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1

Basic Bankruptcy Preference and Fraudulent Conveyance Law and Special Issues in the Oil and Gas Industry.

2

A typical preference case.

3

What is the problem that the preference laws try to solve?

4

Welcome to the bankruptcy party!

5

This is a special party.
Everyone is invited but some people get there early.

6

7

The host may say, “Please put the pieces back so that everyone will get an equal slice.”

8

Should everyone have to return the slices?

Did someone show up early on purpose?

What if no pie is left at all?

9

What is a preference clawback?

10

Not defined in the Bankruptcy Code.
Only what can be “avoided” or not.

11

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1)to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) Made—
a) on or within 90 days before the date of the filing of the petition; or
b)between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

12

Sec. 547 (c) : The trustee **may not avoid** under this section a transfer—

(1) to the extent that such transfer was—
(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

13

Any full payment to a creditor when the debtor is insolvent and followed by a bankruptcy.

14

The rationales for the preference clawback laws.

15

Rationale 1:
Equality of distribution during insolvency.

16

Equality of distribution means - Creditors of *equal* priority should receive pro rata shares of the debtor's property. In other words, the debtor is not permitted to favor one creditor over others by transferring property shortly before filing for bankruptcy.

17

Rationale 2:
Discourage creditors from being aggressive when a company is in trouble and thereby avoiding bankruptcy, if possible.

18

Race to the Courthouse

Section 547 is designed to discourage creditors from racing to the courthouse to sue and obtain judgments against a financially distressed company, or take any other action to collect their claims, that would precipitate the company's filing for bankruptcy.

19

No Intent is Required

Neither the intent nor motive of the parties is relevant in consideration of an alleged preference under 11 U.S.C.S. § 547(b). It is the effect of the transaction, rather than the debtor or creditor's intent, that is controlling. Therefore, what the parties might have intended to accomplish is immaterial; the effect of what was done is controlling

20

21

Standing To Bring A Preference Case

22

In re MPF Holding US LLC

443 B.R. 736 (Bankr. S.D. Tex. 2011)

23

Quick Summary

Trustee initiated preference actions against debtor's creditors

Creditors argued – trustee has no proper authority to sue under debtor's reorganization plan, so can't initiate preference action

Court Conclusion

a) Debtor's reorganization plan included the language
- that created an ambiguity
- did not definitively establish what claims actually trustee had to sue

b) The language in the plan must be "specific and unequivocal" to grant a standing to trustee to sue.

c) The plan must
- identify the parties individually
- set forth the legal basis for the suit clearly.
- clearly state that following confirmation, defendant will be sued

d) The trustee lacked standing to sue those creditors that were specifically not included in the plan as potential defendants.

24

Burden of Proof

25

Sec. 547 (g) : For the purposes of this section, the trustee has the burden of proving the avoidability of a transfer under subsection (b) of this section, and the creditor or party in interest against whom recovery or avoidance is sought has the burden of proving the non-avoidability of a transfer under subsection (c) of this section.

26

In other words, the trustee has the burden of proving the elements of preference.

The defendant has the burden of proving the defenses to a preference.

27

Trustee's burden of proving the elements of preference.

28

In Shapiro v. Art Leather, Inc. (In re Connolly N. Am., LLC)

398 B.R. 564 (Bankr. E.D. Mich. 2008)

29

Facts:

•Trustee sought to avoid $3.2 million as preference.

•Creditor argued that trustee failed to prove an element of preference under § 547(b)(5) – "the creditor received more" element

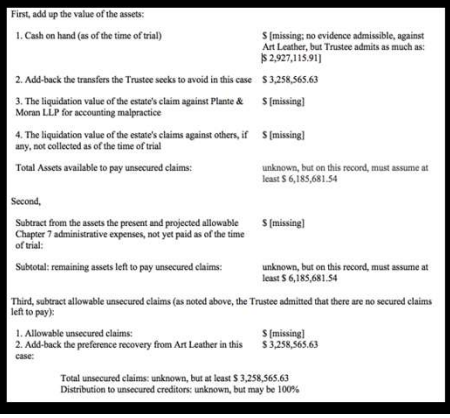
•Court noted that the trustee bore the burden of proving that the non-priority unsecured creditors in the hypothetical Chapter 7 liquidation case would have received less than a 100 percent distribution.

•Trustee submitted a testimony of a Certified Public Accountant (CPA).

•However, the court noted that the testimony was neither admissible nor entitled any weight.

30

Missing facts in trustee's proof



First, add up the value of the assets:	
1. Cash on hand (as of the time of trial)	$ [missing; no evidence admissible, against Art Leather, but Trustee admits as much as: $ 2,927,115.91]
2. Add-back the transfers the Trustee seeks to avoid in this case	$ 3,258,565.63
3. The liquidation value of the estate's claim against Plante & Moran LLP for accounting malpractice	$ [missing]
4. The liquidation value of the estate's claims against others, if any, not collected as of the time of trial	$ [missing]
Total Assets available to pay unsecured claims:	unknown, but on this record, must assume at least $ 6,185,681.54
Second,	
Subtract from the assets the present and projected allowable Chapter 7 administrative expenses, not yet paid as of the time of trial:	$ [missing]
Subtotal: remaining assets left to pay unsecured claims:	unknown, but on this record, must assume at least $ 6,185,681.54
Third, subtract allowable unsecured claims (as noted above, the Trustee admitted that there are no secured claims left to pay):	
1. Allowable unsecured claims:	$ [missing]
2. Add-back the preference recovery from Art Leather in this case:	$ 3,258,565.63

Total unsecured claims: unknown, but at least $ 3,258,565.63
Distribution to unsecured creditors: unknown, but may be 100%

31

Court's ruling:

•Trustee's proof missed several critical facts to prove the "the creditor received more" element.

•Trustee failed to meet his burden of proof.

•Court ruled in favor of the creditor holding that the alleged transfers were not avoidable as preference.

32

Defendant's burden of proving the defenses to preference.

33

Mangan v. Clark Farms, Inc. (In re Quality Sales, LLC),

521 B.R. 450, 2014 Bankr. LEXIS 4702 (Bankr. D. Conn. 2014)

34

Facts:

•The Defendant operated a farm and agreed to grow agricultural produce for sale to the Debtor. Debtor paid $16,355.00 to the Defendant for the Produce during the preference period.

•Trustee sought to recover this amount as preference.

•Defendant sought protection under § 547(c)(1), (2), or (4) exceptions to preference.

•Court noted that Defendant had the burden to prove non-avoidability of the transfers.

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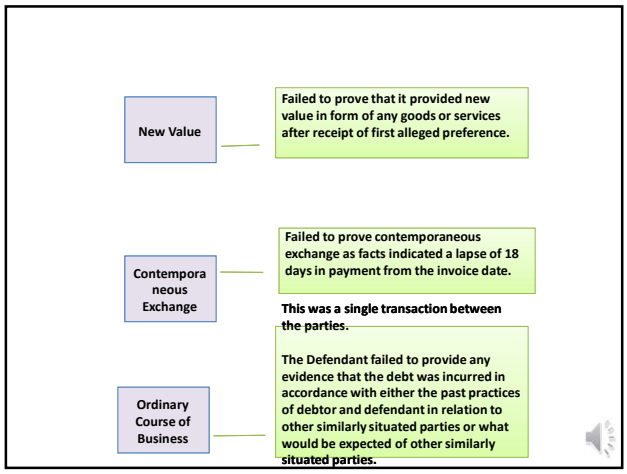

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Court's ruling:

•Defendant failed to prove its burden due to lack critical facts and evidence to prove non-avoidability.

•Court ruled in favor of the Trustee.

•Payments were held to be preferential transfers.

37

Jurisdiction

38

In re American Aluminum Window Corp.,

15 B.R. 803, 1981 Bankr. LEXIS 2438, Bankr. L. Rep. (CCH) P68,638, 8 Bankr. Ct. Dec. 713 (Bankr. D. Mass. 1981)

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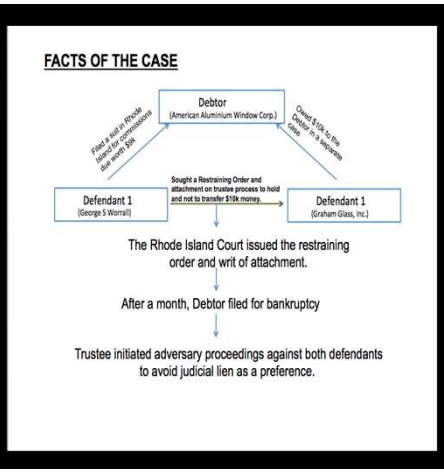
FACTS OF THE CASE



The Rhode Island Court issued the restraining order and writ of attachment.

After a month, Debtor filed for bankruptcy

Trustee initiated adversary proceedings against both defendants to avoid judicial lien as a preference.

40

Defendant 1 —Motion to dismiss→ **Lack of Jurisdiction**

Defendants Arguments

- No sufficient nexus between the Defendant's employment in Rhode Island and the Debtor's bankruptcy petition to confer personal jurisdiction over the Defendant.
- Basis for personal jurisdiction is governed by the Massachusetts Long Arm Statute, Mass.Gen.Laws Ann. ch. 223A, § § 1-14, and since Defendant was employed and worked in Rhode Island, the necessary minimum contacts did not exist.

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- "Source of the Bankruptcy Court's jurisdiction, whether in rem or in personam, comes directly from the 1978 Bankruptcy Act and not from any state long arm statute…."
- "Jurisdiction of a federal court when it is applying a federal statute is not limited by state law. It is not the Commonwealth of Massachusetts but the United States which is exercising its jurisdiction over the Defendant".
- "In *Erie Railroad v. Tompkins, 304 U.S. 64, 78, 58 S. Ct. 817, 822, 82 L. Ed. 1188 (1938)*, the Supreme Court stated that "(e) except in matters governed by the Federal Constitution or by Acts of Congress, the law to be applied in any case is the law of the State."
- " § 1471 controls the jurisdiction of the Bankruptcy Court. Therefore, under even the court created Erie doctrine, the Bankruptcy Court does not look to the Massachusetts Long-Arm statute to determine the extent of its [**14] in personam jurisdiction "

42

28 U.S.C. § 1471:

The basic jurisdictional provision of this Court is set forth in 28 U.S.C. § 1471:

(a)Except as provided in subsection (b) of this section, the district courts shall have original and exclusive jurisdiction of all cases under title 11.

(b) Notwithstanding any Act of Congress that confers exclusive jurisdiction on a court or courts other than the district courts, the district courts shall have original but not exclusive jurisdiction of all civil proceedings arising under title 11 or arising in or related to cases under title 11.

(c) The bankruptcy court for the district in which a case under title 11 is commenced shall exercise all of the jurisdiction conferred by this section on the district courts

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Courts' Ruling

- **Under 28 U.S.C.S. § 1471, the court had original and exclusive jurisdiction over cases arising under Title 11**
- The Defendant was properly served and had notice of the proceedings;
- Procedural due process was satisfied.
- After finding that jurisdiction was proper, the court noted that the judicial lien was transfer within the expansive definition of *11 U.S.C.S. 101(40)* and voided the lien as a ***preference***.

44

Tucker Plastics v. Pay 'N Pak Stores (In re PNP Holdings Corp.),

184 B.R. 805, 1995 Bankr. LEXIS 1088, Bankr. L. Rep. (CCH) P76,631, 27 Bankr. Ct. Dec. 772, 95 Cal. Daily Op. Service 6521, 95 Daily Journal DAR 10976 (B.A.P. 9th Cir. Wash. 1995)

45

Defendant —Motion to dismiss→ Lack of Jurisdiction

Defendants Arguments

- Defendant was a Canadian corporation with no business installations or employees in the United States.
- All of its sales were made by manufacturer's representatives who are independent contractors of Tucker,
- All goods sold were shipped and invoiced from Canada.
- Requirements for service of process in a foreign country as provided by Bankruptcy Rule 7004(e) were not met.

46

Courts' Ruling

•Defendant's motion to dismiss denied. Defendant had submitted itself to the court's jurisdiction by filing a proof of claim.

•Defendant was liable as an initial transferee and awarded judgment for return of preferences.

•Filing a proof of claim evidences consent to jurisdiction, Appellant's Rule 7004(e) argument is without merit.

•No need to address whether personal jurisdiction over Defendant would be proper under Washington's long-arm statute. "Consent is [a] traditional basis of jurisdiction, existing independently of long-arm statutes."

•"Creditor cannot reasonably expect to invoke those portions of the bankruptcy code that allow it to recover on its claims and yet avoid the legal effect of other sections that do not work in its favor."

