**IN THE UNITED STATES BANKRUPTCY COURT
FOR THE NORTHERN DISTRICT OF TEXAS
FORT WORTH DIVISION**

IN RE:	§	Case Nos. 401-40783-BJH-11
	§	Through 401-40790-BJH-11
KEVCO, INC., et al.	§	
	§	Chapter 11
	§	
	§	Jointly Administered Under
Debtors.	§	Case No. 401-40783-BJH-11
	§	
	§	
PLAN ADMINISTRATION AGENT,	§	
ACTING ON BEHALF OF KEVCO, INC.	§	
UNDER ITS CONFIRMED PLAN,	§	
	§	
Plaintiff,	§	
	§	
v.	§	Adversary Proceeding
	§	Case No. 4-03-04051-BJH
NATIONAL SHELTER	§	
PRODUCTS INC.,	§	
	§	
Defendant.	§	

FINDINGS OF FACT AND CONCLUSIONS OF LAW

FINDINGS OF FACT

1. Effective December 5, 1997, National Shelter Products, Inc. ("NSP) and Shelter Distribution, L.P. ("SDLP") entered into an Asset Purchase Agreement (together with a bill of sale), a Covenant Not To Compete, and a letter confidentiality agreement and agreement not to compete from SDLP to NSP (the "Non-Compete Agreement") (collectively, the "APA"). Contemporaneously with entering into the APA, Earl Shepherd, president and sole shareholder of NSP, individually entered into a separate Covenant Not To Compete with SDLP. Shortly before the APA was entered into, Kevco, Inc. ("Kevco" or the "Debtor") acquired SDLP and became responsible for SDLP's obligations under the APA, including

those to NSP.[1]

2. Prior to entering into the APA with SDLP, NSP was (among other business activities) a distributor of a coated woven fabric (the "Fabric"), which it sold under the name "Darco®" and "Darco® FloorShield" to recreational vehicle manufacturers. In addition, NSP was selling or distributing products (including "Darco® FloorBrace" and "Darco® FloorDri") which it had developed and which incorporated the Fabric. NSP then owned and at all times has continued to own the Darco® trademark. In 1997, the manufacturer of the Fabric changed distributors of the Fabric, and terminated NSP as a distributor. The replacement distributor, SDLP, desired to obtain the right to use the "Darco®" name in connection with its sales of the Fabric to recreational vehicle manufacturers (such sales being identified in the APA as the "Darco® Business," and is sometimes referred to as such herein). As a result, NSP and SDLP entered into the APA under which NSP sold selected inventory to SDLP; granted a license for the use of the trademark Darco ® to SDLP solely in connection with the Darco® Business; and entered into a covenant not to compete with SDLP, solely in connection with the Darco® Business. In exchange, SDLP agreed to make certain payments to NSP and executed the Non-Compete Agreement.

3. As the parties had agreed in the APA, after December 5, 1997, NSP continued to distribute, among other products, Darco® FloorBrace and Darco® FloorDri, as to which SDLP had agreed not to compete (the distribution of those products is referred to in the APA as the "Excluded Business," and is sometimes referred to as such herein).

4. In accordance with the terms of the APA, SDLP/Kevco agreed to make quarterly payments

[1]While evidence concerning the precise nature of Kevco's acquisition of SDLP was not introduced, the parties agree that Kevco became responsible for SDLP's obligations under the APA. Since the parties agree that Kevco became responsible for SDLP's obligations under the APA, the Court will refer to SDLP from time to time as SDLP/Kevco.

to NSP, each equal to the total of (a) five per cent of SDLP/Kevco's cost of purchasing the Fabric and Darco® Floorshield from the manufacturer during the preceding quarter, plus (b) ten per cent of the gross amount of SDLP/Kevco's sales of the Fabric and Darco® Floorshield during the same quarter. Each payment was to be made on or before the 45th day following the end of the corresponding calendar quarter.

5. Following each quarter after December 5, 1997, except as stated below, SDLP/Kevco sent the following documents to NSP:

   a. A letter stating the amounts of SDLP/Kevco's purchases and gross sales of Fabric and Darco® Floorshield during the relevant quarter;

   b. A tabulation of quarterly amounts due to NSP under the APA during the current year; and

   c. A check in the amount due NSP from SDLP/Kevco on the basis of the APA and the purchase and sale amounts described above.

NSP did not introduce the tabulation for the quarter ended September 30, 2000 because it was not able to locate that document. However, Kevco's letter dated October 20, 2000 states the purchase and sale amounts from which its payment to NSP can be calculated.

