

UNITED STATES BANKRUPTCY COURT
WESTERN DISTRICT OF NEW YORK

In re:

CASE NO. 98-20728

AAPEX SYSTEMS, INC.

Debtors.

DECISION & ORDER

LUCIEN A. MORIN, II, TRUSTEE
OF AAPEX SYSTEMS, INC.,

Plaintiffs,

V.

AP #99-2054

CANTON SABRECOM, INC.,

Defendants.

LUCIEN A. MORIN, II, TRUSTEE
OF AAPEX SYSTEMS, INC.,

Plaintiffs,

V.

AP #99-2137

SOUTH WILLIAMSPORT SABRECOM, INC.,

Defendants.

BACKGROUND

On December 30, 1999, the Court decided the Motions to Dismiss filed in these Adversary Proceedings by Canton Sabrecom, Inc. ("Canton") and South Williamsport Sabrecom, Inc.

("Williamsport"), by a Decision & Order (the "Section 7501 Trust Decision & Order").¹

In the Section 7501 Trust Decision & Order, the Court determined that: (1) funds which were transferred by AAPEX to the IRS and Williamsport on behalf of Canton and Williamsport during the preference period, which the Trustee had alleged were avoidable preferential transfers, were not impressed with a Section 7501 Trust, and, therefore, the holding in *Begier* could not be extended; and (2) there remained genuine issues of material fact as to whether the transferred funds were required to be or were actually ever held in trust by AAPEX, and whether the funds when transferred were property of AAPEX for purposes of Section 547(b).

Canton and Williamsport appealed the Section 7501 Trust Decision & Order to the United States District Court for the Western District of New York (the "District Court") which granted leave to appeal on the Section 7501 Trust issue.

On November 21, 2000, Chief U.S. District Court Judge David G. Larimer issued a Decision (the "District Court Decision &

¹ See 273 B.R. 19 (Bankr. W.D.N.Y. 2002). The Section 7501 Trust Decision & Order is incorporated herein, and the terms used and defined in that Decision & Order shall have the same meanings when used in this Decision & Order.

Order") which affirmed the Section 7501 Trust Decision & Order on the Section 7501 Trust issue.²

On February 13, 2002, the Court denied a Motion for Summary Judgment (the "Motion for Summary Judgment") filed by the Trustee on February 1, 2002, and on February 28, March 1 and April 25, 2002, the Court conducted a consolidated trial (the "Trial"), at which the following witnesses testified: (1) the Trustee; (2) Jerrilee Harvey ("Harvey"), the Tax Manager for AAPEX from June 1996 through November 1997; (3) Keith Thomas ("Thomas"), the comptroller and treasurer of Sabre Communications ("Sabre") and the treasurer for five of its wholly-owned subsidiaries, Canton, Williamsport, Corning Sabrecom, Inc. ("Corning"), Chemung County Radio, Inc. ("Chemung Radio"), and Arrow Communications of New York, Inc. ("Arrow") from approximately January 1996 through July 2001; and (4) Robert Appleby ("Appleby"), the general manager of the Elmira Water Board and its secretary and treasurer from 1982 through 1997.

² Chief Judge Larimer denied the request of Canton and Williamsport to certify the issue to the United States Court of Appeals for the Second Circuit (the "Second Circuit").

During the trial, the Trustee made an oral motion (the "Motion to Amend"), pursuant to Rule 7015,³ which requested that

³ Rule 7015. Amended and Supplemental Pleadings.

Rule 15 F.R.Civ.P. applies in adversary proceedings.

Rule 15 F.R.Civ.P. provides that:

(a) Amendments. A party may amend the party's pleading once as a matter of course at any time before a responsive pleading is served or, if the pleading is one to which no responsive pleading is permitted and the action has not been placed upon the trial calendar, the party may so amend it at any time within 20 days after it is served. Otherwise a party may amend the party's pleading only by leave of court or by written consent of the adverse party; and leave shall be freely given when justice so requires. A party shall plead in response to an amended pleading within the time remaining for response to the original pleading or within 10 days after service of the amended pleading, whichever period may be the longer, unless the court otherwise orders.