47

Venue

48

Giuliano v. Harko, Inc. (In re NWL Holdings, Inc.),

2011 Bankr. LEXIS 580, 2011 WL 767777 (Bankr. D. Del. Feb. 24, 2011)

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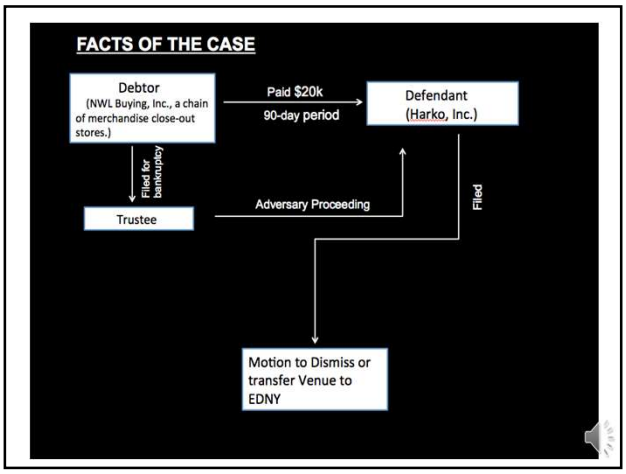

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Arguments

Defendant	Trustee
Venue in this Court is no longer proper after the Debtors' cases were substantively consolidated under NWL Holdings.	Defendant misstates the effects of substantive consolidation.
As a result of the substantive consolidation of the Debtors there is no longer a pending affiliate case that would justify venue in Delaware.	Effect of the substantive consolidation was not to eliminate each of the consolidated cases nor to divest this Court of jurisdiction over the consolidated cases
Court should transfer venue to the Eastern District of New York.	Venue in Delaware is proper
Claim arose in the Eastern District of New York because that is where defendant formed its relationship with the Debtors.	Dispute is centered upon the payments received by defendant within ninety days period, not the relationship that existed prior to filing.
Venue should be transferred as its records are located in New York	Location of books and records not a significant factor due to the ease of transporting documents
More convenient for it to litigate in EDNY	More convenient in Delaware. Venue change would increase the administrative expenses of the estate
As this court focuses on the laws of Delaware and not the laws of New York, this Court would have to dedicate resources to obtaining an understanding of New York fraud and equitable recoupment law.	Action is a preference action arising under the Bankruptcy Code, which is the same in both Delaware and New York

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1412 does not require that the action could have been brought in the transferee district. See, e.g., In re Manville Forest Prods. Corp., 896 F.2d 1384, 1390-91 (2d Cir. 1990); Thomson McKinnon Sec., Inc. v. White (In re Thomson McKinnon Sec., Inc.), 126 B.R. 833, 834-35 (Bankr. S.D.N.Y. 1991). HN10 In making a determination of whether to transfer venue, the Third Circuit has held that courts should consider numerous factors, including:

> 1) plaintiff's choice of forum; 2) defendant's forum preference; 3) whether the claim arose elsewhere; 4) the location of books and records and/or the possibility of viewing premises if applicable; 5) the convenience of the parties as indicated by their relative physical and financial condition; 6) the convenience of the witnesses, but only to the extent that the witnesses may actually be unavailable for trial in one of the fora; 7) the enforceability of the judgment; 8) practical considerations [13] that would make the trial easy, expeditious, or inexpensive; 9) the relative administrative difficulty in the two fora resulting from congestion of the courts' dockets; 10) the public policies of the fora; 11) the familiarity of the judge with applicable state law; and 12) the local interest in deciding local controversies at home.

Jumara v. State Farm Ins. Co., 55 F.3d 873, 879-80 (3d Cir. 1995).

52

Court's Decision

Substantive consolidation did not eliminate the effect of the filing of the Debtors' affiliate cases.
NWL Buying case was not closed and was still an open case. Nothing in the substantive consolidation Order directed that it or the other affiliate cases be closed.
Under section 1408(2), a bankruptcy case may be filed in the district "in which there is a pending case under title 11 concerning such person's affiliate. . . ." 28 U.S.C. § 1408(2). Once filed, a bankruptcy case is "pending" unless it has been closed.
Consequently, the Court finds that venue in Delaware is proper for the NWL Holdings case, as there is still a pending affiliate case. 28 U.S.C. § 1408(1).
After weighing the twelve factors laid down by Third Circuit, the Court found that most of the factors favored venue to remain in Delaware or are neutral.
Transfer of venue is unwarranted.
Defendant's motion to transfer venue was denied.

53

Deadline To Bring a Preference Case
(Statue of Limitation)

54

Sec. 546 (a) - An action or proceeding under section 544, 545, 547, 548, or 553 of this title may not be commenced after the earlier of—

(1)the later of—

(A) 2 years after the entry of the order for relief; or

(B) 1 year after the appointment or election of the first trustee under section 702,1104, 1163, 1202, or 1302 of this title if such appointment or such election occurs before the expiration of the period specified in subparagraph (A); or

(2) the time the case is closed or dismissed.

55

2 year statute of limitation under § 546(a)(1)

56

Elements of a Preference Case (Sec 547(b))

57

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) Made—
a) on or within 90 days before the date of the filing of the petition; or
b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

58

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
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(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.

59

Transfer of Interest of the Debtor in Property.

60

11 U.S. Code § 101 (54) - The term "transfer" means-

(A) the creation of a lien;

(B) the retention of title as a security interest;

(C) the foreclosure of a debtor's equity of redemption; or

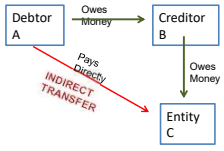
(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—
(i) property; or
(ii) an interest in property.

61

Indirect Transfers

62

INDIRECT TRANSFER



Debtor A pays Entity C for benefit of Creditor B = Indirect Transfer

63

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
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(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.

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ThermoView Indus. v. Clemmens (In re ThermoView Indus.)

358 B.R. 330, 332 (Bankr. W.D. Ky. 2007)

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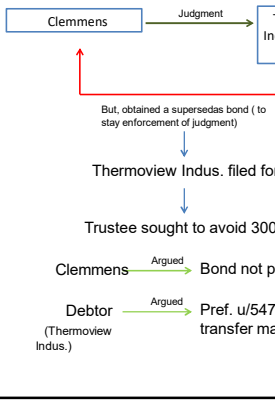

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Court's Conclusion

Interest of the debtor was transferred when the funds came out of the Debtor's account and went to Clemmens
Debtor's estate was diminished by $300,000
Those funds were not available to other creditors
Bond was obtained specifically to stay enforcement of execution of the Judgment. Thus, the transfer certainly for the benefit of a creditor.
Alleged transfer was an indirect transfer of property of the Debtor for the benefit of Clemmens, hence preference

67

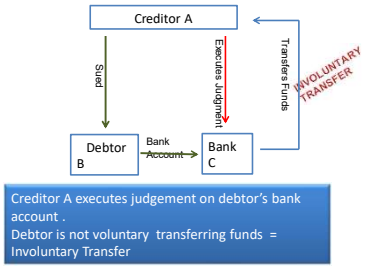
Voidable indirect preferential transfer occurs when a purchaser of assets assumes liabilities as part of the purchase price and makes payments on those liabilities to a creditor of the debtor.

68

Involuntary Transfers

69

INVOLUNTARY TRANSFER



Creditor A executes judgement on debtor's bank account .
Debtor is not voluntary transferring funds = Involuntary Transfer

70

In re Maytag Sales & Service, Inc.

23 B.R. 384 (Bankr. N.D. Ga. 1982)

71

"Lien" as an involuntary transfer.

72

Pysz v. Hawkins (In re Pysz)

2008 Bankr. LEXIS 2828, 2008 BNH 4 (Bankr. D.N.H. 2008)

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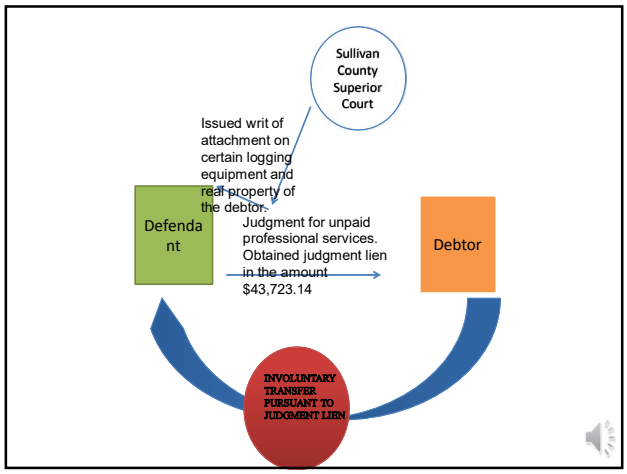

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Arguments:

- Trustee sought to avoid judicial lien as preference.
- Defendant argued that the Defendant was solvent at the time of the attachment.
- Defendant also argued that it did not receive more with the judicial lien than it would without the lien in a chapter 7 case.

75

Court's ruling:

•Records established that Debtor was insolvent. Liabilities exceeded the assets.

•The Defendant's judgment was for unpaid professional services, which, absent the attachment, was a general unsecured debt.

•By obtaining and recording the attachment, the Defendant converted an otherwise unsecured claim to a secured one.

•Thus, the lien enabled the Defendant to receive more than he would without the lien in a Chapter 7 case.

•It was preferential transfer.

76

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
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c) such creditor received payment of such debt to the extent provided by the provisions of this title.

77

Transfer of Interest of the Debtor in Property.

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Transfer of Interest of the Debtor in Property.

79

Earmarking

80

Bender Shipbuilding & Repair Co. v. Malone Consulting Servs.
(In re Bender Shipbuilding & Repair Co.)

2012 Bankr. LEXIS 4834 (Bankr. S.D. Ala. Oct. 15, 2012)

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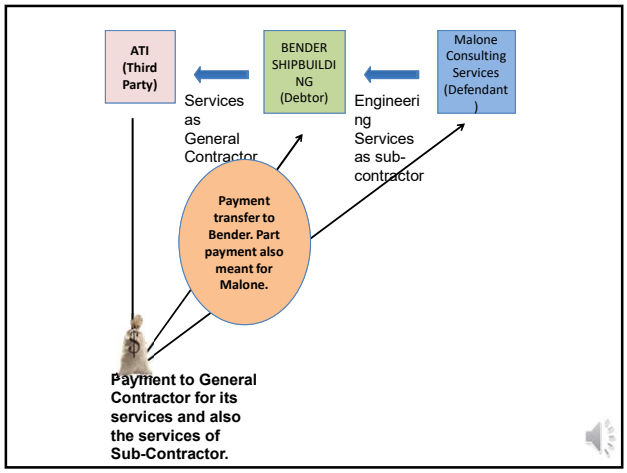

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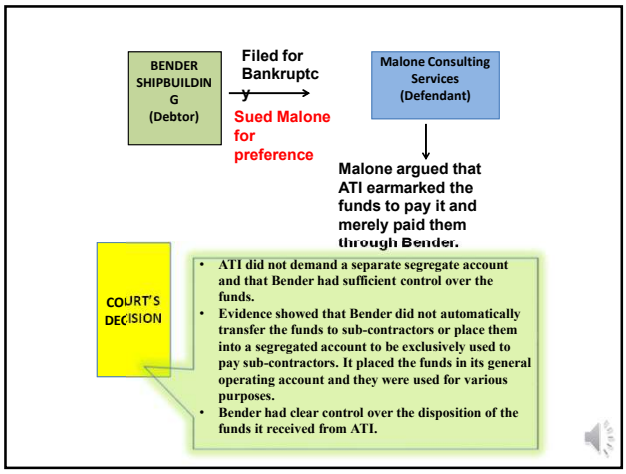

83

Diminution of Debtor's Property

84

Yoppolo v. MBNA Am. Bank, N.A. (In re Dilworth),

560 F.3d 562, 2009 U.S. App. LEXIS 6419, 2009 FED App. 0118P (6th Cir.), Bankr. L. Rep. (CCH) P81,451, 61 Collier Bankr. Cas. 2d (MB) 875 (6th Cir. Ohio 2009)

85

Facts:

•In order to make payment towards her credit card debt, Debtor Jeannette Dilworth transferred $10,500.00 to the creditor bank MBNA America Bank, N.A., using a balance transfer check drawn on her CitiPlatinum Select Card.

•This transfer took place during the preference period. Trustee Louis Yoppolo sought to recover the payment as preferential transfer.

Arguments:

•Creditor bank argued that the Debtor had simply used the balance transfer check to substitute one creditor for another, and therefore, the transfer did not diminish the bankruptcy estate.

•Trustee argued that bank-to-bank transfer dimished Debtor's assets.

86

Court's ruling:

•Bankruptcy Court ruled in favor of the Trustee. Held the transfers as preferential. On appeal, the Court of Appeals for the Sixth circuit affirmed.

•The court observed that the debtor demonstrated significant control over the distribution of the funds when she decided to pay the former creditor and not her other creditors.

