UNITED STATES BANKRUPTCY APPELLATE PANEL FOR THE FIRST CIRCUIT

BAP No. MW 97-101

IN RE: MARKETECHS, INC.,
Debtor.

DAVID M. NICKLESS, TRUSTEE,
Appellant,

v.

ROBERT FEIGE, PATRICIA FEIGE, TIMOTHY COX, BERNARD COX, DP REALTY TRUST AND CHARLES HESNER,
Appellees.

Appeal from the United States Bankruptcy Court for the District of Massachusetts
(Hon. James F. Queenan, Jr., U.S. Bankruptcy Judge)

Before
Haines, Vaughn, and Carlo, U.S. Bankruptcy Judges

David M. Nickless and James L. O'Connor, Jr., on brief for Appellant.

Lawrence E. Desilets, on brief for Appellees Robert Feige, Patricia Feige, Timothy Cox, Bernard Cox and DP Realty Trust.

Albert Auburn, on brief for Appellee Charles Hesner.

August 20, 1999

VAUGHN, J.

On July 31, 1996, Marketechs, Inc. ("Debtor") filed a petition for relief under Chapter 7 of the Bankruptcy Code. Shortly thereafter, David M. Nickless ("Nickless") was appointed the Chapter 7 trustee. To recover monies under the law of preferences and fraudulent transfers, Nickless commenced two adversary proceedings, numbers 96-4428-JFQ and 97-4002-JFQ, against Robert Feige ("Feige"), Charles Hesner ("Hesner") and other defendants unconnected to this appeal.[1] For the purposes of this appeal, we will only recite the pertinent facts.

Complaint number 96-4428-JFQ focused on certain payments by the Debtor in 1996. The trustee alleged various payments were both preferential and transferred for less than reasonably equivalent value while the Debtor was insolvent, or that the payments effected the Debtor's insolvency. Count III of that complaint, which comprises part of this appeal,[2] alleged that a payment of $11,751, made on June 7, 1996, by the Debtor to one of the defendants,[3] was a preferential transfer.

The issues of complaint number 97-4002-JFQ pertinent to this appeal alleged that: (1) a promissory note executed in 1993 by Feige to

---

[1] Adversary proceeding number 96-4428-JFQ was filed against Robert Feige and Charles Hesner, individually, and as trustees of a certain CRS Realty Trust, and also against Stephen Kelly. Adversary proceeding number 97-4002-JFQ was filed against Trustee Defendant Bank of Boston, and Defendants Robert Feige, Patricia Feige, Timothy Cox, Bernard Cox, DP Realty Trust and Charles Hesner.

[2] This issue is numbered as issue one in this opinion.

[3] The defendant named was Stephen Kelly.

the Debtor corporation for $475,000 remained unpaid;[4] (2) within the year preceding the bankruptcy filing, Feige, an insider, fraudulently and preferentially received anywhere from $80,000 to $120,000;[5] (3) Feige and Hesner breached their fiduciary duty to Marketechs, Inc. by effectuating a September 30, 1993, stock redemption under which the Debtor purchased Hesner's fifty percent interest in the corporation for $475,000;[6] and (4) the September 30, 1993, transaction undercapitalized the corporation.[7]

Both adversary proceedings were consolidated, and the bankruptcy court issued its findings and conclusions of law by written opinion on November 26, 1997. The bankruptcy court found that "the Debtor was not possessed of unreasonably small capital [but remained a going concern] until February 28, 1996, five months before the July 31, 1996 voluntary filing of its chapter 7 petition." (App. to the Br. for the Appellant at 161; Ct.'s Findings and Conclusions at 2.) The bankruptcy court also found that: (1) the Debtor was insolvent in late May 1996; (2) neither the September 30, 1993, note nor payments on it were fraudulent transfers since they were made for value; (3) only one $11,751 payment,

---

[4] This issue is numbered as issue two in this opinion.

[5] Paragraph 16 in the facts of the complaint alleges certain monetary amounts totaling $120,000 that Feige transferred to his, his wife's and DP Realty Trust's benefit. (App. to the Br. for the Appellant at 7; Compl. at 2.) Counts I and II of the complaint request judgment of $80,000 against Feige. (App. to the Br. for the Appellant at 8-9, Compl. at 2-3.) This issue is numbered as issue four in this opinion.