(b) Amendments to Conform to the Evidence. When issues not raised by the pleadings are tried by express or implied consent of the parties, they shall be treated in all respects as if they had been raised in the pleadings. Such amendment of the pleadings as may be necessary to cause them to conform to the evidence and to raise these issues may be made upon motion of any party at any time, even after judgment; but failure so to amend does not affect the result of the trial of these issues. If evidence is objected to at the trial on the ground that it is not within the issues made by the pleadings, the court may allow the pleadings to be amended and shall do so freely when the presentation of the merits of the action will be subserved thereby and the objecting party fails to satisfy the court that the admission of such evidence would prejudice the party in maintaining the party's action or defense upon the merits. The court may grant a continuance to enable the objecting party to meet such evidence.

(c) Relation Back of Amendments. An amendment of a pleading relates back to the date of the original pleading when

(1) relation back is permitted by the law that provides the statute of limitations applicable to the action, or

(2) the claim or defense asserted in the amended pleading arose out of the conduct, transaction, or occurrence set forth or attempted to be set forth in the original pleading, or

in the Williamsport Adversary Proceeding the Court, in its discretion, permit: (1) Sabre, Canton, Corning, Chemung Radio and Arrow be added as defendants; (2) the Trustee's Section 547 pleadings to be conformed to the evidence presented at the Trial; and (3) the Trustee's pleadings be amended to include a Section 548 fraudulent transfer cause of action against Sabre, in the event that Sabre denied that with respect to certain funds which it received from AAPEX during the preference period, it had acted as a conduit for its subsidiaries.

The Trustee and Williamsport agreed that: (1) they would argue the Motion to Amend during the Trial on March 1, 2002, and then file written submissions with the Court; and (2) the Court would decide the Motion at the same time it issued its decision on whether the funds transferred by AAPEX that were ultimately utilized to pay the taxes of Sabre and its subsidiaries, were

(3) the amendment changes the party or the naming of the party against whom a claim is asserted if the foregoing provision (2) is satisfied and, within the period provided by Rule 4(m) for service of the summons and complaint, the party to be brought in by amendment (A) has received such notice of the institution of the action that the party will not be prejudiced in maintaining a defense on the merits, and (B) knew or should have known that, but for a mistake concerning the identity of the proper party, the action would have been brought against the party.

impressed with a trust, or otherwise were not the property of AAPEX for purposes of Section 547(b).

With respect to the Motion to Amend, the Trustee's oral argument and June 10, 2002 submission asserted that: (1) when the Trustee commenced the Adversary Proceeding against Williamsport, to the best of his knowledge, information and belief, the records of AAPEX indicated that: (a) AAPEX check number 95008, dated December 17, 1997 in the amount of \$138,224.17 ("Check 95008"), was made payable to Williamsport; and (b) the proceeds of the Check were used by Williamsport to pay any of its remaining second, third and fourth quarter payroll taxes that AAPEX had failed to pay; (2) on February 27, 2002, the day before the Trial, the attorneys for Williamsport focused the attention of the attorneys for the Trustee on the facts that: (a) Check 95008 was made payable to Sabre, not Williamsport; and (b) as fully disclosed and described in an April 12, 1999 affidavit of Thomas (the "Thomas Affidavit"), filed by Williamsport in connection with its Motion to Dismiss, Sabre deposited Check 95008 into its general operating account and then paid some of its payroll taxes that AAPEX had failed to pay and disbursed the balance of the proceeds of the Check to its subsidiaries, who then used the proceeds to pay any of their remaining second, third and fourth quarter 1997 payroll taxes

that AAPEX had failed to pay;⁴ (3) during all phases of his prosecution of the Williamsport Adversary Proceeding prior to the Trial, including pretrial conferences, the Williamsport Motion to Dismiss and his Motion for Summary Judgment, the Trustee and his attorneys were focused on the various trust issues raised by Williamsport, and they had inadvertently failed to fully focus on: (a) the payee on Check 95008, even though a copy of the Check was included as an exhibit to the Trustee's opposition to the Williamsport Motion to Dismiss, which he filed on June 7, 1999; (b) the information set forth on the remittance portion of Check 95008, which may have indicated to the Trustee and his attorneys that the Check was for the taxes of Sabre and Arrow as well as Williamsport; and (c) the details set forth in the Thomas Affidavit concerning the Check and the distribution to and use of the proceeds by Sabre and its subsidiaries; (4) from the facts and circumstances presented, it was clear that the requirements of Rule 7015 for the Court to permit amendment and relation back existed, since: (a) the claim sought to be asserted in an amended complaint against Williamsport and the