•The transfer thus resulted in a diminution of value in the bankruptcy estate.

•The Court opined in favor of the Trustee and concluded that bank-to-bank transfer of funds diminished Dilworth's assets.

87

Constructive Trusts

88

Claybrook v. Consol. Foods, Inc. (In re Bake-Line Group, LLC),

359 B.R. 566, 2007 Bankr. LEXIS 275, 47 Bankr. Ct. Dec. 217 (Bankr. D. Del. 2007)

89

Facts:

•The Debtor and the Defendant did not have any business relationship with each other but they both had offices in the same building.

•One of the Defendant's customers mailed a check that was mailed to the Debtor by mistake.

•The Debtor erroneously deposited the check in its own account.

•On realizing the mistake, the Debtor issued a check to the Defendant in the same amount.

•4 days later, the Debtor filed for bankruptcy. Trustee sought to recover the transfer of amount to the Defendant as preferential transfer.

90

Defendant's Arguments:

•It was not a creditor of the Debtor.

•The Debtor held the money for the defendant in a constructive trust

•No transfer of Debtor's property occurred.

Court's ruling:

•The Court that the transfer was not avoidable. Defendant was not a creditor. The Debtor was only holding the money in constructive trust.

•The Debtor had never had any interest in the money and had essentially converted it.

• Due to the reason that the Debtor had no legal or equitable interest in the funds, the funds could not be estate property available for distribution to the estate's creditors.

91

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
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(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 ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

92

To Or For The Benefit Of A Creditor

93

Status of a conduit

94

Kirschenbaum v. Leeds Morelli & Brown and Nancy Isserlis (In re The Robert Plan of New York)

2011 Bankr. LEXIS 1845 (Bankr. E.D.N.Y. May 5, 2011)

95

Facts:

- Defendant Leeds Morelli & Brown (LMB) was the law firm representing the co-defendant Nancy Isserlis in a suit against the Debtor.
- The Debtor and Isserlis executed a settlement agreement pursuant to which the Debtor made the settlement payments in the amount $33,000.00 to LMB, which were placed in its escrow account.
- As per its retention agreement with Isserlis, LMB deducted its fees from the settlement payments and conveyed the remainder to Isserlis.

Arguments:

- The Trustee sought to recover the transfers as preference payments.
- Defendant argued that it received the transfers from the Debtor in the capacity of a conduit. It was not a creditor of the Debtor.

96

Court's ruling:

•The court found that LMB was merely acting on behalf of the Isserlis.

•The Debtor did not owe any debt to LMB.

•LMB did not have any separate collection rights as against the Debtor pursuant to an agreement between the Debtor and Nancy Isserlis.

•LMB was not a creditor of the Debtor. The Transfers could not be avoided from LMB.

97

To or For the Benefit of a Creditor

98

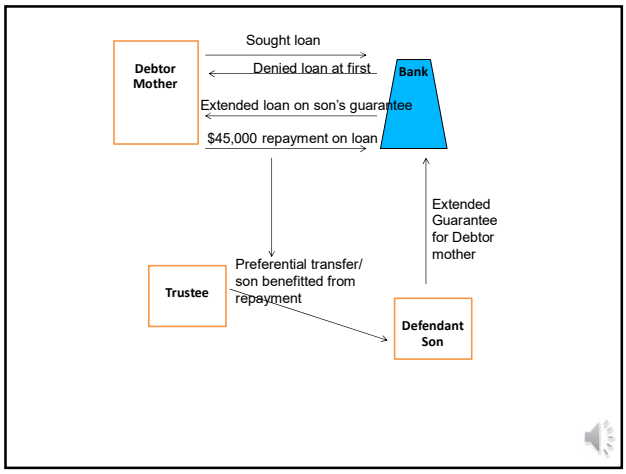
Guarantors

99

Osberg v. Halling (In re Halling),

449 B.R. 911, 2011 Bankr. LEXIS 2128 (Bankr. W.D. Wis. 2011)

100



101

Arguments:

- Trustee sought to avoid this amount from the son contending that he benefited from the transfer and that the transfer was preferential payment.
- The son argued that the amount could not be avoided as he was not a 'creditor' of his mother's estate because he would have never attempted to collect the repayment.

102

Court's ruling:

•Son had a contingent "right to payment" from the Debtor mother which constituted his claim against her. Son was a creditor.

•The alleged payment reduced son's obligations towards the bank as the guarantor of debtor's loan. Therefore, son benefitted from the alleged payment.

•Court held that alleged payment was avoidable from the defendant son.

103

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) **to or for the benefit of a creditor;**
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
(3) made while the debtor was insolvent;
(4) Made—
a) on or within 90 days before the date of the filing of the petition; or
b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

104

For or on account of an antecedent debt

105

Anderson News, LLC v. News Group, Inc. (In re Anderson News, LLC)

2012 Bankr. LEXIS 3855 (Bankr. D. Del. Aug. 22, 2012)

106

Facts:

•Defendant, The News Group, was a magazine and book wholesaler and was a competitor of Debtor Anderson.

•During the 90 days before filing bankruptcy, the Debtor transferred about $2.5 million to the Defendant. The transfers represented a certain pre-petition Settlement Amount against four pre-petition invoices.

•Thereafter, Anderson as debtor-in-possession, sought to recover the transfers as alleged preference transfers..

Defendant's argument:

•The Defendant argued that the alleged transfers were payments made for a simultaneous debt and not for an antecedent debt. It contended that the issuance of the invoices and payments by the Debtor were simultaneous.

107

Court's ruling:

•For three of the four transactions, the invoice date and check date were identical, and the fourth transaction occurred shortly after the alleged invoice date.

• The Court granted an opinion in favor of the Defendant.

•The transfers were held to have not been made on account of an antecedent debt.

108

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
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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.

109

Made while debtor was insolvent

110

101(32)(A) defines an insolvent corporate debtor as one whose "financial condition [is] such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation."

111

"going concern" valuation test

112

Brown v. Shell Can. (In re Tennessee Chem. Co.)

143 B.R. 468, 1992 Bankr. LEXIS 1225, 23 Bankr. Ct. Dec. 455 (Bankr. E.D. Tenn. 1992)

113

Facts:

•Shortly before filing bankruptcy, Debtor secured a debt to the Defendant by giving it a security interest in its property.

•The Trustee sought to recover the transfer of the security interest as preferential transfer.

Arguments:

•Defendant argued that at the time of making the transfer, the Debtor was solvent. Defendant relied on Debtor's schedules and an operating report of the Debtor filed with the Trustee.

•The schedules showed assets worth $45,300,000 and debts totalling $41,200,000.

•Defendant argued that the values in the schedules must be treated as market value because the schedules are supposed to give market value.

114

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
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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.

115

Sec. 547 (b) (4) Made—
(a) on or within 90 days before the date of the filing of the petition; or
(b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

116

Timing of Transfer

117

Barnhill v. Johnson

503 U.S. 393, 394 (U.S. 1992)

(Supreme Court of the United States, March 25, 1992)

118

Facts:

•The Debtors made payment on a debt by delivering a check to the Creditor.

•Check delivered to Creditor on: November 18, 1985

•Check was dated: November 19, 1985

•Check was honored: November 20, 1985

•Debtors' bankruptcy was filed on: February 18, 1986 (90^{th} day from check honor date)

Arguments:

•Defendant contended that the "transfer" was made on the date the check was delivered. Therefore, it was made out of preference period.

119

Supreme Court's ruling:

•A check is simply an order to the drawee bank to pay the sum stated on demand. If the check is honored, the debtor's obligation is discharged, but if it is not honored, a cause of action against the debtor accrues to the check recipient "upon demand following dishonor."

•Honoring the check left the debtor in the position that it would have occupied had it withdrawn cash from its account and handed it over to Barnhill.

•The rule of honor is consistent with § 547(e)(2)(A), which provides that a transfer occurs at the time it "takes effect between the transferor and the transferee," particularly since the debtor here retained the ability to stop payment on the check until the very last.

120

Delay in perfection of a lien may affect the timing of "transfer"

121

French v. State Farm Mut. Auto. Ins. Co. (In re LaRotonda)

436 B.R. 491, 2010 Bankr. LEXIS 3241 (Bankr. N.D. Ohio 2010)

122

Arguments:

•Defendant argued that it because a secured creditor on the day it obtained lien i.e. in the year 2006. Therefore, the transfer was outside the preference period.

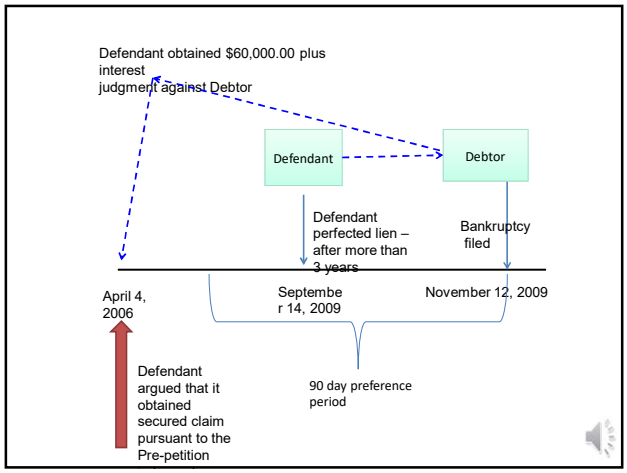
•Trustee argued that the lien was perfected during the preference period. Here the transfer was preferential.

Court's ruling:

•Pre-petition lien judgment standing alone does not give rise to a secured interest. Defendant needed to perfect the lien as per State law.

•As lien was perfected during the preference period, it was a valid preferential transfer avoidable by the Plaintiff.

123



124

Sec. 547 (b) (4) Made—
(a) on or within 90 days before the date of the filing of the petition; or
(b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

125

How are transfers made before an involuntary petition treated?

126

Sec. 547 (b) (4) Made—
(a) on or within 90 days before the date of the filing of the petition; or
(b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

127

Affiliates are deemed insiders

128

Weinman v. Walker (In re Adam Aircraft Indus.)

2012 Bankr. LEXIS 5998 (Bankr. D. Colo. Dec. 28, 2012)

129

Facts:

•The president of an aircrafts company was made to resign the company by its board of directors.

•The company paid him over $200,000 pursuant to his separation agreements with the company.

•Seven months after this transfer, the company filed for bankruptcy.

•The Trustee sought to recover the amount as preference.

Defendant's argument:

•The ex-president argued that the transfer was made in the ordinary course of business and as per the terms of the separation agreement.

•He had no insider information about the bankruptcy because he did not attend company's office after resignation and had no control or influence over company's affairs.

130

Court's ruling:

•Ex-president remained friends with the founder of the company and may have been in a strong bargaining position at the time of entering into the separation agreement.

•The ex-president failed to show that the separation agreements were entered at arm's length.

•Although evidence the parties presented suggested that the former president did not fall within the statutory definition of an "insider", the U.S. Court of Appeals for the Tenth Circuit had held that a person could be a "non-statutory insider" for purposes of the Bankruptcy Code.

131

Its all relative.

132

(31) The term "insider" includes— (A) if the debtor is an individual— (i) relative of the debtor or of a general partner of the debtor;
(ii) partnership in which the debtor is a general partner;
(iii) general partner of the debtor; or
(iv) corporation of which the debtor is a director, officer, or person in control;
(B) if the debtor is a corporation— (i) director of the debtor;
(ii) officer of the debtor;
(iii) person in control of the debtor;
(iv) partnership in which the debtor is a general partner;
(v) general partner of the debtor; or
(vi) relative of a general partner, director, officer, or person in control of the debtor;
(C) if the debtor is a partnership— (i) general partner in the debtor;
(ii) relative of a general partner in, general partner of, or person in control of the debtor;
(iii) partnership in which the debtor is a general partner;
(iv) general partner of the debtor; or(v) person in control of the debtor;D) if the debtor is a municipality, elected official of the debtor or relative of an elected official of the debtor;
(E) affiliate, or insider of an affiliate as if such affiliate were the debtor; and
(F) managing agent of the debtor.

133

101(45) The term "relative" means individual related by affinity or consanguinity within the third degree as determined by the common law, or individual in a step or adoptive relationship within such third degree.

134

Gold v. Rubin (In re Harvey Goldman & Co.),

2011 Bankr. LEXIS 3149, Bankr. L. Rep. (CCH) P82,072, 55 Bankr. Ct. Dec. 99 (Bankr. E.D. Mich. Aug. 24, 2011)

135

Facts:

•David Simcha, was the President of the Debtor company. Yitzchok Rubin was the second cousin of the President.

•During more than 90 days before filing of Debtor's bankruptcy, the President made a transfer of $22,000.00 to Rubin.

•The Trustee sought to recover this transfer as alleged preferential transfer.