[6] This issue is numbered as issue five in this opinion.

[7] This issue is numbered as issue three in this opinion.

made on May 31, 1996, was a preference; (4) none of Feige's capital withdrawals from Marketechs, Inc. were fraudulent transfers since Feige's net capital contributions to the company totaled $77,000; and, finally, (5) the September 30, 1993, $475,000 from Feige to the corporation was a "sham" and was not a valid obligation upon which the trustee could collect.

The trustee timely filed the above-captioned appeal, which encompasses Count III of adversary proceeding number 96-4428-JFQ (the June 7, 1996, alleged preferential $11,751 payment) and adversary proceeding number 97-4002-JFQ in its entirety.

FACTS

The Debtor was a Massachusetts corporation formed in 1972 by Hesner and Rollin Thompson ("Thompson"). The Debtor had been a modestly profitable entity until 1990 when it barely broke even. The Debtor would never again realize a profit during a full fiscal-year period, as it incurred losses of $79,457 in 1991, $314,510 in 1992, and $136,725 in 1993. (Pretrial Stipulation at 3.) In 1991, Thompson sold his fifty percent interest in the Debtor to Feige for $125,000. (Tr. Vol. 2 at 42-43.)

Shortly after Feige bought out Thompson's interest in the Debtor, he and Hesner began discussions regarding either's acquisition of one hundred percent of the Debtor's stock.

On September 30, 1993, the Debtor redeemed Hesner's fifty percent interest with a $475,000 promissory note. (Pl.'s Ex. 17.) The Debtor paid Hesner $100,000 within ninety days and $11,751 per month thereafter. (Pl.'s Ex. 17.) Hesner received all but $58,000 of the payments owed to him under his note. Hesner and the Debtor also entered into a non-compete agreement whereby Hesner was to receive $120,000 over sixty months. The non-compete agreement's consideration was paid to Hesner from an annuity that was fully funded by the Debtor in or about October 1993. (Tr. Vol. 1 at 231-32.) The defendants did not consult an independent expert to determine if the price paid by the Debtor to redeem Hesner's stock was a fair price. (Tr. Vol. 2 at 12-13.) No one projected if the Debtor's cash flow was sufficient to pay the obligation it had incurred to Hesner. (Tr. Vol. 2 at 12-13.) No one sought an opinion, expert or otherwise, to determine the effect of the transaction on the Debtor's capitalization. (Tr. Vol. 2 at 12-13.)

There was ample testimony from both Feige and Hesner as to the basis for determining the $475,000 purchase price for Hesner's stock. Hesner, who apparently wished to retire from Marketechs, Inc., stated that the price was a result of negotiations between him and Feige, which were affected significantly by a third-party's offer to purchase the entire company for $1,100,000 for the inventory, plus an undetermined amount for good will. (Tr. Vol. 2 at 11-12.) Feige, in his testimony, further elaborated on how he and Hesner arrived at the $475,000 purchase price, citing not only the third party's offer to purchase the company, but that company sales had increased $1,800,000 in one year, and that the company was much further along in its transition from a hardware company to a network integration company. (Tr. Vol. 2 at 45-46.) The evidence also showed that, at the time the noncompetition agreement was executed, Mr. Hesner was sixty-eight years old and in good health. (Tr. Vol. 2 at 11.)

Simultaneously with the Debtor's redemption of Hesner's stock, Feige signed and delivered to the Debtor a note promising to pay it $475,000. According to Feige's testimony at trial, this note was intended as an offset against the Debtor's note to Hesner. (Tr. Vol. 2 at 100-01.) According to Feige, booking the transaction in this manner was at the behest of the Debtor's primary lender at the time, Middlesex Savings Bank. (Tr. Vol. 2 at 97-99.)

After September 1993, Feige was the sole stockholder and chief executive officer of the Debtor. The Debtor's financial performance did not improve, as it sustained losses of $264,947 and $1,407,606 in fiscal years 1994 and 1995, respectively. (Pl.'s Ex. 1.) The Debtor's gross revenues also declined over that period from $6,672,918 in 1994, to $5,578,240 in 1995. (Pl.'s Ex. 1.)