⁴ The Thomas Affidavit indicated that the proceeds of Check 95008 were disbursed to and paid over to the IRS by Sabre and its subsidiaries, as follows:

Canton	\$14,148.76
South Williamsport	63,694.64
Sabre	1,029.08
Corning	23,123.62
Chemung Radio	3,772.32
Arrow	32,445.75

additional defendants arose out of the same transaction as the claim asserted in the original pleadings against Williamsport with respect to the transfer evidenced by Check 95008; (b) the additional defendants, whose treasurer, Thomas, was the same as the treasurer of Williamsport, received notice of the filing of the Complaint within the applicable time for service of the Complaint and before the expiration of the applicable statute of limitations, so that the additional defendants would not be prejudiced in maintaining any defenses available to them, which the Trustee believed were identical to the defenses asserted by Williamsport; and (c) the additional defendants knew that but for the Trustee's mistake as to the identity of all of the entities that benefitted from Check 95008, the additional defendants would have been named in the original Complaint in the Williamsport Adversary Proceeding; and (5) AAPEX Check 95008 had been requested by and delivered to Thomas and Paul Rothfuss ("Rothfuss"), the president of Sabre, Canton, Williamsport, Corning, Chemung Radio and Arrow, on December 17, 1997 at a meeting which Sabre had demanded of AAPEX, after Thomas and Rothfuss had learned that AAPEX had not paid all of the second, third and fourth quarter 1997 payroll taxes of Sabre and its subsidiaries even though all of the funds necessary to pay those taxes had been paid over to AAPEX by Sabre and the subsidiaries.

With respect to the Motion to Amend, the oral argument and June 10, 2002 submission of Williamsport asserted that: (1) the statute of limitations for the Trustee in the AAPEX case to commence an Adversary Proceeding to avoid preferential transfers expired on March 23, 2000, two years from the order for relief which was entered on March 23, 1998 (the "Statute of Limitations"); (2) prior to February 28, 2002 when the Trustee made this oral Motion to Amend, the Statute of Limitations had expired as to Sabre, Canton, Corning, Chemung Radio and Arrow with respect to the transfer evidenced by Check 95008; (3) the Trustee and his attorneys had in their possession prior to the expiration of the Statute of Limitations on March 23, 2000: (a) Check 95008, since it was included as an exhibit to the Trustee's opposition to the Williamsport Motion to Dismiss that the Trustee filed on June 7, 1999; and (b) the Thomas Affidavit, which fully explained the receipt, distribution and payment to the IRS of the proceeds of Check 95008; (4) in view of the information the Trustee and his attorneys had prior to the expiration of the Statute of Limitations, the Trustee's mistake regarding the proper recipients of the funds transferred by AAPEX by Check 95008 is not the type of mistake concerning the identity of a proper party as is contemplated by the relation back provisions of Rule 7015; (5) Sabre, Canton, Corning,

Chemung Radio and Arrow are separate and distinct corporate entities from Williamsport, notwithstanding that their president, treasurer and board of directors may have been identical at the time of the commencement of the Williamsport Adversary Proceeding; (6) when he commenced the Williamsport Adversary Proceeding, the Trustee and his attorneys did not misname or misidentify Williamsport as the proper and only party which had received and benefitted from the transfer evidenced by Check 95008, they simply failed to correctly analyze the Check and its remittance portion in order to determine that, at a minimum, the proper parties that had benefitted from that transfer included Sabre, the payee of the Check, and Arrow; (7) the Trustee's failure to commence actions against Sabre, Canton, Corning, Chemung Radio and Arrow in connection with the transfer evidenced by Check 95008 after he received the Thomas Affidavit, could not be found to be a justifiable mistake concerning the identity of the proper defendants; and (8) the Trustee's request to amend his Complaint and have it relate back to the commencement of the Williamsport Adversary Proceeding should be denied.