136

Arguments:

- Trustee argued that Rubin, as Simcha's second cousin, was within the third degree of consanguinity, and was therefore Simcha's relative as per the definition of the term "relative" under § 101(45) of the Bankruptcy Code.
- Also, as Rubin was Simcha's relative, he was an "insider" of the Debtor.
- Hence, the Trustee claimed that the payment was preferential as it was made by Rubin, an insider, during the one year reach back period prior to the petition date.
- Rubin argued that as Simcha's second cousin, he was only related to Simcha by consanguinity within the sixth degree and, therefore, was not his relative.

137

Court's ruling:

•The court looked to Michigan common law to determine the proper method of counting degrees of consanguinity because the Debtor was a Michigan corporation in a bankruptcy case filed in Michigan.

•Applying the common law of Michigan, the court held that Rubin, although a second cousin of the Simcha, was related within the sixth degree of consanguinity and therefore was not Simcha's relative and not an insider for the purpose of preference issue.

•The court held that the transfers could not be avoided as Trustee could not recover transfers made beyond the 90 days preference period.

138

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
(1) to or for the benefit of a creditor;
(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
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b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

139

The Hypothetical Chapter 7 Distribution Test

140

Sec. 547 (b) (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.

141

The hypothetical Chapter 7 test compares two calculations:

(1) the amount a creditor would receive on its claim in a hypothetical Chapter 7 liquidation had no transfer been made (the "**hypothetical liquidation**"), and

(2) the amount the creditor received from the allegedly preferential transfer combined with the amount the creditor would be entitled to receive on its claim in the actual bankruptcy case (the "**real liquidation**"). *11 U.S.C. § 547(b)(5).*

142

Secured creditors realize in a chapter 7 case the value of their collateral. But partially secured creditors paid in full may be preferred.

143

Luker v. Heartland Cmty. Bank (In re Frankum)

453 B.R. 352, 2011 Bankr. LEXIS 2816 (Bankr. E.D. Ark. July 18, 2011)

144

Facts:

•The debtors owned several medical facilities, including two nursing homes, a hospital, and a clinic, before they declared bankruptcy.

•When they were unable to pay their debts they decided to sell the hospital to a corporation that offered to buy it.

•As part of the purchase agreement, the corporation agreed to pay each debtor $250,000 in exchange for their agreement not to compete with the corporation, and that payment was made by the corporation's closing agent to a bank less than 90 days before the debtors declared bankruptcy.

•Trustee James C. Luker sought to obtain both payments of $250,000 as preferential transfers.

145

Court's ruling:

- The payments allowed the only partially secured Defendant Bank, in its capacity as a creditor of the Debtors' bankruptcy estate, to receive more than it would have received as a creditor if the payments had not been made.
- No evidence as to the value of its security interest at time of transfer.
- Bank argued that post-petition it became fully secured through payments to the estate.

146

Sec. 547 (b) (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.

147

In Leicht v. Fifth Third Bank (In re Zaring)

2012 Bankr. LEXIS 2777 (Bankr. S.D. Ohio May 18, 2012)

148

Facts:

- Defendant FTB was the holder of two notes and a guaranty executed by the Debtor, Zaring.
- During the preference period, the Debtor made payments totaling $553,875.30 to the Defendant.
- Trustee sought to avoid these payments as preferential transfers.

Arguments:

- The Defendant argued that it could have set off the $553,875.30 in bankruptcy if the transfers had not been made.
- The Trustee argued that the Defendant never effectuated a setoff and therefore did not possess a security interest in the funds.

149

Court's ruling:

- The Court concluded even if the Defendant did not effectuate setoff, it possessed hypothetical setoff rights under § 553(a) of the bankruptcy code which provides that non-bankruptcy rights of setoff are preserved in bankruptcy, with limited exceptions not raised by the Trustee.
- The Court also observed that the Defendant possessed setoff rights under the applicable Ohio law.
- Thus, the Court granted summary judgment in favor of the Defendant and dismissed Trustee's complaint.

150

Defenses To a Preference Claim

151

§ 547 (c)- The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
(B) made according to ordinary business terms;

152

(3) that creates a security interest in property acquired by the debtor—
(A) to the extent such security interest secures new value that was—
(i) given at or after the signing of a security agreement that contains a description of such property as collateral;
(ii) given by or on behalf of the secured party under such agreement;
(iii) given to enable the debtor to acquire such property; and
(iv) in fact used by the debtor to acquire such property; and
(B) that is perfected on or before 30 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
(A) not secured by an otherwise unavoidable security interest; and
(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

153

Contemporaneous Exchange Defense

154

§ 547 (c)- The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—
(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—
(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
(B) made according to ordinary business terms;

155

Purpose behind this provision:

•The section protects transfers that do not result in diminution of the estate because unsecured creditors are not harmed by the transfer if the estate was replenished by an infusion of assets that are of roughly equal value to those transferred.

156

•To prevent from avoidance the transactions that are technically "on account of an antecedent debt," but were not really credit transactions.

157

If it's a simultaneous exchange of cash for goods, then in theory that debt is really not created.

The purpose of the preference law is to make sure that creditors are treated equally.

158

If a vendor is paid immediately, that vendor is not a creditor because he/she is not owed money.

159

Silverman Consulting, Inc. v. Canfor Wood Prods. Mktg. (In re Payless Cashways, Inc.)

306 B.R. 243,Bankr. L. Rep. (CCH) P80,057, 51 Collier Bankr. Cas. 2d (MB) 1213, 42 Bankr. Ct. Dec. 180, 53 U.C.C. Rep. Serv. 2d (Callaghan) 518 (B.A.P. 8th Cir. 2004)

160

Facts:

•The creditor shipped lumber to the debtor.

•The goods were shipped via trucks and rail.

•The parties had agreed that shipments would only be made if the debtor paid by electronic funds transfer (EFT).

•All of the payments were made within 15 days of the shipment date for rail shipments and within 6 days of the shipment date for truck shipments.

•At least as to eight of the payments, the creditor received payment prior to delivery.

•The parties intended that the debtor would not obtain possession until after payment.

161

Arguments:

- Trustee - any transaction that was evidenced by an invoice was an antecedent debt.
- Creditor - By allowing the goods to be delivered to the debtor, it made a contemporaneous exchange for a new value.

162

Court's ruling:

The Court held that the payments were contemporaneous exchanges for new value because of the following reasons:

1. The creditor treated each shipment as a receivable on the date of shipment, and the debtor treated it as a payable on that same date.

2. The estate was not diminished, as shipments were to be diverted if payment was not received.

3. In any event, payments were made within 15 days of shipment which was substantially contemporaneous.

On appeal, the BAP for the 8th Circuit affirmed Bankruptcy Court's ruling.

163

Section 547(c) (1) The trustee may not avoid under this section a transfer —

(1) to the extent that such transfer was —

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange.

164

Section 547(c) (1) The trustee may not avoid under this section a transfer —

(1) to the extent that such transfer was —

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange.

165

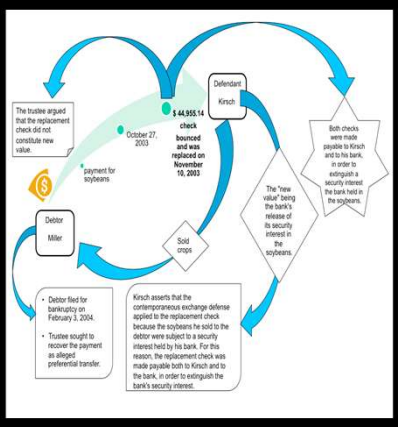
New value in context of contemporaneous exchange defense

166

Velde v. Kirsch

366 B.R. 902, (D. Minn. 2007)

167



168

Court's ruling:

➢Bankruptcy Court – defense not applicable in a bounce-check situation.

➢District Court – The debtor did not receive his "new value" (the bank's release of its security interest in the soybeans) when he issued the bounced check.

•Release of the security interest occurred only when the bank received "payment" for the soybean.

•Only after the debtor issued the replacement check (which was honored) that the bank's security interest was released.

•Thus, the necessary contemporaneousness between the transfer (the replacement check) and the new value (the bank's release of its security interest) existed in the transaction.

169

Section 547(c) (1) The trustee may not avoid under this section a transfer —

(1) to the extent that such transfer was —

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange.

170

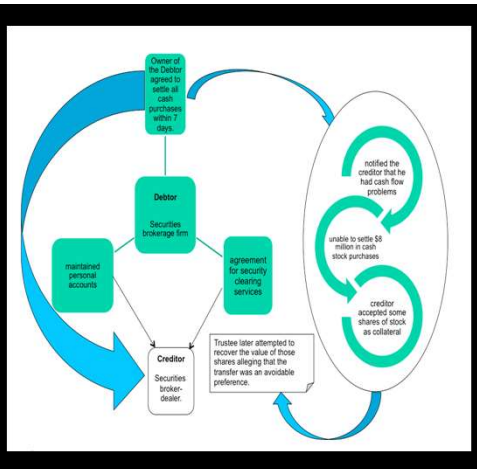
Can be inferred from circumstantial evidence.

171

In re Lewellyn & Co.,

(929 F.2d 424, 1991 U.S. App. LEXIS 5253, Bankr. L. Rep. (CCH) P73,880 (8th Cir. Iowa 1991)

172



173

Court's ruling:

•The transfer was a contemporaneous exchange for new value.

•The parties intended the transfer to have been a contemporaneous exchange in lieu of cash settlement.

• The transfer did, in fact, occur within 7 business days of purchases through the owner's cash account.

•The creditor extended new value in the form of $ 8 million worth of new credit to the owner.

174

Section 547(c) (1) The trustee may not avoid under this section a transfer —

(1) to the extent that such transfer was —

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

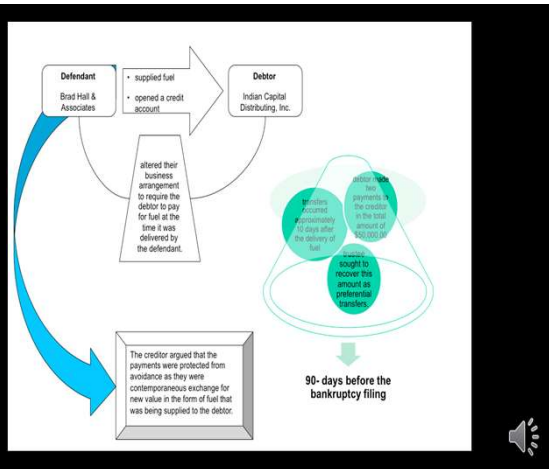
(B) in fact a substantially contemporaneous exchange.

175

Dill v. Brad Hall & Assocs. (In re Indian Capitol Distrib.)

2012 Bankr. LEXIS 3725, 2012 WL 3292891 (Bankr. D.N.M. Aug. 10, 2012)

176



177

Court's ruling:

•The payments could not be avoided.

•The transfers occurred approximately 10 days after the delivery of fuel to the debtor and such periods qualified as substantially contemporaneous with the deliveries of fuel.

•10 days was sufficiently immediate in view of the time required for administrative tasks such as determining the amounts due, preparing invoices, and arranging for payment.

178

Ordinary Course of Business Defense

179

§ 547 (c)- The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—
(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—
(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
(B) made according to ordinary business terms;

180

The policy behind this exception is "to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual transactions by either the debtor or his creditors during the debtor's slide into bankruptcy."

181

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

182

Ordinary course exception is directed primarily to ordinary trade credit transactions.

183

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

184

In re Craig Oil Co.,

785 F.2d 1563, 1986 U.S. App. LEXIS 23769, 14 Bankr. Ct. Dec. 553 (11th Cir. Ga. 1986)

185

Facts

•Defendant supplied gas to the debtor Craig Oil, a gas station.

•Payment was due within ten days of billing.

•Despite the stated payment, defendant did not consider any payment overdue unless it arrived more than sixteen days after billing.

•Few months prior to Craig's bankruptcy, Craig made 14 payments to the defendant via cashier's checks rather than the corporate checks which it previously used.

•The trustee sought to avoid all payments made by cashier's check.

186

Arguments

•Creditor claimed – Payments were immune from avoidance as they were made in the ordinary course of business.

•The Bankruptcy Court rejected creditor's argument and avoided the alleged payment as preferences.

•On appeal, the court affirmed

187

Court's Observation

"…. Marathon correctly concludes that a creditor's state of mind is now immaterial in finding a preference. In making this argument, Marathon slides away from the issue in the case -- which is not whether there was a preference, but whether the preferred transfer was in the ordinary course of business between Marathon and Craig and whether the payments were made according to ordinary business terms. Conceptually, it is difficult to disentangle these legal propositions and the facts which go to prove three separate statutory sections. It does not follow from the above that a *debtor's* state of mind or motivation is likewise immaterial in applying the preference *exception* of *§ 547(c)(2)*."