Both Feige and Hesner testified that even before Feige became sole stockholder in September 1993, shrinking profit margins in the computer hardware business prompted the Debtor to transition itself from a hardware provider to a networking company. Hesner testified that the Debtor slowly began to enter the networking business in 1986, but the emphasis towards networking shifted dramatically in 1992. (Tr. Vol. 2 at 23, 24.) Feige explained in detail the exact nature of the transition including, but not limited to, the need to train and hire a more sophisticated technical and sales staff. (Tr. Vol. 2 at 158-61.) Feige further testified that the end result of the transition significantly increased revenues (Tr. Vol. 2 at 161-63), and that in

November 1995, the Debtor's sales approximated $500,000. Sales more than doubled in December 1995 to $1,100,000, and sales in January 1996 were $1,400,000. (Tr. Vol. 2 at 173.)

By February 1995, the Debtor's financial condition had deteriorated to such an extent that its primary lender, Middlesex Savings Bank, deemed its loans, secured by all the Debtor's assets, to be less than fully secured and required additional collateral over and above those assets. (Pl.'s Ex. 70.) At that time, the bank also downgraded the Debtor's loans to a "less than satisfactory" rating, based upon the Debtor's financial performance for the fiscal year ending September 30, 1994. (Pl.'s Ex. 74.)

In November 1995, the Debtor entered into a contract with Vestex Corporation whereby Vestex was to provide the Debtor $2,500,000 to $5,000,000 in equity. In the end, Vestex, or its affiliates, only contributed approximately $250,000 of that amount as equity. (Tr. Vol. 2 at 85.) The defendants cited Vextex's failure to fully perform according to the contract as the cause for the Debtor's demise.

Throughout these transitions, Hesner continued to be paid under the noncompetition agreement through June 1996. He received a regular note payment of $11,721 on May 31, and, on June 6, 1996, the Debtor paid that same amount, on his behalf, to a third party as part of a real estate transaction.[8] In the months preceding Marketech's demise, Feige intermittently made, and withdrew, capital from the corporation.

[8] Under the transaction, Hesner and Feige acquired certain real estate, where the Debtor's principal place of business was located, from CRS Realty Trust. Three months post-petition, they sold the real estate to OFC Corporation.

In early June 1996, the company paid $20,000 on his behalf to the same third party as part of the same real estate transaction. The Debtor itself realized no benefit from that deal.

STANDARD OF REVIEW

We review the bankruptcy court's conclusions of law de novo. Jeffrey v. Desmond, 70 F.3d 183, 185 (1st Cir. 1995); Official Unsecured Creditors' Comm. v. Stern (In re SPM Mfg. Corp.), 984 F.2d 1305, 1311 (1st Cir. 1993); LaRoche v. Amoskeag Bank, 969 F.2d 1299, 1301 (1st Cir. 1992). In addition, findings of fact will be overturned only if they are clearly erroneous. FED. R. BANKR. P. 7052(a); Jeffrey, 70 F.3d at 185; Official Unsecured Creditors' Comm., 984 F.2d at 1311.

DISCUSSION

I. Issues on Appeal.

The trustee has raised five issues on appeal:

1. Did the bankruptcy court err in not finding that the $11,751 transfer made June 7, 1996, from the Debtor to Stephen Kelly was for the benefit of Charles Hesner and therefore a preferential transfer under section 547 of the Bankruptcy Code?

2. Did the bankruptcy court err in finding the September 30, 1993, promissory note from Robert Feige to the Debtor was a sham?

3. Did the bankruptcy court err in finding the September 30, 1993, redemption of the Debtor's stock from Charles Hesner did not leave the Debtor with unreasonably small capital?

4. Did the bankruptcy court err in finding the $100,000 withdrawals of capital by Robert Feige were not fraudulent transfers?

5. Did the bankruptcy court err in finding that the defendants, Robert Feige and Charles Hesner, did not breach their fiduciary duties to the Debtor by causing the Debtor to enter into the September 30, 1993, agreement with Charles Hesner to redeem all of Hesner's stock in the Debtor?