6. Based on the documents identified in paragraph 5 above, the amounts paid to NSP under the APA and the dates on which NSP received those payments are set forth on Plaintiff's Exhibit 22. In general, NSP received each payment, other than the payment due for the third quarter of 2000, from 14 - 16 days after the close of the 45-day period prescribed by the APA.

7. Only the payment which NSP received on November 15, 2000 in the amount of $65,287.00

is contested by the plaintiff[2] as preferential (the "Disputed Payment"). The Disputed Payment arose from purchases and sales by SDLP/Kevco during the quarter ending September 30, 2000.

8. NSP's receipt on November 15, 2000 of the Disputed Payment occurred 46 days following the end of that quarter; and thus, was 1 day late under the terms of the APA. While late by 1 day, the Disputed Payment was not as late as previous payments under the APA, which were received by NSP, on average, approximately 15 days late.

9. The Annual Reports of Kevco, Inc. pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (Form 10-K) for the fiscal years ending December 31, 1997 and December 31, 1998 indicate that, during the period shortly before and after December 5, 1997, Kevco acquired the stock or assets of one or more companies in addition to SDLP.

10. Earl Shepherd, president of NSP, testified that during the period from 1995 through 2002, NSP entered into at least three non-competition agreements with various parties other than Kevco or its predecessors. Mr. Shepherd further testified that, since the commencement of Kevco's bankruptcy case, NSP has licensed certain rights to use the Darco® trademark to an entity other than Kevco.

11. The transaction under the APA involved only a portion of the assets and business of NSP. After December 5, 1997, NSP continued to conduct business related to the manufacture of mobile homes and trucking equipment and the construction of single- and multi- family residences and commercial structures; it also continued to sell or distribute the products encompassed in the Excluded Business.

---

[2]The plaintiff in this adversary proceeding is the Plan Agent who was appointed pursuant to the Debtor's confirmed plan of reorganization and is responsible for prosecuting avoidance actions for the benefit of creditors under the plan.

12. Lawrence E. Glasgow, a lawyer who specializes in mergers and acquisitions, testified that the transaction embodied in the APA was not unusual among business entities in the United States at or since the time of execution of the APA. Mr. Glasgow further testified that the industries in which NSP and SDLP/Kevco do business do not differ from other manufacturing industries in the United States in any material respect relative to the execution and performance of asset purchase agreements, license agreements, and agreements not to compete.

13. The APA represents an arm's-length transaction. In entering into the APA, SDLP/Kevco was not subject to duress or overreaching by any person. There is no evidence that the APA constituted an attempt to place assets beyond the reach of creditors of SDLP/Kevco.

14. At no time prior to its receipt of the Disputed Payment did NSP contact or otherwise communicate with SDLP/Kevco concerning the payment due under the APA for the third quarter of 2000. NSP has never engaged in litigation to enforce its right to that payment. NSP did not take advantage of SDLP/Kevco's deteriorating financial condition to induce Kevco to make the Disputed Payment. In fact, there is no evidence in the record to suggest that NSP was aware of Kevco's deteriorating financial condition.

15. NSP and Kevco have not taken part in any collusive arrangements to favor NSP as a creditor during the period preceding Kevco's bankruptcy filing.

16. As measured against the amounts of SDLP/Kevco's purchases and sales of the Fabric and Darco® Floorshield pursuant to the APA, the amount of the Disputed Payment did not vary from the required calculation under the APA and thus, did not vary from the manner of calculating all prior payments. The form of Kevco's tender of the Disputed Payment did not differ from the form of its previous payments.

17. The payment terms prescribed by the APA, as well as the manner of payments actually made by SDLP/Kevco under that agreement, were within the range of payment terms and practices which other business entities have observed in transactions similar to that evidenced by the APA.

18. The APA itself was within the range of customary practices of other business entities in transactions involving sales of assets, license agreements, and non-compete agreements.

19. To the extent any finding of fact constitutes a conclusion of law, it should be construed as such.

CONCLUSIONS OF LAW

20. The Court has jurisdiction over this adversary proceeding pursuant to 28 U.S.C. §§ 157 and 1334. The adversary proceeding is a core proceeding within the meaning of 28 U.S.C. § 157(b)(2)(F).

21. While the Plan Agent has the initial burden of proof here, NSP agreed at the outset of the trial that the Plan Agent has made a prima facia case of an avoidable preference with respect to the Disputed Payment. Thus, unless NSP has a valid defense to the Plan Agent's preference claim, the Plan Agent will be entitled to a judgment against NSP.