188

Ruling

- Debtor had not previously paid by cashier's check
- A significant number of the payments were overdue
- Payments were made after Craig stopped buying from defendant.
- Continued payment was induced by the creditor's request for assurance of payment and because another creditor was attempting to push the debtor into bankruptcy
- Such payments were not made in the ordinary course of business or according to ordinary business terms.

189

Baseline of Dealings

190

Ellenberg v. Tulip Prod. Polymerics (In re T.B. Home Sewing Enters.),

173 B.R. 782 (Bankr. N.D. Ga. 1993)

191

Facts of the Case

- Defendant, Tulip was a supplier of paints to the Debtor pre petition.
- Payment was due within 60 days.
- Tulip took some extraordinary collection measures approximately one-year before bankruptcy when the debtor fell seriously in arrears in payments, threatening to withhold shipments until its invoices were paid.
- The debtor paid, but then again fell behind before the 90-day period.
- Trustee sought to recover $ 141,813 paid during the preference period.

192

Baseline of Dealing

…..“A creditor must establish a "baseline of dealings" so that the court may compare the practice of late payments during the preference period with the prior course of dealing”.

…..”This "baseline of dealings" must be fixed at least in part during a time in which debtor's day-to day operations were "ordinary" in the laymen's sense of the word. Preferably, the material period should extend back into the time before the debtor became financially distressed”

193

Tulip established a "baseline of dealings" with the debtor in which late payments were the norm :

•A review of the payment history during the pre-preference showed that debtor's payments to defendant ranged from 27 to 176 days after the invoice date. During the preference period, payments were made from 90 to 98 days past the invoice date.

•A review of the payment history also showed a similarity in the average number of days to pay.Payments during the preference period averaged 93.42 days after the invoice date, while payments during the entire pre-preference period averaged 87.36 days after the invoice date.

194

- The expert's affidavit established that late payments were the norm in the industry, to meet § 547(c)(2)(C)'s objective requirement.
- Subject payments are preferences; that defendant has proven the ordinary course of business exception under § 547(c)(2) and that there is no genuine issue of material fact which precludes summary judgment

195

Subjective Similarity Between Base Period Transactions and Preference Period Transactions

196

McCord v. Venus Foods (In re Lan Yik Foods Corp.),

185 B.R. 103, 1995 Bankr. LEXIS 1073, 27 Bankr. Ct. Dec. 743 (Bankr. E.D.N.Y. 1995)

197

Facts of the Case

•Debtor was a distributor of Chinese food products.

•Defendant Venus, was a manufacturer and supplier of Chinese food products.

•Payment terms were net 14 days. However, debtor never paid in 14 days and, in general, Defendant’s' payment terms were 60 to 90 days.

•Defendant received payments aggregating $ 65k during the preference period.

198

- After offsetting the new value worth $ 37,474.10 the amount of alleged preferential transfers at issue was approx. $ 27k. The trustee sought to recover this amount as preference.
- The Defendant argued that the payments are protected under Sec. 547 (c) (2).
- Trustee argued - payments do not fell under the protection of the ordinary course of business defense because

  (a) they differed substantially from previous payments in terms of the amount of time from invoice date until payment;

  (b) the dollar amount of the payments significantly exceeded the dollar amount of payments during other time periods of the same duration

199

Court's Ruling

•During the pre-preference period, the Debtor's payments averaged 89 days after the invoice date. During the preference period, the Debtor made 4 payments which were 104, 110, 112 and 115 days after the invoice date for an average of 110 days after invoicing.

•Between 58 and 142 days in 9 year base period.

•A comparison of the pre-preference and preference payments showed that in both periods there were substantial and significant delays in payments.

•Absolute consistency in actual or average payment dates is unrealistic and not required.

•The submitted payment history demonstrates a practice of substantially late payments

200

- No evidence to indicate that there was any unusual action by Venus to collect the debt,
- No evidence to show that Venus did anything to gain any advantages based upon the Debtor's deteriorating financial condition or that Venus even knew of such condition.
- No change in the form of payment.
- No evidence indicating that the subject payments were made after the Debtor ceased business operations.
- Alleged Payments were within the scope of "recurring, customary credit transactions" which the statute was designed to protect.
- Defendant carried its burden in establishing that the subject preference payments were made in the ordinary course of business of the parties as required by section 547(c)(2)(B).

201

Payment Averages

202

Branch v. Ropes & Gray (In re Bank of New England Corp.),

161 B.R. 557

203

Facts of the case

•In November 1989, Defendant R&G was retained by Debtor bank, BNEC to provide legal services.

•BNEC made ten payments to R&G by check or wire transfer totaling $ 614k. All of these transfers occurred within ninety (90) days of BNEC's petition date.

•All of these transfers occurred within ninety (90) days of BNEC's petition date and the trustee sought to recover them as preferences.

•Defendant asserted an affirmative defense of "ordinary course of business" payments under § 547(c)(2).

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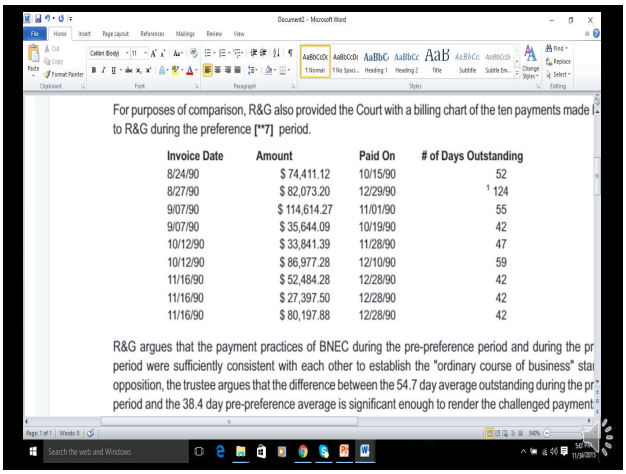
204



For purposes of comparison, R&G also provided the Court with a billing chart of the ten payments made to R&G during the preference [**7] period.

Invoice Date	Amount	Paid On	# of Days Outstanding
8/24/90	$ 74,411.12	10/15/90	52
8/27/90	$ 82,073.20	12/29/90	[1] 124
9/07/90	$ 114,614.27	11/01/90	55
9/07/90	$ 35,644.09	10/19/90	42
10/12/90	$ 33,841.39	11/28/90	47
10/12/90	$ 86,977.28	12/10/90	59
11/16/90	$ 52,484.28	12/28/90	42
11/16/90	$ 27,397.50	12/28/90	42
11/16/90	$ 80,197.88	12/28/90	42

R&G argues that the payment practices of BNEC during the pre-preference period and during the pr
period were sufficiently consistent with each other to establish the "ordinary course of business" stai
opposition, the trustee argues that the difference between the 54.7 day average outstanding during the pr
period and the 38.4 day pre-preference average is significant enough to render the challenged payment

205

Arguments

- R&G argued that the payment practices of BNEC during the pre-preference period and during the preference period were sufficiently consistent with each other to establish the "ordinary course of business" standard.
- The trustee argued that the difference between the 54.7 day average outstanding during the preference period and the 38.4 day pre-preference average is significant enough to render the challenged payments outside of the ordinary course of business. All ten of the challenged payments were made outside the 38.4 pre-preference average

206

Court's Ruling

- While the Court did not question the accuracy of the trustee's mathematics or statistical computations, the Court did not find that the difference between the two averages was significant, with the exception of the payment made on December 29, 1990.
- The fact that R&G issued its bills to BNEC an average of 17.75 days more quickly during the preference period did not suggest that the debts they represented were not incurred in the ordinary course, nor did it change the fact that the payment of these bills was consistent with the prior practices of the parties.
- Except for the December 29, 1990 payment, R&G sustained its burden R&G of proving the "ordinary course" exception as to nine of the ten challenged payments.

207

No Prior Payment History

208

Smith v. Shearman & Sterling (In re BCE West, L.P.),

2008 Bankr. LEXIS 569 (Bankr. D. Ariz. Feb. 28, 2008)

209

"When there are no prior transactions with which to compare, the court may analyze other indicia, including whether the transaction is out of the ordinary for a person in the debtor's position, or whether the debtor complied with the terms of the contractual arrangement, generally looking to the conduct of the parties,
or to the parties' ordinary course of dealing in other business transactions."

210

Bills were paid on average within 72 days of billing;

-92% of bills were paid between 0-179 days of billing;

-Clients regularly paid bills at the closing of financing or at the completion of a project;

-Bills covering 60 days, 45 days and 20 days of work were normal within the practice;

-Payment of multiple invoices with one check was ordinary;
-There was no policy regarding engagement letters; and
-That payment of Bills # 3, # 4, # 5, # 6, # 7, and # 8 were within the ordinary course of Shearman's business.

211

Facts:

- Debtor Board of Directors of Boston Chicken, Inc. ("BCI") engaged Defendant Shearman & Sterling ("Shearman") to advise it in connection with a proposed merger and roll up transaction.
- The transaction closed July 15, 1998. BCI filed for Chapter 11 relief on October 5, 1998.
- During the ninety days prior to the filing, BCI paid Shearman three checks for legal fees in the total amount of $ 582,832.54.
- The Trustee sued Shearman to recover these amounts as preferential.
- The parties agree that all five subsections of § 547(b) have been satisfied. Shearman asserts that the payments may not be avoided because they were made in the ordinary course of business under § 547(c)(2)

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212

Ranges of Payments

213

Continentalafa Liquidation Trust v Human Resource Staffing, (In re Continentalafa Dispensing Company),

2011 Bankr. LEXIS 1743 (Bankr. E.D. Mo. May 9, 2011)

214

Facts:

- Plaintiff Continentalafa Liquidation Trust sought to recover an alleged preferential payment of $103,856.28 paid to creditor Human Resource Staffing
- Trustee contended that the transfer amounts were unusually large as compared to the payment amounts during the comparison period. The two transfers made during the preference period represented 419% and 211% increases as compared to the average base period payment amounts.
- The defendant counter argued that the alleged preferential payments were consistent with the payments in the base period as they were made within a period of 30-60 days which was the usual practice.

215

Defendant argues that the ordinary course of business defense applies because the Transfers were consistent with the past practice between Debtors and Defendant in that 90% of payments during the Pre-Preference Period were paid between 30 and 60 days of invoicing — the remaining 10% was paid between 15 and 30 days of invoicing — while 100% of the Transfers during the Preference Period were paid between 30 and 60 days of invoicing.

216

Conclusion

- Given the nature of the services provided, and the nature of the business relationship between debtors and the agency, the court did not find the variation in the amount of invoices and thus variation in payment amounts to dispel the ordinary course of business defense.
- Payments came out to be consistent when calculated using the range of payments. The range of payment during preference period was similar to the range during the preference period.

217

Change to wires payment during preference period

218

Modern Metal Prods. Co. v. Virtual Eng'g, Inc. (In re Modern Metal Prods. Co.),

2015 Bankr. LEXIS 1188 (Bankr. N.D. Ill. Apr. 8, 2015)

219

Facts of the Case

- Debtor Modern Metal Products Co. was a manufacturer of seat mechanisms and other automotive parts.
- Defendant Virtual Engineering, Inc. provided engineering services to the debtor.
- Payment terms were net 30 days.
- Despite the terms stated on the invoices, the debtor generally paid as late as 60 to 90 days after the invoice date.
- Debtor paid defendant $50k by wire transfer to pay 21 separate invoices for engineering services during the preference period.

220

Arguments

- The Defendant asserted the "ordinary course defense" under Section 547(c)(2) which the Trustee contested.
- The Trustee argued that the payments were not ordinary course because: (1) they were made by wire transfer instead of check, (2) Defendant sent an e-mail to the Debtor inquiring about payment, and (3) Defendant knew at the time of the transfer that Debtor was contemplating bankruptcy.

221

Court's Ruling

- Although check had been the usual form of tender in the past, the Debtor had paid by wire transfer also one or more times in the past.
- In *Brown Transp. Corp. v. BP Exploration & Oil, Inc. (In re Brown Transp. Truckload, Inc.)*, 161 B.R. 735, 740 - it was held that "the mere fact the Defendant paid by wire transfer" rather than "corporate check as the parties had done in the past" did "not take this conduct outside the ordinary course of business".
- The Court concluded that there was no indication that payment by wire transfer rather than check was intended to convey any benefit upon the defendant.
- Defendant met its burden, and showed by the preponderance of the evidence that the payment was made in the ordinary course of business.