DISCUSSION

I. The Motion to Amend

We know from the decision of the Second Circuit in *Barrow v. Wethersfield Police Dep't*, 66 F.3d 466 (2d Cir. 1995), *modified*, 74 F.3d (2d Cir. 1996) ("*Barrow*"), that in order for an amended complaint that adds a new party to relate back to the original complaint, each of the following four conditions must be met: (1) the claim must have arisen out of the same conduct, transaction or occurrence as described in the original Complaint; (2) the party or parties proposed to be added must have received sufficient notice of the commencement of the action so that they will not be prejudiced in maintaining a defense; (3) the party or parties proposed to be added should have known that, but for a mistake concerning identity, the action would have been brought against them; and (4) within one hundred twenty (120) days of the filing of the original complaint, conditions 2 and 3 must have been satisfied.

Based upon the facts and circumstances presented, the Trustee's Motion to Amend in order to: (1) add Sabre, Canton, Corning, Chemung Radio and Arrow as defendants in the Williamsport Adversary Proceeding with respect to the transfer evidenced by Check 95008; and (2) have the amendment relate back

to the filing of his Complaint, must be denied. Even though the Federal Courts favor having matters resolved on their merits, the Trustee has failed to meet his burden to demonstrate that he or his attorneys made a mistake "concerning" the identity of all of the parties that received a transfer from AAPEX as the result of Check 95008, a necessary requirement under Rule 7015.

Although it would be difficult to imagine a set of circumstances under Rule 7015 where the unnamed proposed additional defendants: (1) had received more effective notice of the existence and nature of a trustee's claim to avoid a preferential transfer, since Thomas, the treasurer of each of the proposed additional defendants, participated in: (a) the meeting which resulted in the issuance of Check 95008; (b) the redistribution of the proceeds of the Check and the payment of those redistributed proceeds to the IRS; and (c) the Williamsport Adversary Proceeding, by fully describing the transactions in his Affidavit; (2) could be less prejudiced in having to maintain a defense, since there are no unique facts with respect to either their relationship with AAPEX, or the transactions in question, and their only defenses are identical to those already asserted by Williamsport; and (3) were more fully aware that the Trustee had made a mistake in naming less than all of the proper defendants, it is, nevertheless, clear

that the Trustee's mistake was not a mistake concerning the identity of all of the proper parties that received or benefitted from the transfer evidenced by Check 95008. The Trustee simply made an error in failing to identify and name all of the correct party defendants.⁵ That type of mistake about identity is not the type of mistake concerning identity that Rule 7015 contemplates and requires. It is the equivalent of a lack of knowledge, as discussed in *Barrow*, and, on the facts presented, it is also not the type of mistake that can be overcome by an identity of interest argument.⁶

Furthermore, within one hundred and twenty (120) days of the filing of his Complaint, the Trustee knew the identity of all of the entities that directly or indirectly received or benefitted from the transfer of the funds evidenced by Check 95008, since he had a copy of Check 95008 and the remittance portion of the Check in his possession, and he had received the Thomas Affidavit. With that information the Trustee could have: (1) prior to the expiration of that one hundred and twenty (120) day

⁵ At a minimum, the Trustee should have named Sabre, the payee on Check 95008, as a defendant in his Complaint. That would have required Sabre to disclose, as Williamsport did, the facts regarding the redistribution of the proceeds, but the Trustee would then, presumably, have focused on that information. In addition, if he had named Sabre, the parent company, as the only defendant in his Complaint, the Trustee might have had a more persuasive identity of interest argument.

⁶ 66 F.3d 466, 470.

period, moved to amend his Complaint to add the proposed additional parties; or (2) prior to the expiration of the Statute of Limitations, commenced separate adversary proceedings against the parties he now seeks to add. However, the Trustee inexcusably neglected to take either of those actions.