II. Two Cornerstone Findings Affirmed.

In its decision, the bankruptcy court arrived at two findings of fact that are crucial to most of the issues on appeal: (1) the Debtor did not have unreasonably small capital until February 28, 1996; and (2) the Debtor was not insolvent until late May 1996. The Panel finds that both of these findings are amply supported by the record below and are not clearly erroneous.

The clearly erroneous standard,[9] used by appellate courts in reviewing alleged factual errors, is a "high" hurdle to clear, Drohan v. Vaughn, ___ F.3d ___, 1999 WL 312538 at *2 (1st Cir. May 20, 1999) (citing Wilson v. Maritime Overseas Corp., 150 F.3d 1, 6-7 (1st Cir. 1998)), since it is well established public policy that appellate courts must "accord appropriate deference" to trial courts' findings, Irving v. United States, 162 F.3d 154, 185 (1st Cir. 1998). The Supreme Court, in Anderson v. Bessemer has stated that:

> Under Federal Rule of Civil Procedure 52(a)—which provides that "[f]indings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge [ ] the credibility of the witness[es]"—"[a] finding is 'clearly erroneous' when although there is evidence to support it, the reviewing court on the entire evidence is left with a definite and firm conviction that a mistake has been committed." United States v. United States Gypsum Co., 333 U.S. 364, 394-395, 68 S. Ct. 525, 541-542, 92 L. Ed. 746. If the district court's account of the evidence is plausible in light of the record viewed in

[9] This standard is also called the "plain error" standard.

> its entirety, the court of appeals may not reverse it even though convinced that had it been sitting as the trier of fact, it would have weighed the evidence differently. This is so even when the district court's findings do not rest on credibility determinations, but are based on physical or documentary evidence or inferences from other facts. When findings are based on determinations regarding the credibility of witnesses, Rule 52(a) demands even greater deference to the trial court's finding.

Anderson v. Bessemer, 470 U.S. 564, 564 (1985).

As explained more fully in this decision, and given the two previously mentioned, affirmed factual findings, we reverse only issues one and two. Issue one is carried over the clearly erroneous hurdle by the bankruptcy court's factual findings regarding a prior preferential transfer. The record, however, carries issue two, and we reverse, finding that the evidence compels the conclusion that the Feige note is valid.

III. Affirming Issues Three and Five.

In support of the trustee's position that the Debtor was insolvent as of September 1993, the trustee employed Barry Sussman, a certified public accountant with Arthur Anderson and Company, who testified at trial. Based on his analysis, which did not include a capitalized income approach, he opined that the company was insolvent in September 1993, and further, that the stock transaction between Hesner and Feige left the Debtor with unreasonably small capital at that time.

In contrast to this testimony, the Appellee presented John Czyzewsky, also a certified public accountant who was an employee of, and stockholder in, Theodore Salmon and Company, a CPA firm that had provided the Debtor's certified statements through 1993, a review in 1994, and a compilation in 1995. Mr. Czyzewsky testified that as of

September 30, 1993, the Debtor had a positive net worth of $455,000 and was solvent. He further testified, based on the work his company performed for the Debtor through November 1995, that the Debtor had a going-concern value through December 1995, and possibly through January 1996. He further discounted the opinion of Sussman because Sussman had relied on comparing the Debtor to a public company although the Debtor was a private company. It is clear that the bankruptcy court below found the testimony of Czyzewsky, based on his personal knowledge of the Debtor, to be more credible and reliable in rendering its decision, and we defer to this finding.

In further support of the bankruptcy court's finding that the Debtor did not have unreasonably small capital until February 1996, the bankruptcy court relied on evidence that the Debtor was involved in a restructuring from a hardware provider to a networking supplier and, in fact, sales rose from $500,000 in November 1995, to $1,100,000 in December 1995, and to $1,400,000 in January 1996. The bankruptcy court's conclusion that the Debtor did not have unreasonably small capital until February 28, 1996, when it became obvious that the Debtor was not going to receive the Vestex investments (see App. to the Br. for the Appellant at 161; Ct.'s Findings and Conclusions at 2-3), was thus amply supported by the record and not clearly erroneous. Based on our previous finding affirming the bankruptcy court's conclusion that the Debtor did not have unreasonably small capital until February 28, 1996,[10] and based on our independent conclusions drawn from

[10] We refer to section II of this decision, supra.

the record on appeal, we answer the questions posed on issue three— and five, as follows—in the negative.