22. NSP's defense to the Plan Agent's avoidance of the Disputed Payment is based on section 547(c)(2) of the Bankruptcy Code, commonly referred to as the ordinary course of business defense.

23. As this Court noted in *SWP Corp. v. A.P.V. Equip., Inc. (In re SPW Corp.),* 96 B.R. 676, 679 (Bankr. N.D. Tex. 1989) (quoting H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 373 (1977) *reprinted in* 5 U.S. Code Cong. & Admin. News 5787, 6329 (1978)), "[t]he purpose of the ordinary course of business exception is to 'leave undisturbed normal financial relations,

because it 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.'" Or, as stated by the Fifth Circuit in *Gulf City Seafoods, Inc. v. Ludwig Shrimp Co., (In re Gulf City Seafoods, Inc.),* 296 F.3d 363, 367 (5th Cir. 2002), the purpose of section 547(c)(2) is to distinguish between ordinary payments and those which "represent collusive arrangements designed to favor the particular creditor during the debtor's slide into bankruptcy."

24. In order to prevail on its ordinary course of business defense, NSP bears the burden of proof, *see* 11 U.S.C. § 547(g), and must establish that the Disputed Payment was:

> A. in payment of a debt incurred by SDLP/Kevco in the ordinary course of business or financial affairs of SDLP/Kevco and NSP;
>
> B. made in the ordinary course of business or financial affairs of SDLP/Kevco and NSP; and
>
> C. made according to ordinary business terms.

See 11 U.S.C. § 547(c)(2).

25. In *SWP Corp.,* this Court stated:

> In considering which transactions are 'ordinary,' courts generally look at several factors including the timing, the amount and manner a transaction was paid and the circumstances under which the transfer was made.
>
> ***
>
> As one court noted 'the cornerstone of this element [ordinary course of business] of a preference defense is that the creditor needs demonstrate some consistency with other business transactions between the debtor and the creditor.' [quoting *In re Magic Circle Energy Corp.*, 64 B.R. 269, 273 (Bankr. W.D. Okla. 1986)].

SWP Corp., 96 B.R. 676 at 681.

26. The evidence before the Court is that the payments from SDLP/Kevco to NSP during the pre-preference period were made anywhere from approximately 14 days late under the terms of

the APA to 16 days late,[3] and the transfer during the preference period was 1 day late. Therefore, comparing the pre-preference period with the preference period, the preference period payments were made within the range of days for payments made during the pre-preference period. The evidence establishes that NSP took no unusual action to collect the amounts owing to it under the APA during the preference period. Further, the preference period payment was made in the same manner as the payments from SDLP/Kevco to NSP during the pre-preference period.[4]

27. While the Plan Agent argued that since SDLP/Kevco could not enter into the APA after its bankruptcy filing without Court approval (because the transaction would be outside the ordinary course of Kevco's business), and therefore, by analogy, the transaction should not be found to be in the ordinary course of SDLP/Kevco's business prior to its bankruptcy filing, that argument misstates the issue. Under section 547(c)(2)(A), it is the transfer (here, the Disputed Payment) that must be in payment of a debt incurred by SDLP/Kevco in the ordinary course of business of SDLP/Kevco and NSP.

28. The characterization of an underlying transaction as having occurred in the ordinary course of business within the meaning of section 547(c)(2)(A) does not require a finding that the debtor in a particular case has engaged in previous, similar transactions. In *Gosch v. Burns (In re Finn),* 909 F.2d 903, 908 (6th Cir. 1990) (emphasis added), the court stated:

---

[3]Although 1 payment under the APA was received approximately 46 days late, the parties agree that this payment was an aberration and should not be included in the preference analysis.

[4]The Plan Agent argues that because the check issued in connection with the Disputed Payment had only one signature when two signatures were required, that differentiates the Disputed Payment from prior payments. While the Court concedes that the missing signature makes this check different, no explanation was offered as to why the check was issued with only one signature. Moreover, nothing in the record suggests that NSP had anything to do with the issuance of a check with only one signature. In any event, the fact remains that the Disputed Payment was made in the same manner as all prior payments – *i.e.*, by check. If SDLP/Kevco's bank should have refused to honor a check with only one signature, then the Plan Agent should have pursued a claim against the bank.

