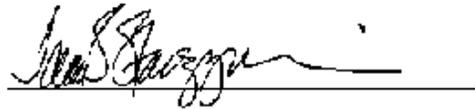
E. The transfer enabled Egeland to receive more than he would otherwise receive.

Plaintiff's exhibits 19 is a mathematical computation of projected dividends in the MMC bankruptcy. It demonstrates that unsecured claims will not be paid in full. "[S]o long as the distribution in a Chapter 7 is anything less than one hundred percent, the transfer is more than [the creditor] would have

received but for the prepetition transfer." World Financial Services, 78 B.R. at 242. Egeland has not filed a claim for this \$35,000 in the MMC bankruptcy, because he stated it was paid in full and he was no longer a creditor. Therefore, the Court finds that Egeland has received more as a result of the \$35,000 transfer than he would have received in a chapter 7 liquidation.

Conclusion

The Plaintiff has met his burden of proof with respect to all elements of a preferential transfer. Judgment should be entered in favor of plaintiff, and against defendant Jerry Egeland, in the amount of \$35,000.00.



Honorable James S. Starzynski
United States Bankruptcy Judge

I hereby certify that, on the date stamped above, a true and correct copy of the foregoing was either electronically transmitted, faxed, delivered or mailed to the listed counsel and parties.

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