Issue five, which concerns whether the September 30, 1993, stock redemption was a fraudulent transfer, is easily disposed of, as we reiterate that the bankruptcy court was not clearly erroneous in its conclusion that the Debtor had unreasonably small capital until February 28, 1996. Further, in support of the bankruptcy court's finding that there was no breach of fiduciary duty, there is ample support in the record justifying the amount of consideration for the stock redemption, including the offer to purchase made to the Debtor, shortly before the redemption took place.

IV. Reversing Issue One.

With respect to the first issue raised on appeal, we reverse. The bankruptcy court found in its November 26, 1997, opinion that the payment to Hesner on May 31, 1996, of $11,751 was a preference. In its prior ruling on the motion for summary judgment, the bankruptcy court found that the payment from the Debtor to Kelley on June 7, 1996, of $11,751 was for "equivalent value" and dismissed that claim against Hesner. As a matter of law, that conclusion was wrong. As a matter of fact, since the bankruptcy court found that the May 31, 1996, payment was preferential, the conclusion that the June payment was also preferential is inescapable. Since the June 7, 1996, payment was made after the date that the bankruptcy court found that the Debtor was insolvent, was for an antecedent debt, was for the benefit of Hesner and resulted in Hesner receiving more than he would have in a Chapter

7 liquidation, all of the elements of a preference are present;[11] thus, the bankruptcy court's conclusion must be reversed.

V. Affirming Issue Four.

Issue four concerns Feige's $100,000 capital withdrawals. The trustee argues that the bankruptcy court's finding, that these

---

[11] Section 547(b) states that:

> 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; or
>
> (B) between 90 days and one year before the date of the filing of the petition, if the creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor were 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.

11 U.S.C.A. § 547(b) (West 1988).

withdrawals were not fraudulent transfers, was in error and should be reversed; in support of his position, the trustee states two arguments.

The first argument is a factual one: the trustee claims that Feige produced no documentary evidence in support of the capital contributions he testified that he made in 1995 and 1996. However, the trustee provided no corporate records indicating that, in fact, these contributions were not made. Moreover, the trustee provided no testimony to refute Feige's sworn testimony as to why he could not produce the documents, i.e.: (1) the time involved in doing so; (2) that the documentary evidence had been a part of other litigation in which he had been involved; and (3) he was unable to locate the documents. This Panel defers to the factual findings of the bankruptcy court, which had the opportunity to assess Feige's credibility concerning these capital contributions. FED. R. BANKR. P. 8013; Drohan v. Vaughn, ___ F.3d ___, 1999 WL 312538 at *2 (1st Cir. May 20, 1999) (clearly erroneous standard is a "high" one and is used for review of factual errors) (citing Wilson v. Maritime Overseas Corp., 150 F.3d 1, 6-7 (1st Cir. 1998)). After reviewing the record on appeal, we conclude that the bankruptcy court had sufficient evidence before it to find that Feige did, indeed, make offsetting capital contributions in the months before the Debtor closed its doors. (See App. to the Br. for the Appellant at 164; Ct.'s Finding and Conclusions (referring to Feige's chalk); see also Tr. Vol. 2 at 52 (noting Pl.'s Ex. 78, Feige's Apr. 7, 1997, affidavit regarding his capital contributions).)

The trustee's second argument regarding issue four is a legal one: that no law supports the theory that contributions and withdrawals may be "netted out" in defending against a fraudulent transfer claim. This argument was neither raised in the bankruptcy court nor meaningfully articulated by the trustee in his brief. Therefore, we follow the trustee's lead, and also decline to undertake this undeveloped, yet interesting, legal issue.

VI. Reversing and Remanding Issue Two: Whether the Bankruptcy Court Erred in Finding the September 30, 1993 Promissory Note from Robert Feige to the Debtor was a "Sham."