In summary, on the facts and circumstances presented, it is clear that prior to the expiration of the Statute of Limitations, the Trustee did not make a mistake regarding the correct identification, name or capacity of the proper party or parties that received an allegedly avoidable preferential transfer as the result of AAPEX issuing Check 95008 to Sabre. His mistake was that he failed to identify the existence of those proper parties, even though he and his attorneys had all of the information necessary to identify them; information, in part, supplied to them by Williamsport.

II. Property of the Debtor

In their June 10, 2002 Post-Trial Brief, Canton and Williamsport have asserted that the funds from the Master Payroll Account transferred to them or to the IRS during the preference period (the "Transferred Funds") were not property of AAPEX for purposes of Section 547(b) because the funds, paid to AAPEX by its clients, which AAPEX deposited into the Master Payroll Account so that it could pay the client's payroll taxes

(the "Client Funds"), were: (1) subject to an express or implied trust; (2) impressed with a constructive trust; (3) impressed with a statutory Section 7501 Trust; or (4) escrowed funds in the hands of AAPEX as an agent.

A. The Section 7501 Trust Decision & Order

The Court determined in the Section 7501 Trust Decision & Order, as affirmed by the District Court Decision & Order, that the Transferred Funds were not impressed with a Section 7501 Trust. For all of the reasons set forth in the Section 7501 Trust Decision & Order, the Court's determination on that issue remains the same.

In the Section 7501 Trust Decision & Order, the Court concluded that, at least with the provisions of Section 7501, when the Client Funds were deposited with AAPEX, the clients transferred the legal and beneficial interest in those Funds to AAPEX so that it could perform the services contracted for under their respective Payroll Service Agreements. After hearing all of the evidence produced at Trial, and for all of the reasons set forth in the Section 7501 Trust Decision & Order and in this Decision & Order, the Court's determination is that AAPEX had a legal and beneficial interest in the Client Funds.

B. Tracing

In the Section 7501 Trust Decision & Order, the Court indicated that it might find that the Transferred Funds were not property of AAPEX for purposes of Section 547(b), if: (1) by the use of any acceptable tracing rule, Canton or Williamsport could demonstrate that the Transferred Funds included any funds actually paid by them to AAPEX; and (2) from the evidence produced by Canton or Williamsport at a trial, the Court could find that the traced funds were required to be and were in fact held in trust by AAPEX.

In their June 10, 2002 Post-Trial Brief, Canton and Williamsport have further asserted that, because the Client Funds were never commingled with any other funds of AAPEX, except for the de minimis amounts deposited by the clients into the Master Payroll Account to pay the fees earned by AAPEX (the "Fees"), Canton and Williamsport were not required to trace the Transferred Funds.

Consistent with their position that tracing was not required, neither Canton nor Williamsport has produced any evidence to demonstrate that all or any portion of the Transferred Funds were funds that: (1) were actually paid by them to AAPEX; or (2) by the use of any acceptable tracing rule could be deemed to have been paid by them.

Even if a Court could find that the Client Funds paid by Canton and Williamsport to AAPEX for their second, third or fourth quarter 1997 payroll taxes were trust funds, escrowed funds or funds impressed with a constructive trust, because Canton and Williamsport cannot trace those Funds to the Transferred Funds, the Court cannot determine that the Transferred Funds were not the property of AAPEX for purposes of Section 547(b). Furthermore, Canton and Williamsport clearly never paid to AAPEX the amounts of the Transferred Funds used to pay the penalties and interest due for their unpaid payroll taxes.

Contrary to the position asserted by Canton and Williamsport, all of the Client Funds deposited into the Master Payroll Account did become commingled funds, in that they were: (1) commingled with the Fees which were clearly the property of AAPEX;⁷ and (2) commingled with the funds of other clients.

The position of Canton and Williamsport appears to be that: (1) all of the Client Funds which were commingled and unidentifiable as to source during the preference period, were, nevertheless, a pool of trust or escrowed funds in which each

⁷ Canton and Williamsport assert that these amounts were de minimis when compared with the deposits for payroll taxes. However, in theory, all of its commercial clients believed that these fees were sufficient for AAPEX to operate its business.

client was a beneficiary with an undivided interest; and (2) any of the pooled trust or escrowed funds could be utilized by AAPEX or any client beneficiary to pay the payroll taxes or penalties and interest due for unpaid taxes for any client which they chose to pay.