222

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
(B) made according to ordinary business terms;

223

What is an industry standard

224

Buchwald v. Avista Energy, Inc. (In re North American Energy Conservation, Inc.),

339 B.R. 75 (Bankr. S.D.N.Y. 2006)

225

Facts:

- Debtor North American Energy Conservation Inc. filed a voluntary petition for relief under chapter 11 of the Bankruptcy Code
- Defendant, was a supplier to the Debtor's electric energy trading division.
- At issue were transfers worth $ 1,698,400 made by wire to Avista during the ninety-day preference period.
- Avista argued that Debtor's complaint is without merit and that the transfers fall squarely within the Code § 547(c)(2) ordinary course of business exception

226

…."courts generally focus on determining whether the transfers were consistent with the parties' previous transactions, conformed to standard industry practices, or were made as a result of unusual actions of either party or other extraordinary circumstances"

….."to be deemed objectively ordinary, the subject transfer must be shown to be consistent with the industry norm"….

Court accepted as probative of industry standards the statement of the defendant creditor's credit manager that the invoice and payment practice between the parties was a commonplace in the energy trading industry.

227

- The Debtor and Avista are both entities whose businesses consist or consisted in part of entering into contracts regarding the purchase and sale of Electricity.
- Both parties have similar contracts with other entities, as evidenced by the other adversary proceedings and the associated pleadings in this case regarding similar business arrangements.
- The Debtor has put forth no evidence to dispute Avista's contention that in the electrical energy trading industry, invoices evidencing financial terms are typically generated and sent to the other party as the Electrical Agreement set forth; that the monthly settlement payment is a typical structure of these types of contracts; and that the Transfers constituted payments that were timely paid in the amounts due according to the Invoices.
- Both the Debtor and Avista have other relationships with other entities which parallel the financial relationship between the Debtor and Avista.
- Transfers were made according to ordinary industry standards.

228

Evidence required

229

Testimony by a lay person

230

Webster v. Fujitsu Consulting, Inc. (NETtel Corp.)

369 B.R. 50, 2007 Bankr. LEXIS 1796 (Bankr. D.D.C. 2007*)*

231

Facts:

- Trustee sought to avoid and recover two transfers made by debtor, as a result of cash infusions, to defendant vendor as preferential payments.

Arguments:

- The vendor argued that the payment were made according to the ordinary terms of the industry.
- The vendor demonstrate that debtor's preference period payments were made in accordance with the practices in which firms similar in some general way to the creditor in question engaged.
- The vendor submitted a declaration by a vendor witness as evidence of the IT consulting industry standards by itself to satisfy § 547(c)(2)(C).
- Trustee argued that the declaration by a vendor witness was inadmissible as it was based on personal experiences.

232

Court's ruling:

- Without going into the substance of the vendor witness's declaration, the Court held that the declaration provided enough evidence of the relevant industry standards by itself.
- The Court granted vendor's motion for summary judgment on ordinary course of business defense.

233

Some courts have based their decisions on reports obtained from Risk Management Association and Dun & Bradstreet.

234

Dietz v. Jacobs

2014 U.S. Dist. LEXIS 37144 (D. Minn. Mar. 21, 2014)

235

Facts:

- Plaintiff sought to avoid certain payments as preferential transfers, made by the Debtor to the Defendants during the preference period.

Arguments:

- The Defendants sought protection under the ordinary course of business defense. The Trustee argued that based on a report obtained by Risk Management Association (RMA), the payments were not made as per industry standard.
- Defendants contended Plaintiff's reliance on data from RMA's yearly report to determine industry norms on the "payment date range," without any independent validation or additional evidence renders his opinion unreliable.
- Defendants noted that the RMA characterizes its statistics as providing "general guidelines" and not "absolute industry norms."

236

Court's ruling:

•Court held that RMA reports were a respected source of industry information.

•While Defendants pointed to certain caveats that RMA included in its publication "The Annual Statement Studies: Financial Ratio Benchmarks, 2009-2010," the same document also claimed that RMA is the "most respected source" of industry information and that for over 88 years, RMA's Annual Statement Studies® had been the industry standard for comparison financial data."

237

New Value Defense

238

§ 547 (c)- The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—
(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—
(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
(B) made according to ordinary business terms;

239

(3) that creates a security interest in property acquired by the debtor—
(A) to the extent such security interest secures new value that was—
(i) given at or after the signing of a security agreement that contains a description of such property as collateral;
(ii) given by or on behalf of the secured party under such agreement;
(iii) given to enable the debtor to acquire such property; and
(iv) in fact used by the debtor to acquire such property; and
(B) that is perfected on or before 30 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—
(A) not secured by an otherwise unavoidable security interest; and
(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

240

Section 547(c) The trustee may not avoid under this section a transfer--

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

241

Bogdanov v. Avnet, Inc.

2011 U.S. Dist. LEXIS 113080, 2011 DNH 153, 2011 WL 4625698 (D.N.H. 2011)

242

Facts:

• Defendant Avnet, a global distributor of electronic products, supplied goods, primarily software and computer components, to Debtor Amherst on an unsecured basis for over nine years.

•June, 2005 – The Debtor placed an ordered with the Defendant for $4 million in software.

•July 1, 2005 – The Defendant shipped $4 million worth of software to the Debtor.

•July 13, 2005 – The Debtor wrote its last prepetition check to the Defendant in the amount of $400,202.13.

•Between April 20, 2005 and July 13, 2005: The Debtor paid the Defendant $8.1 million on outstanding invoices. The Defendant shipped goods worth over $7 million to the Debtor on an unsecured basis.

•On July 20, 2005 – Debtor filed bankruptcy.

243

Arguments:

- Trustee sought to recover the $7 million transfers to the Defendant as preference.
- The Defendant claimed that it was owed over $5.3 million in unpaid invoices.

Court's ruling:

- Bankruptcy Court's decision - $ 7 million worth of goods shipped to the Debtor constituted new value.
- District court affirmed.
- It was supported by the evidence and was not clearly erroneous as each time the Defendant shipped on credit for the debtor for an order, the order constituted new value.

244

"Under the subsequent ***new value*** defense, *§ 547(c)(4)*, a creditor will escape preference liability to
the extent it provides ***new value*** after the debtor made a preference transfer to the creditor."

245

"On the other hand, the subsequent ***new value*** defense will ***not*** apply if the creditor, who has the burden of proof, does ***not*** establish that "the debtor did ***not*** make an otherwise unavoidable transfer" "on account of" the ***new value***. *11U.S.C. § 547(c)(4)(B)*."

246

"The double negatives are unnecessarily complicated, but, essentially, the creditor must show that the debtor did ***not*** later pay for the ***new value*** with an "otherwise unavoidable transfer." Id.

That is, the creditor cannot both shield a prior preference payment by offsetting it with subsequent ***new value***, and also keep a subsequent preferential payment for the ***new value*** under some other defense (e.g., contemporaneous exchange)."

247

That is, the creditor cannot both shield a prior preference payment by offsetting it with subsequent ***new value***, and also keep a subsequent preferential payment for the ***new value*** under some other defense (e.g., contemporaneous exchange)."

248

"On the other hand, the subsequent ***new value*** defense will ***not*** apply if the creditor, who has the burden of proof, does ***not*** establish that "the debtor did ***not*** make an otherwise unavoidable transfer" "on account of" the ***new value***. *11U.S.C. § 547(c)(4)(B)*."

249

"The bankruptcy court plausibly concluded that "otherwise" should be construed as referring to all defenses to avoidability **other** than the subsequent ***new value*** defense described in *§ 547(c)(4)*." Emphasis added.

250

Section 547(c) The trustee may not avoid under this section a transfer--

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

251

Controlling date of transfer for the purpose of new value is the "check delivery date" and not the "check honor date".

•*Barnhill v. Johnson*, 503 U.S. 393, 394 (U.S. 1992) (U.S Supreme Court)

•*Giuliano v. Innovative Nationwide Builders, Inc. (In re Ultimate Acquisition Partners LLP)*, 2014 Bankr. LEXIS 1559, 8-10 (Bankr. D. Del. Jan. 31, 2014)

252

Preference Clawback Issues in the Oil & Gas Industry

253

Goodman v. Candy Fleet, LLC (In re Gulf Fleet Holdings, Inc.), Nos. 10-50713, 12-05010,

2014 Bankr. LEXIS 1123 (U.S. Bankr. W.D. La. Mar. 21, 2014)

254

Facts:

- This case was before the Bankruptcy Court for the Western District of Louisiana which falls under the Fifth Circuit.
- The Debtor owned and operated a fleet of offshore and fast supply vessels that supported oil and gas exploration and production companies and other oilfield services companies. The Debtor also brokered sea vessels to other companies.
- The Defendant was the owner and operator of sea vessels used primarily in the offshore oil and gas exploration industry. The Defendant leased its vessels through third-party brokers such as the Debtor.
- During the 90-day preference period, the Defendant was paid by the Debtor approximately $166,625 for vessels brokered by the Debtor.
- The Trustee sought to recover these payments as alleged preferential transfers.

255

Defendant's Arguments:

- The Defendant asserted that the alleged payments were made on a "pay when paid" basis after the Debtor received payment from the end customer.
- The Defendant contended that the average payment delay from payment by the end customer to the payment to the Defendant during the base period was about 14.61 days and during the preference period was about 22.5 days. Therefore, the alleged payments were made in the ordinary course of business.
- The Defendant also argued that the payment terms during the preference period to the Defendant were similar to the payment terms to the other vessel owners that brokered their vessels through the Debtor.

256

Trustee's Arguments:

- The Trustee, argued that 22-day average payment gap during the preference period was almost a 50% increase from the average payment gap from January 1, 2008 through April 30, 2009.
- The Trustee contended that this difference increased if the payment baseline was limited to payments occurring in 2008, which were paid within an average of 13 days.
- The Trustee also argued that the Defendant's position ignored the significant change in Debtor's payment practices occurring in 2009.
- Specifically, the payment gap increased from an average of 13 days in 2008 to about 22 days during the first four months of 2009, then increased to about 113 days from May 2009 through December 2009 and then decreased during the preference period to 22.5 days.
- Therefore, the payments were not ordinary in light of the shifting pattern of payments to the Defendant from 2008 through 2010.

257

Issue:

- Whether the alleged transfers were made in the ordinary course of business of the parties?

258

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

259

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

260

Court's ruling:

- The court agreed with the Trustee and held that the facts showed that the average payment gap for the alleged three payments during the preference period (approximately 22.5 days) differed materially from the average payment gap during 2008 (approximately 13 days).
- This difference negated the Defendant's ordinary course of business defense.
- As to the industry standard defense, the court held that the payment history between the Debtor and the Defendant after 2008 was driven largely by circumstances unique to the Debtor, and the shifting payment history largely tracked Debtor's deteriorating financial condition in 2009. In sum, the record did not support an ordinary course defense based on industry custom.
- The court found that the Trustee was entitled to judgment in the amount of $166,625 as well as prejudgment and postjudgment interest.

261

Conclusion:

- Payments during the preference period significantly deviating from the parties' past practices may not found to be made in the ordinary course of business of the parties.

262

Goodman v. Reama, Inc. (In re Gulf Fleet Holdings, Inc.), Nos. 10-50713, 12-05046,

2014 Bankr. LEXIS 1124 (U.S. Bankr. W.D. La. Mar. 21, 2014)

263

Facts:

- This case was before the Bankruptcy Court for the Western District of Louisiana which falls under the Fifth Circuit.
- The Debtor owned and operated a fleet of offshore and fast supply vessels that supported oil and gas exploration and production companies and other oilfield services companies.
- The Defendant provided welding and repair services to the Debtor
- During the 90-day preference period, the Debtor paid the Defendant a total of $85,121.86 for Defendant's services.
- The Trustee sought to recover these payments as alleged preferential transfers.

264

Arguments:

- The Trustee asserted that the transfers were preferential payments as all the elements of preference as required under Section 547 (b) were present.
- The Defendant argued that all 9 transfers of payment made during the preference period were made within 18 days to 250 days which was the range of payment established during the base period. Therefore, the transfers made during the preference period were made in the ordinary course of business.
- The Defendant also asserted that payments in the amount of $1,062.50 constituted new value provided to the Debtor.

265

Issue:

- Whether the alleged transfers were made in the ordinary course of business of the parties?
- Were the alleged transfers constituting $1,062.50 protected by the new value defense?

266

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

267

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

268

Section 547(c) The trustee may not avoid under this section a transfer--

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

269

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(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

270

Court's ruling:

- The court concluded that the Defendant could not rely on the ordinary course of business defense for all of the 9 alleged transfers covering about 13 invoices.
- During the base period, the range of payments was 18 days to 250 days with an average delay of about 103 days. During the preference period, the range of payments was 46 to 85 days with an average delay of about 62 days. The court found that the average delay for the preference period was made materially shorter than the average delay during the base period.
- The court held that although the preference period payments all fell within the base period delay range of 18 to 250 days, this range was too broad to serve as a baseline for judging the payments made during the preference period.
- The court held that using such a broad baseline captured outlying payments that skew the analysis of what was ordinary.