With regard to this second issue, we first note that at the hearing before the Panel, the Appellant stated that both issues of fact and law were on appeal. The issue of law, first raised on appeal, is whether Feige's no consideration defense is moot given the fact that the note was executed under seal. We need not address this legal issue since the uncontroverted evidence demonstrates beyond question that Feige received consideration in exchange for his promise to pay the Debtor. This leads us to the factual issue upon which we base our decision: whether the bankruptcy court erred in finding that the promissory note was a "sham." We find the bankruptcy court's factual determination, that the promissory note was a "sham,"[12] to be clearly erroneous as the record contained sufficient evidence to conclude the note was a valid obligation. Further, we remand so that the bankruptcy court may determine what amount remains due under the note.

---

[12] We note that the promissory note was called a "sham" by the bankruptcy court in its November 26, 1997, opinion. A term of art under tax law, see BLACK'S LAW DICTIONARY 1375 (6th ed. 1990), "sham" is defined as "something that is not what it purports to be; a spurious imitation; fraud or hoax . . . ." RANDOM HOUSE UNABRIDGED DICTIONARY 1758 (2nd ed. 1993). For the purposes of today's decision, we will not continue to italicize the term.

In its decision, the bankruptcy court determined the note was a sham because it offset the Debtor's note to Feige, and it was created at the behest of Middlesex Savings Bank, the Debtors' primary lender at the time, merely for bookkeeping purposes:

> The Trustee asserts a claim against Robert Feige for his failure to pay an account receivable which the Debtor carried on its books as due from him. That receivable, however, is a sham. It was placed on the books as of September 30, 1993 in the sum of $475,000 at the same time the Debtor booked a note payable to Feige for $550,000. This was done at the request of the Middlesex Savings Bank, the Debtor's lender at the time, to satisfy the bank's requirement that the Debtor's net worth (as defined by the bank) equal at least $1,000,000. The offsetting $475,000 receivable and payable has no economic reality. The additional $75,000 payable was as a result of a $75,000 loan which Feige made to the Debtor in the fall of 1993.

(App. to the Br. for the Appellant at 160; Ct.'s Findings and Conclusions at 6-7.) With due deference to the bankruptcy court, we hold that its ruling is clearly erroneous for the reasons that follow. Plaintiff's Exhibit 16 submitted at trial is a letter dated November 10, 1994, from Robert F. Feige as President of Marketechs, Inc. to Mr. Thomas Fontaine of Middlesex Savings Bank. In this letter, Feige writes, "[t]he note from me to the company is something that I legally owe the company regardless of the status of the subordinated note to me, so it is a source of recourse for the bank and should not be deductible." (Pl.'s Ex. 16.) Plaintiff's Exhibit 15 is the note executed by Feige to the corporation on September 30, 1993, wherein he promises to pay the company $475,000 in quarterly payments, and in full within three years. (Pl.'s Ex. 15.) The negotiations whereby Feige obtained full control of the corporation began in July 1992, and culminated more than a year later with Feige not only promising to repay the corporation, but Hesner as well. (Tr. Vol. 2 at 7-13.) In 1992, Marketechs, Inc. had a net worth covenant with Middlesex Savings Bank, the company's primary lender. (Tr. Vol. 2 at 25.) The promissory note was drafted by Feige's attorney (Tr. Vol. 2 at 28), and was the subject of extensive negotiations (Tr. Vol. 2 at 44). In fact, Feige testified that he had discussions regarding buying out Hesner prior to his buying out Thompson's interest. (Tr. Vol. 2 at 22.) Indeed, Feige answered in the affirmative when queried with the following: "[T]he promissory note from you to the debtor and the promissory note from the debtor to Mr. Hesner were intended as offsetting transaction, isn't that true?" (Tr. Vol. 2 at 48.) He was also asked, "[s]o therefore as the debtor paid pursuant to its promissory note to Hesner, you were to be paying the debtor on your promissory note[,]" and provided the following response: "Not necessarily, but I don't have a problem with your phrasing it that way." (Tr. Vol. 2 at 48.) Moreover, although irregularly, Feige made payments on the note, which he termed "capital contributions." (Tr. Vol. 2 at 50.)