However, there is no evidence that Canton, Williamsport or any other client of AAPEX believed or agreed that: (1) their Client Funds were trust or escrowed funds; and (2) their trust or escrowed Client Funds could be used to pay any other clients' payroll taxes or penalties and interest.⁸

Furthermore, although that analysis might have some appeal if the Court could find that the Client Funds were trust or escrowed funds and it was presented with the question of who was entitled to the funds in the Master Payroll Account as between AAPEX and any one of its clients, these adversary proceedings have been commenced by the Trustee, in his representative capacity, for the benefit of the AAPEX estate and all of the client creditors of AAPEX. All of the client creditors of AAPEX paid AAPEX one hundred percent of the amounts

⁸ When Rothfus and Thomas, on behalf of Sabre, met with Bombarger on December 17, 1997 and demanded Check 95008, it is doubtful that the other clients of AAPEX, if they had known about the actual financial condition of AAPEX and Sabre's demand, would have ratified the transaction as to the use of their Client Funds.

necessary to pay their payroll taxes, but many had none or a smaller percentage of their payroll taxes paid than Canton or Williamsport did, in part, because AAPEX did not make payments to them or on their behalf during the preference period as it did for Canton and Williamsport.

In *Sonnenschein vs. Reliance Ins. Co.*, 353 F.2d 937 (2d Cir. 1965), the Second Circuit indicated that the basic idea of the trust doctrine as applied in bankruptcy is a fair and reasonable identification of the fund so as not to harm other creditors. In this case, it would be harmful and inequitable to AAPEX's other clients for the Court to abrogate the tracing rules for Canton and Williamsport, based upon their pooled trust fund theory, when there is absolutely no evidence that: (1) any of the Transferred Funds, which were unidentifiable as to source, included funds actually paid to AAPEX by Canton or Williamsport; and (2) other clients of AAPEX agreed to such a pooled trust fund.

In the absence of the ability of Canton and Williamsport to trace any of the Transferred Funds to funds actually paid by them to AAPEX, the Court cannot find that those Funds, commingled and unidentifiable as to source, were not the property of AAPEX for purposes of Section 547(b).

C. Constructive Trust

As correctly pointed out by Canton and Williamsport in their June 10, 2002 Post-Trial Brief, the Constructive Trust Doctrine is equitable in nature, and it is often utilized by courts to prevent unjust enrichment.⁹

In the Equitable Considerations section of the Section 7501 Trust Decision & Order, and as discussed above, the Court pointed out that many of the other client creditors of AAPEX were less fortunate than Canton and Williamsport. They paid AAPEX one hundred percent of the amounts necessary to pay their payroll taxes, however, because they did not benefit from any transfers made during the preference period, some of those taxes were not paid, or the percentage of those taxes and penalties and interest paid was less than that in the cases of Canton and Williamsport. Those client creditors will benefit from the recoveries that the Trustee has made as a result of settlements or court decisions in the other adversary proceedings that he commenced to avoid preferential transfers.

If the Court were to find that the Transferred Funds were impressed with a constructive trust for the benefit of Canton and Williamsport, it would be Canton and Williamsport that would be unjustly enriched, not as between them and the now

⁹ See *Koreag, Controle, et Revision S.A. v. Refco F/X Associates (In re Koreag, Controle, et Revision S.A.)*, 961 F.2d 341, 352-355 (2d Cir. 1992).

defunct AAPEX, but at the expense of the other client creditors of AAPEX who, because of the various avoidable preferential transfers that AAPEX made, including those to Canton and Williamsport, have had less of a percentage of their payroll taxes paid than Canton and Williamsport would have paid if the Court were to make such a constructive trust finding. For that reason, the Court, in its equitable discretion, will not impose a constructive trust on the untraceable Transferred Funds, especially to the extent that those Funds were used to pay penalties and interest.