271

- The court held that the actual baseline of payments was established by 3 payments on 5 invoices totaling $44,270.24 with payment delays ranging from 69 to 75 days and an average delay of 72 days. These 3 payments amounted to almost 50% of the base period payments.
- Therefore, using the actual baseline and the new range of payments, the court held that invoices totaling $19,886.75 were protected by the ordinary course of business defense because they had a delay period that exceeds 69 days and they did not materially depart from the 72 day average delay period of the baseline payments.
- The court also held that $1,062 in services was provided as new value to the Debtor.
- Therefore, out of the $85,121.00 total preference claim, $20,929 was protected by the combination of ordinary course defense and new value defense.

272

Conclusion:

- If a broad baseline captures outlying payments that skew the analysis of what is ordinary, the could may not consider that baseline of dealings.
- The courts usually look at each individual payment made during the preference period to identify whether it was made in the ordinary course of business or not.
- Payments made in the ordinary course of business cannot be recovered as preferential payments.
- New value in the form of goods or services provided to the Debtor after the receipt of the first alleged payment and up till the petition date, may not be avoided as preference transfers.

273

Goodman v. Ferro Mgmt., Inc. (In re Gulf Fleet Holdings, Inc.), Nos. 10-50713, 12-05040,

2013 Bankr. LEXIS 2663 (U.S. Bankr. W.D. La. June 25, 2013)

274

Facts:

- This case was before the Bankruptcy Court for the Western District of Louisiana which falls under the Fifth Circuit.
- The Debtor owned and operated a fleet of offshore and fast supply vessels that supported oil and gas exploration and production companies and other oilfield services companies.
- The Defendant was in the business of marine consulting and was hired by the Debtor to provide services in connection with the construction of the M/V Gulf Tiger in 2010.
- During the 90-day preference period, the Defendant sent four invoices to the Debtor totaling $32,500. The Debtor paid each of these invoices by check.
- The Trustee sought to recover the payments as alleged preference transfers.

275

Arguments:

- Both parties filed their respective motions for summary judgment.
- The Defendant argued that the alleged transfers were made in the ordinary course of business.
- To counter this, the Trustee contended that the debt related to the transfers did not incur in the ordinary course.
- The Trustee contended that the Debtor's engagement of the Defendant's consulting services was atypical because the Defendant provided services in connection with the construction of a vessel, the interest of which was assigned to an affiliate of the Debtor. The Debtor had no ownership in it.

276

- The Trustee conceded that the Debtor had previously acquired construction-related consulting services for vessels it owned, but never under the circumstances of the Defendant's engagement.
- Further, the Defendant argued that it provided approximately $16,250.00 of services as new value to the Debtor.
- To this, the Trustee argued the the Debtor was not benefitted by the new value provided by the Defendant. The services of the Defendant solely benefitted the affiliate of the Debtor.

277

Issue:

- Was the debt incurred in the ordinary course of business of the parties and were the transfers made in the ordinary course of business?
- Were the alleged transfers constituting $16,250.00 protected by the new value defense?

278

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) Made—
a) on or within 90 days before the date of the filing of the petition; or
b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—
a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

279

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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.

280

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

281

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(B) made according to ordinary business terms;

282

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283

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(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

284

Court's ruling:

- The Court found that the Trustee met his burden to prove all elements of a preferential transfer.
- Regarding the ordinary course of business defense, the court found that it may well have been that the debt was incurred in the ordinary course despite the unique circumstances of the transaction. However, the circumstances surrounding the engagement of the Defendant by the Debtor created genuine questions of material fact with respect to whether the Debtor was incurred in the ordinary course defense.
- As to the new value defense, the court found that that there were genuine questions of material fact with respect to whether the Defendant's services benefitted that Debtor or Debtor's affiliate.
- The court granted the Trustee partial summary judgment with respect to the elements of his 11 U.S.C.S. § 547(b) preference claim and the affirmative defenses the court identified. The court denied the Defendant's motion for summary judgment.

285

Conclusion:

- If a debt is not incurred in the ordinary course of business, the transfers may not be in the ordinary course of business.
- If there are genuine issues of material facts present in a case, the courts may not grant summary judgment.

286

Compton v. Tanner Constr. Co. of Tex., Inc. (In re Tri-Union Dev. Corp.),

Nos. 03-44908, 05-3761, 2006 Bankr. LEXIS 4223 (U.S. Bankr. S.D. Tex. Nov. 15, 2006)

287

Facts:

- The Debtor Tri-Union Development Corporation was an oil and gas production company.
- The Defendant Tanner Construction Company of Texas, Inc. was a general oilfield and pipeline contractor that constructed and built drilling locations.
- Prior to filing for bankruptcy, the Debtor transferred the sum of $178,492.66 in eight checks to the Defendant. Trustee sought to avoid these transfers as preferential payments.
- At trial, the Defendant stipulated to Trustee's assertion that section 547(b) transfers were made and waived all affirmative defenses with respect to the first two transfers but not with respect to the other six transfers.

288

Arguments:

- The Defendant argued that the transfers were protected by the ordinary course of business defense because the amount and form of the transfers were customary between the parties and congruent within the industry (i.e., 30-day payment terms).
- The Debtor argued that expert testimony is required because general testimony by an employee of the Defendant is insufficient to establish whether a transfer is within ordinary business terms in the industry.

289

Issue:

- Were the remaining six transfers totaling about $177,533.66 received in the ordinary course of business of the Debtor and the Defendant?
- Does the ordinary course of business defense require expert testimony to establish whether a transfer is within ordinary business terms in the industry?

290

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

291

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(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

292

Court's ruling:

- The Court found that both Debtor and Defendant customarily engaged in the sort of transactions that they conducted with each other, and the debt was incurred in the ordinary course of their business affairs.
- Although only one transaction took place prior to the preference period, the Court noted that it was sufficient to establish an ordinary course of business because every transfer occurred within contract terms (30 days) and was paid for by check. Additionally, there were no unusual collection activities, and the circumstances surrounding the transfers were ordinary.
- Relying on the Defendant's witnesses' testimony, the Court found that 30-day payment terms were ordinary in the oil and gas industry.
- Therefore, the Court held that the payments were not avoidable as preference.

293

Conclusion:

- A creditor asserting an ordinary course of business defense usually proves all statutory elements by a preponderance of the evidence.
- Even a first-time or singular transaction prior to the preference period may be sufficient to establish ordinary course of business in cases where the parties follow the agreed payment terms.
- Although case law from other bankruptcy courts requires expert testimony to identify ordinary business terms, the Fifth Circuit may permit a creditor to use testimony from its own company representatives about the practices of other creditors and debtors in the industry.

294

Torch Offshore LLC, v. C & D Marine, LLC (In re Torch Offshore, Inc.),

Nos. 05-10137 SECTION "B", 05-10138, 05-10140, 07-1001, 2008 Bankr. LEXIS 1898 (U.S. Bankr. E.D. La. June 18, 2008)

295

Facts:

- Debtors Torch Offshore, LLC, *et al.* were in the business of subsea pipeline construction.
- Defendant C & D Marine, LLC ("C&D") provided marine transportation services to the Debtors, and Defendant Hercules Wire Rope & Sling Company, Inc. ("Hercules") provided the Debtors construction supplies.
- During the 90-day preference period, Defendant C&D received ten payments totaling $161,552.56 from the Debtors, and Defendant Hercules received three payments totaling $35,696.91 from the Debtors. The third payment was made on January 7, 2005 approximately two hours before the Debtors filed for bankruptcy.
- After the Debtors filed for bankruptcy, the Trustee sought to avoid and recover all the payments as alleged preference.

296

Arguments:

- Defendant Hercules argued that the payment received on January 7, 2005 was not subject to avoidance because it was not made on or within 90 days before the date of the petition filing.
- Additionally, both Defendants asserted that the transfers were protected by the ordinary course of business defense because the payments during the preference period were comparable to those payments made before the preference period.

297

Issue:

- Whether the payment made to Defendant Hercules on January 7, 2005, approximately 2 hours before the Debtors filed for bankruptcy, was avoidable?
- Were the transfers to both Defendants received in the ordinary course of business between the Debtors and the Defendants?

298

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made—
- a) on or within 90 days before the date of the filing of the petition; or
- b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—
- a) the case were a case under chapter 7 of this title;
- b) the transfer had not been made; and
- c) such creditor received payment of such debt to the extent provided by the provisions of this title.

299

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

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- a) the case were a case under chapter 7 of this title;
- b) the transfer had not been made; and
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300

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(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

301

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(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

302

Court's ruling:

- The Court noted that the language of section 547(b)(4)(A) clearly says that the trustee may avoid a transfer made on the date of the filing. Because January 7, 2005 was the date of the filing and the payment was made on that date, the Court found that it was avoidable.
- As to Defendant C&D's defense, the court noted that all payments were made by check, there were no collection activities, and the average time for pre-preference payments was 92 days, which was within the oil and gas industry norm and close to the average of 89 days during the preference period.

303

- As to Defendant Hercules' defense, the Court noted that the first two payments fell outside the average oil and gas industry standard of 86 to 93 days, while the third payment was made by wire transfer instead of the usual method of payment by check.
- Therefore, the Court held that the payments to Defendant Hercules were avoidable as preference. The payments to Defendant C&D were not avoidable.

304

Conclusion:

- A payment made on the date of and before the filing may be avoided if not subject to a valid defense.
- The creditor typically has the burden to show that the debt between it and the debtor was both incurred and paid in the ordinary course of their business dealings and that the transfer of the debtor's funds to the creditor was made in an arrangement that conforms with ordinary business terms.

305

Goodman v. Triple "C" Marine Salvage, Inc. (In re Gulf Fleet Holdings, Inc.),

485 B.R. 329 (Bankr. W.D. La. 2013)

306

Facts:

- This case was before the Bankruptcy Court for the Western District of Louisiana which falls under the Fifth Circuit.
- The Debtor owned and operated a fleet of offshore and fast supply vessels that supported oil and gas exploration and production companies and other oilfield services companies.
- The Defendant supplied marine equipment to the Debtor. The Defendant also installed certain marine equipment on four of Debtor's vessels.
- During the 90-day preference period, the Debtor made two payments totaling $27,400 to the Defendant for the supply and installation work. For one of the payments, the check was issued during the base period and it cleared during the 90-day preference period.
- The Trustee sought to recover these two payments as alleged preferential transfers.

307

Arguments:

- The Trustee asserted that the alleged transfers met all the elements of a preferential transfer.
- The Defendant argued that payments by one of the checks was not avoidable as the check was issued before the 90-day preference period.
- The Defendant also argued that it had a valid maritime lien on the four vessels on which its equipment was installed. Therefore, it was a fully secured creditor and as such it did not receive more than it would have received in a hypothetical chapter 7 liquidation.
- To this, the Trustee argued that the Defendant received more than it would have received in a hypothetical Chapter 7 liquidation because, even if the Defendant had a lien on the equipment supplied, the lien was unsecured because a superior lien by a third-party bank was under-secured.

308

- The Defendant also argued that the two payments were made in the ordinary course business. One payment was made within the agreed 30 days period and the other payment was made late after the Debtor and the Defendant agreed to extend the time for the payment until after equipment was installed on the vessel and tested for performance
- Additionally, the Defendant contended that the payments were as per the ordinary business terms as it was customary for sellers of used equipment for marine vessels to delay their payment deadline until after a buyer had an opportunity to install and test the equipment on its vessel.
- Lastly, the Defendant also argued that its release of its maritime lien was new value provided to the Debtor.
- To this, the Trustee argued that the record evidenced that the third-party bank had a ranking preferred ship-mortgage on the Debtor's vessels in question and that there was no equity to which the Defendant's lien could attach.

309

Issue:

- Whether the Defendant's maritime lien was valid and whether it was a secured creditor?
- Whether the alleged transfers were made in the ordinary course of business or as per the industry standard?
- Whether the release of the Defendant's maritime lien constituted new value supplied to the Debtor?

310

§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) made according to ordinary business terms;

311

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312

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313

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(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

314

Court's ruling:

- For the check that was issued during the base period but was honored during the preference period, the court held that the check honor date controlled the timing of payment and therefore it was held to be made within the preference period.
- The Defendant received more than it would have received in a hypothetical Chapter 7 liquidation because, even if it had a lien on the equipment supplied and installed, the lien was unsecured because a superior lien of the third-party bank was undersecured.
- As there was no equity to which the Defendant's lien could attach, no new value was provided by the Defendant to the Debtor.