Feige testified that the notes were signed merely because Middlesex Savings Bank required it.[13] The bankruptcy court cited this fact as part of its reasoning that the note was a sham. However, we find that this requirement is a further part of the consideration under the note: financing was the lifeblood of this Debtor and Marketechs' primary lender required a new "asset" since the corporation would be

[13] If true, this is a questionable practice for both the bank and the Debtor.

indebted to Hesner for $475,000. Essentially, Feige had to execute a promissory note if he were to obtain total control of the corporation. This asset was carried on the books as a receivable after Middlesex Savings Bank was paid off—Feige testified that he believed the balance sheets were "reliable," that "he didn't have a problem with it done that way" and he "was using those for the purposes of trying to finance the company." (Tr. Vol. 2 at 68.) Feige even agreed to execute a personal guarantee to Hesner, which was not an alleged requirement of Middlesex Savings Bank. (Tr. Vol. 2 at 99.) The Appellees have argued Feige did not receive the stock from this transaction, but the trial transcript uncloaks this, and other "form over substance" arguments raised on appeal: Feige contemplated controlling the Debtor before he bought Rollins' stock, and one year later achieved this control. Thus, the transactions were not completely contemporaneous since Feige envisioned controlling the company back in 1992. Placing the asset on the books kept Marketechs from falling into default with Middlesex Savings Bank—all along, Feige believed the company would be profitable, and he labored to both reposition the company into networking and obtain desperately needed financing. He had an enormous interest in keeping the company afloat: he was its sole stockholder. This asset buoyed the company by providing accounting stability[14] while Feige endeavored to obtain financing.

At trial, the Defendants' own witness, John Czyzewski, C.P.A., testified that the Debtor's $455,000 net worth on September 30, 1993,

---

[14] The inventory and receivables were the company's biggest assets. (Tr. Vol. 2 at 133.)

encompassed this obligation (Tr. Vol. 2 at 115-17); however, the bankruptcy court found that "on a book value basis, [Marketechs'] interim balance sheets continue to show a positive net worth at least through May 31, 1996." The company's net worth on May 31, 1996, was $187,765, which included the promissory note, in the amount of $327,117, as a receivable. Overextending the company without adequate financing, not the promissory notes, were alleged to have precipitated the Debtor's bankruptcy. Thus, for all the aforementioned reasons, the trial court's determination that Feige's promissory note to the Debtor was a sham was clearly erroneous.[15]

---

[15] We also note that the "earmarking doctrine" recognized by the First Circuit in Kapela v. Newman, 649 F.2d 887, 892 (1st Cir. 1981), and the Panel in In re Neponset River Paper Co., 231 B.R. 829 (B.A.P. 1st Cir. 1999), does not apply to this issue. The doctrine is "entirely a court-made interpretation of the statutory requirement that a voidable preference must involve a transfer of an interest of the debtor in property[,]" id. at 834 (internal citations and quotations omitted), and "under certain circumstances, a transfer from a third party to a creditor of the debtor is not avoidable as a preference." Id. Three factors should be considered in deciding whether a transfer satisfies the earmarking doctrine:

> (1) the existence of an agreement between the new lender and the debtor that the new funds will be used to pay a specified antecedent debt, (2) performance of that agreement according to its terms, and (3) [whether] the transaction[, when] viewed as a whole (including the transfer in of the new funds and the transfer out to the old creditor)[,] does not result in any diminution of the estate.

Id. at 835. The so-called "cornerstones" of the doctrine have not been met in this case: "(1) the absence of control by the debtor over the disposition of the funds, and (2) no diminution of the debtor's estate as a result of the transfer." Id. at 834-35.

CONCLUSION

Thus, for the foregoing reasons, we reverse the bankruptcy court's finding that the $11,751 transfer from the Debtor to Kelly on June 7, 1996, was not a preferential transfer under section 547 of the Bankruptcy Code and affirm the bankruptcy court's findings under issues three, four and five as identified in this decision. With regard to the second issue as identified above, we conclude that the September 30, 1993, promissory note executed by Feige to the Debtor was not, as the bankruptcy court characterized it, a sham, but rather is a valid note; we therefore reverse and remand the bankruptcy court's decision on this matter for a determination as to the amount due on that obligation.