> We hold that, as a general rule, subject to the individual fact-finding powers of the district court in a specific inquiry, a transaction can be in the ordinary course of financial affairs even if it is the first such transaction undertaken by the customer. This rule holds where the transaction *would not be out of the ordinary for a person in the borrower's position.*

Similarly, in *Hovis v. Aerospace Solutions, Inc. (In re Air South Airlines, Inc.)*, 247 B.R. 153, 162 (Bankr. D.S.C. 2000), the court held that the "ordinary course" defense is available "even if there is no prior history of dealings and the transaction is the first to take place between the creditor and the debtor." Even in an instance in which a debtor has not engaged in previous transactions similar to the one at issue, the "ordinary course" defense under section 547(c)(2) is available if the transaction in question is a normal financial relationship and is not an "'*unusual* action' undertaken during the 'slide into bankruptcy,'" *Gosch,* 909 F.2d at 907.

29. On this record, the Court is satisfied that the debt owing to NSP under the APA was incurred by both SDLP/Kevco and NSP in the ordinary course of their respective businesses or financial affairs, thus satisfying the first element of the ordinary course of business defense.

30. Section 547(c)(2)(B) requires a determination that the Disputed Payment was made "in the ordinary course of business or financial affairs of the debtor and the transferee." Under section 547(c)(2)(B), the issue in part is whether the contested transfer occurred as part of "recurring, customary credit transactions." *Hovis,* 247 B.R. at 158 (quoting *Energy Coop v. SOCAP Int'l, Ltd. (In re Energy Coop, Inc.)*, 832 F.2d 997, 1004 (7th Cir. 1987)). Moreover, periodic payments of a long-term obligation may constitute transfers in the ordinary course of business under section 547(c)(2)(B). *Union Bank v. Wolas*, 502 U.S. 151, 151, 112 S. Ct. 527, 528 (U.S. 1991)(holding that payments on long-term debt, as well as those on short-term debt, may qualify for the ordinary course of business exception to a trustee's power to

avoid preferential transfers); *Gosch*, 909 F.2d at 908.

31. In analyzing section 547(c)(2)(B) and the factors typically considered when comparing pre-preference period transfers with preference period transfers, this Court must consider (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. *See Payne v. Clarendon Nat'l Ins. Co. (In re Sunset Sales, Inc.),* 220 B.R. 1005, 1020-21 (10th Cir. BAP 1998). Similar criteria are stated in *Hovis,* 247 B.R. at 160: (1) the prior course of dealing between the parties, (2) the amount of the payments, (3) the timing of the payments, and (4) the circumstances surrounding the payments. Within a limited range, the timing of a contested payment may vary from the timing of previous payments without defeating the application of section 547(c)(2)(B). *Id.* at 161 (citing *Huffman v. New Jersey Steel Corp. (In re Valley Steel Corp.)*, 182 B.R. 728, 737 (Bankr. W.D. Va. 1995)); *see ML Assoc., Inc. v. T&R Demolition, Inc.* (*In re ML Assoc., Inc.*), 301 B.R. 195, 204 (Bankr. N.D. Tex. 2003)(stating that courts concentrate on the time within which the debtor ordinarily paid the creditor, whether the timing of the payments during the preference period demonstrated some consistency with that practice, comparing the prior dealings between the debtor and creditor with their dealings during the preference period to determine whether the challenged dealings are ordinary, the timing of the payments, the amount and manner in which the transaction was paid, and the circumstances under which the transfer was made).

32. After considering all of the relevant factors, the Court concludes that the Disputed Payment reflects "some consistency" with the pre-preference period payments, *see Gasmark Ltd.*

Liquidating Trust v. Louis Dreyfus Natural Gas Corp., 158 F.3d 312, 317 (5th Cir. 1998); thus, the preference period payment was made in the ordinary course of SDLP/Kevco's and NSP's business or financial affairs, thereby satisfying the second element of the ordinary course of business defense.

33. Finally, the Court must determine whether the Disputed Payment was made according to "ordinary business terms." Because the Bankruptcy Code does not define the phrase "ordinary business terms" in section 547(c)(2)(C), courts have been left to fashion a definition or a test as to whether payments were made according to "ordinary business terms." In *Gulf City Seafoods, Inc.*, 296 F.3d at 367-8 (5th Cir. 2002), the Fifth Circuit noted the general consensus among the circuit courts that:

> a payment is 'according to ordinary business terms' if the payment practices at issue comport with the standard in the industry . . . . [T]he relevant inquiry is 'objective'. . . we compare the credit arrangements between other similarly situated debtors and creditors in the industry to see whether the payment practices at issue are consistent with what takes place in the industry. By consistent, we do not necessarily mean identical.