D. Trust Funds

In their June 10, 2002 Post-Trial Brief, Canton and Williamsport have also asserted that the funds in the Master Payroll Account were impressed with an express or implied trust.

As discussed in the Trust Funds section of the Section 7501 Trust Decision & Order, the provisions of the Payroll Service Agreement are inconsistent, ambiguous and ineffective to create an express trust.

Canton and Williamsport, however, have asserted that, from the conduct of the parties and all of the surrounding facts and circumstances presented, the Court should conclude that the Transferred Funds were funds held in trust by AAPEX for the benefit of others, since the only reasonable conclusion to be drawn from the evidence is that the clients of AAPEX expected

the funds to be used for their designated purposes, in the case of Canton and Williamsport, to pay their payroll taxes.

Although some of the loosely, but very carefully, strung together facts and circumstances that Canton and Williamsport have emphasized existed or failed to exist in the relationship between AAPEX and its clients, might be consistent with a trust relationship, they are not sufficient for this Court to find an implied trust. These facts and circumstances included that: (1) some clients may have made more detailed inquiries into the processes and procedures employed and to be employed by AAPEX, including exactly what was supposed to happen with the Client Funds;¹⁰ (2) some clients may have received oral representations at times from representatives of AAPEX, including its principal, Daniel Bombarger ("Bombarger"), and Harvey, that Client Funds were being used only to pay payroll taxes, or that they were being held in trust; and (3) AAPEX used the designation word "trust" on the Hexagon System for deposits of Client Funds into the Master Payroll Account. However, it is clear from the testimony of Harvey that at least from June 1996 on, Bombarger was treating the Master Payroll Account as a "honey pot," a fund utilized to pay whatever was necessary or

¹⁰ From the testimony at Trial, it is clear that when their Payroll Service Agreements were entered into, Appleby had more detailed discussions with representatives of AAPEX than the discussions that Thomas had on behalf of Canton and Williamsport.

desired. This included the operational expenses of AAPEX, penalties and interest due on the unpaid payroll taxes of clients, past due and current payroll taxes of clients, and who knows what else. It is also clear from the testimony of Thomas that he did not insist that the Client Funds paid to AAPEX by Sabre or any of its subsidiaries be segregated and held in trust, and no specific representations were made to him that such funds would be segregated and held in trust for the benefit of Sabre and its subsidiaries.

Furthermore, there is no evidence from which a court could conclude that Client Funds were being held in trust to pay penalties and interest on payroll taxes that AAPEX had failed to pay.

E. Escrowed Funds

Although the Master Payroll Agreement does have references to escrowed funds and AAPEX being an agent for certain payroll tax deposit purposes, and the checks issued by AAPEX on the Master Payroll Account were at times designated as an "Agency Check," including Check 95008, by the preference period, the conduct of AAPEX indicated that it never intended to act as an escrow agent for the Client Funds. Furthermore, once again, Canton and Williamsport have failed to: (1) trace the alleged escrowed funds paid by them to AAPEX to the Transferred

Funds, especially with respect to the Transferred Funds that were used to pay penalties and interest; or (2) present any evidence that the other clients of AAPEX had agreed to a pooled escrow fund arrangement.

CONCLUSION

The Motion to Amend the Williamsport Adversary Proceeding Complaint to add Sabre, Canton, Corning, Chemung Radio and Arrow as defendants with respect to the transfer evidenced by Check 95008 is denied. The Motion is granted, however, to the extent that the alleged avoidable preferential transfer made to Williamsport as the result of the issuance of Check 95008 is reduced to \$63,694.64.

The transfers to or on behalf of Canton and Williamsport, as set forth in the Canton and Williamsport Complaints, except to the extent that the Williamsport Complaint has been modified with respect to the transfer evidenced by Check 95008, are found to be avoidable preferential transfers, and the amount of these transfers shall be paid over to the Trustee within ten (10) business days from the date of this Decision & Order.

IT IS SO ORDERED.

HON. JOHN C. NINFO, II

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CHIEF U.S. BANKRUPTCY JUDGE

Dated: August 16, 2002