Expressing general agreement with the Seventh Circuit's views in *In re Tolona Pizza Prods. Corp.,* 3 F.3d 1029, 1033 (7th Cir. 1993) (only dealings so *idiosyncratic* as to fall outside that broad range should be deemed extraordinary and, therefore, outside the scope of ordinary business terms), the *Gulf City Seafoods, Inc.* court stated that "the ultimate question is simply whether a particular arrangement is so out of line with what others do that it fails to be 'according to ordinary business terms.'" 296 F.3d at 369. Similarly, the Sixth Circuit has held that a transfer is outside the ordinary course of business if the transfer is so unusual as to render it an *aberration* in the relevant industry. *See Luper v. Columbia Gas of Ohio, Inc. (In re Carled, Inc.),* 91 F.3d 811, 818 (6th Cir. 1996). The Third and Fourth Circuits have defined the standard such that the transfer must be a *gross departure* from the industry norm.

See Fiber Lite Corp. v. Molded Acoustical Prods., Inc., (In re Molded Acoustical Prods., Inc.), 18 F.3d 217, 226 (3rd Cir. 1994); *Advo-Sys., Inc. v. Maxway Corp.,* 37 F.3d 1044, 1050 (4th Cir. 1994). The Eighth Circuit has looked to see if the transfers were *particularly unusual* in the relevant industry. *See Jones v. United Sav. & Loan Ass'n (In re U.S.A. Inns of Eureka Springs, Ark., Inc.),* 9 F.3d 680, 685 (8th Cir. 1993).

34. According to the *Gulf City Seafoods, Inc.* court, "[d]efining the industry whose standard should be used for comparison is not always a simple task . . . . In our view, for an industry standard to be useful as a rough benchmark, the creditor should provide evidence of credit arrangements of other debtors and creditors in a similar market, preferably both geographic and product." *Gulf City Seafoods, Inc.*, 296 F.3d at 369.

35. Here, the Plan Agent argues that the relevant industry is a narrow one – *i.e.*, the recreational vehicle or mobile home industry, and that the Court must consider what terms are standard for transactions like the APA within that narrow industry. Because NSP did not introduce particularly compelling evidence with regard to these types of transactions within that narrow industry, the Plan Agent concludes that NSP failed to carry its burden of proof; thus, the Plan Agent is entitled to a judgment in his favor with respect to the avoidance of the Disputed Payment.

36. Conversely, NSP argues that the relevant industry is a broader one – *i.e.*, a general industry of merger and acquisitions. According to NSP's expert, Lawrence Glasgow, there is nothing in the APA that makes it particularly unique from similar transactions he has negotiated and documented outside of the recreational vehicle and mobile home industry. According to Glasgow, while each deal is different and the product of negotiation between the buyer and seller, the payment terms at issue here are common in these types of transactions. Moreover,

in Glasgow's experience, it is not uncommon for payments to be made a few days after the stated due date in the agreement.

37. The Court agrees with NSP that the industry does not have to be defined as narrowly as the Plan Agent contends. While Glasgow did not have specific experience in the recreational vehicle and mobile home industry, he did have broad experience with transactions such as that embodied in the APA. The Court found his testimony persuasive with respect to the nature of these types of transactions in general and the fact that there is nothing unusual with regard to the payment terms in the APA in particular.

38. Thus, after considering the relevant industry and the record made by the parties, the Court concludes that the fact that the Disputed Payment was received 1 day late is not "so out of line with what others do," *Gulf City Seafoods, Inc.*, 296 F.3d at 369, to be "an aberration in the relevant industry," *Luper v. Columbia Gas of Ohio, Inc. (In re Carled, Inc.)*, 91 F.3d 811, 818 (6th Cir. 1996), "a gross departure from the industry norm," *Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.)*, 18 F.3d 217, 226 (3rd Cir. 1994); *Advo-Sys., Inc. v. Maxway Corp.*, 37 F.3d 1044, 1050 (4th Cir. 1994), "particularly unusual in the relevant industry," *Jones v. United Sav. & Loan Ass'n (In re U.S.A. Inns of Eureka Springs, Ark., Inc.)*, 9 F.3d 680, 685 (8th Cir. 1993), or "so idiosyncratic as to . . . [be] extraordinary," *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993). In fact, the Plan Agent conceded at the conclusion of the trial that should the Court define the "industry" more broadly, as suggested by NSP, then NSP had satisfied the third element of its ordinary course of business defense.

39. In sum, NSP has carried its burden of proof and has established the existence of the ordinary course of business defense to the Plan Agent's preference claim. Thus, the Plan Agent is not

entitled to recover the Disputed Payment from NSP in accordance with section 547 of the Bankruptcy Code.

40. To the extent any conclusion of law constitutes a finding of fact, it should be construed as such.

SIGNED: March 25, 2004.

Barbara J. Houser
United States Bankruptcy Judge