315

- The court held the affidavit by a representative of the Defendant in support of Defendant's ordinary course defense and industry standard defense was sufficient for the purpose of summary judgment to show that there were genuine disputes of material fact with respect to the subjective and objective prongs of the ordinary course defense.
- However, the court required the Defendant to introduce credible and admissible evidence at trial in order to prevail on its industry standard defense as there was no baseline of dealings in this case.
- The court granted the Trustee's motion in part, denying the motion as to the Defendant's ordinary course of business defense.

316

Conclusion:

- A materialman's lien or maritime lien on the products supplied or services provided by a creditor is may be undersecured if there is an existing superior undersecured lien over Debtor's property.
- If there is no equity to with the creditor's lien can attach, then it may be deemed that no new value is provided to the Debtor.

317

Royal v. Sharkey Well Serv. (In re DCD, Inc.),
Nos. 03-21439, 05-2042,

2006 Bankr. LEXIS 1455 (U.S. Bankr. D. Wyo. June 12, 2006)

318

Facts:

- The creditor performed work on oil and gas properties owned by the debtor that were located in Wyoming.
- In 2001, the creditor filed oil and gas lien statements against the debtor's oil and gas properties and sent notice of the liens to the purchaser of the debtor's oil production from the properties.
- On April 7, 2003, a judgment was entered in favor of the creditor on its action to foreclose the liens. The creditor recorded the judgment in May 2003.
- On July 17, 2003, the debtor filed for bankruptcy.
- The trustee sought to recover the liens as unperfected under Section 544 and as preferential transfer under Section 547.

319

Arguments:

- The trustee contended that the creditor did not have a perfected lien in the crude oil production sold to the purchaser of the debtor's oil production because there was no evidence that the creditor provided notice as required by Wyo. Stat. Ann. § 29-3-105(b).
- The Trustee argued that at best there was a genuine issue of material fact requiring an evidentiary hearing.
- The creditor contended that it was a secured creditor pursuant to the April 7, 2003 Judgment in favor of the creditor on its action to foreclose the liens. The judgment entitled the creditor to issue or claim preclusive effect on the question of whether the liens were valid and perfected.

320

- The creditor asserted that it also provided requisite notice to the purchaser of its asserted liens in the crude production proceeds. The creditor produced four certified mail receipts of notices delivered to the purchaser, and a March 4, 2002 letter from the purchaser acknowledging receipt of the notice.

321

Issue:

- Whether the liens were valid and perfected?
- Whether the creditor was a secured creditor in order to protect the liens from avoidance?

322

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

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(3) made while the debtor was insolvent;

(4) Made—
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- b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—
- a) the case were a case under chapter 7 of this title;
- b) the transfer had not been made; and
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323

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(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.

324

Court's ruling:

- The trustee's claim under Section 544 failed because the trustee was bound by the judgment, which contained a finding that the creditor's liens were valid, and the creditor provided requisite notice of its liens in the crude production proceeds under Wyo. Stat. Ann. § 29-3-105(b).
- As to the trustee's preference claim, the statutory oil and gas liens were valid and perfected in the oil and gas properties as of the dates those liens were filed, and in the proceeds of production from the date notice was delivered to the purchaser of the debtor's crude oil production from the oil and gas properties subject to the creditor's lien statements.
- The court held that the creditor was a secured creditor for the purpose of 11 U.S.C.S. § 547.
- The court issued a judgment in favor of the creditor.

325

Conclusion:

- For a lien to be valid and perfected, a creditor is usually required to meet the state lien perfection requirements including proper notice and timely recording of the lien.
- If a creditor is a secured creditor, creditor's lien does may not amount to the creditor receiving more in a hypothetical chapter 7 case. Therefore, the lien does not meet one of the basic requirements for a preferential transfer.

326

Rand Energy Co. v. Strata Directional Tech., Inc. (In re Rand Energy Co.),

259 B.R. 274 (Bankr. N.D. Tex. 2001)

327

Facts:

- Plaintiff debtor was an oil and gas exploration company.
- The defendant performed work on debtor's oil well.
- During the preference period, the debtor made three payments to the defendant totaling $159,004.66 for defendant's services.
- The plaintiff debtor sought to recover these three transfers as alleged preferential payments.

328

Arguments:

- The defendant argued that it had a statutory lien as per Texas laws for the work it performed for the Debtor. Therefore, the alleged payments could not be avoided under 11 U.S.C.S. § 545 and 11 U.S.C.S. § 547(c)(6).
- The trustee argued that the Defendant had no lien as it failed to perfect its lien.
- The defendant contended that it did not perfect its lien because the debtor made the payments. As such it let go of its lien rights when the payment was made which constituted new value being provided to the debtor.

329

Issue:

- Whether the defendant had a valid lien even when the lien was not perfected?
- Did the defendant provide new value to the debtor when it let go of its inchoate lien rights?

330

Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

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(4) Made—
- a) on or within 90 days before the date of the filing of the petition; or
- b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—
- a) the case were a case under chapter 7 of this title;
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331

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(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.

332

Sec. 547 (c) : The trustee may not avoid under this section a transfer—

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

333

11 U.S. Code § 545 - Statutory liens –

The trustee may avoid the fixing of a statutory lien on property of the debtor to the extent that such lien—

(1) first becomes effective against the debtor—

(A) when a case under this title concerning the debtor is commenced;

(B) when an insolvency proceeding other than under this title concerning the debtor is commenced;

(C) when a custodian is appointed or authorized to take or takes possession;

(D) when the debtor becomes insolvent;

(E) when the debtor's financial condition fails to meet a specified standard; or

(F) at the time of an execution against property of the debtor levied at the instance of an entity other than the holder of such statutory lien;

334

(2) is not perfected or enforceable at the time of the commencement of the case against a bona fide purchaser that purchases such property at the time of the commencement of the case, whether or not such a purchaser exists, except in any case in which a purchaser is a purchaser described in section 6323 of the Internal Revenue Code of 1986, or in any other similar provision of State or local law;

(3) is for rent; or

(4) is a lien of distress for rent.

335

Court's decision:

- The district court concluded that forgoing, by operation of law, the right to perfect a lien is not the exchanging of "new value" with the debtor because it is not money or money's worth in goods, services, or new credit, nor is it a release of property by the lienor that has previously been transferred to the lienor.
- However, the court held that pursuant to 11 U.S.C.S. § 547(c)(6), the transfers were not avoidable. Under this section, the trustee could not avoid a transfer that was the fixing of a true statutory lien that was not avoidable under § 545, also included transfers that precluded imposition of such liens.
- § 545 essentially provides that the trustee could not avoid as a preferential transfer the perfection within the preference period of a true statutory lien.

336

Court's ruling:

- The court found that two invoices covered work performed on an oil well. Had debtor not paid for those services, creditor could have perfected a lien under Tex. Prop. Code Ann. § § 56.001-56.045. Creditor did not perfect its lien because debtor paid.
- Under binding precedent by the United States District Court of the Northern District of Texas, debtor could not avoid a preferential transfer that was the fixing of a statutory lien that was not avoidable under 11 U.S.C.S. § 545. 11 U.S.C.S. § 547(c)(6).
- As to the remaining disputed transfers not covered by the two invoices, the court held that defenses presented by the defendant had to go to trial.
- The court dismissed the complaint as to the two alleged transfers. Debtor was entitled to a partial summary judgment establishing the elements of a preferential transfer as to one remaining transfer. Debtor's motion for summary judgment as to creditor's affirmative defenses to that transfer was denied.

337

Conclusion:

- The courts may recognize an inchoate lien defense if the creditor possessed a statutory lien under a state law and let go of its lien rights when the debtor made the payments.

338

Fraudulent Conveyance Transfers

339

What is a Fraudulent Transfer?

340

A pre-bankruptcy transfer of property while the debtor is insolvent which results in creditors getting less money or no money after a bankruptcy is filed.

341

A pre-bankruptcy transfer of property while the debtor is insolvent which results in creditors getting less money or no money after a bankruptcy is filed.

- Parking assets
- Sweetheart deals
- Bad deals
- Ponzi schemes
- Fraudulent conspiracies against third parties who become creditors

342

A pre-bankruptcy transfer of property while the debtor is insolvent which results in creditors getting less money or no money after a bankruptcy is filed.

- Parking assets

343

A pre-bankruptcy transfer of property while the debtor is insolvent which results in creditors getting less money or no money after a bankruptcy is filed.

- Sweetheart deals
- Bad deals

344

A pre-bankruptcy transfer of property while the debtor is insolvent which results in creditors getting less money or no money after a bankruptcy is filed.

- Ponzi schemes
- Fraudulent conspiracies against third parties who become creditors

345

- Ponzi schemes—profit to you was just money stolen from somebody else.
- Tom invests 100k and gets back 150k. The "profit" of 50k came from Bill who invested a 100k after Tom. Bill's money is used to pay Tom
- At some point music stops and investors don't get paid.
- All victims are creditors.
- Trustee requires return of all False Profits so that all creditors victims and "winners" are treated equally by the bankruptcy estate.
- Not fair for "winners" to keep money belonging to victims.

346

- Fraudulent conspiracies—debtor and other stole money from third parties. Trustee sues both to make creditors whole.
- Conspirator gets paid to perpetuate a fraudulent scheme against creditors.
- Conspirators actions don't benefit the debtor or creditors of the debtor.
- Conspirators actions actually hurt creditors by creating more creditors and thus there is less to distribute to each creditor. Same size pie. More people eating.

347

§ 548 (a)

(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

348

548 (a) (1) (B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

349

§ 548(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545 or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

350

Reach-Back Period Under Federal Law
And Limitation Period Under Applicable State Law

351

The Federal Law:

- The Federal Law provides for a reach-back period under §548(1).
- A trustee may avoid transfers made within 2 years from the time the petition was filed under the bankruptcy code (federal law).
- This applies to both actual fraud as well as constructive fraud claims.

352

§ 548 (a)

(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

353

Application of State Law

- The Bankruptcy Code provides for application of applicable state law under the provision 11 U.S. Code § 544.

354

11 U.S. Code § 544 - Trustee as lien creditor and as successor to certain creditors and purchasers

(b) (1) Except as provided in paragraph (2), the trustee may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable under section 502 of this title or that is not allowable only under section 502(e) of this title.

(2) Paragraph (1) shall not apply to a transfer of a charitable contribution (as that term is defined in section 548(d)(3)) that is not covered under section 548(a)(1)(B), by reason of section 548(a)(2). Any claim by any person to recover a transferred contribution described in the preceding sentence under Federal or State law in a Federal or State court shall be preempted by the commencement of the case.

355

The State Law

- Most state laws are modeled after either the Uniform Fraudulent Conveyance Act (UFCA) or the Uniform Fraudulent Transfer Act (UFTA).
- The applicable state law may provide for a limitations period which usually commences at the time of the transfer.
- For example, Texas has adopted UFTA which provides for a 4 year limitation period which commences at the time of the transfer and expires in 4 years. This 4 years limitation period under Texas law applies to both actual and constructive fraudulent transfer claims.

356

548 (a) (1) (B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

357

The most common focus of trustees in a constructive fraudulent transfer case is on the following:

- The debtor received less than reasonably equivalent value
- Transferee acted in bad faith
- Insolvency of the debtor

358

548 (a) (1) (B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

359

PSN Liquidating Trust v. Intelsat Corp. (In re PSN USA, Inc.),

615 Fed. Appx. 925, 2015 U.S. App. LEXIS 15774 (11th Cir. Fla. 2015)

360

Facts:

- This was a case before the Eleventh Circuit Court of Appeals.
- The debtor's parent company PSNI contracted with the defendant-appellees to provide satellite services necessary for the debtor PSN USA, Inc. to produce and broadcast the debtor's channel.
- The debtor was not a party to the services contract. Nonetheless, it was the general policy of the network for the debtor to pay all production expenses, including the contractual obligations of PSNI when it related to production.
- Pursuant to the contract, the debtor made certain payments to the defendant-Appellees.
- The plaintiff-appellant sought to recover those payments as alleged constructively fraudulent transfers.

361

Arguments:

- The plaintiff contended that the debtor did not receive reasonably equivalent value in exchange for the payments. It argued that the services were provided for the benefit of debtor's parent company not not for the benefit of the debtor.
- The defendant-appellees contended that the debtor received reasonably equivalent value in exchange of the transfers as the debtor derived an economic benefit from the transfers. It received and used the services that were the subject of the services contract.

362

Decision of the Court:

- The court affirmed the bankruptcy court's and district court's ruling that the debtor received reasonably equivalent value in exchange for the payments. As such the transfers were not constructively fraudulent.
- The debtor was able to use the satellite services, even though it was not obligated on the contracts.
- In exchange for its payments, the debtor received satellite services that were required to operate the debtor's television channel.
- For operating the channel, the debtor earned a service fee from its parent company.
- As the debtor received payments from the parent for its operation of the channel, the debtor indirectly benefited from the parent by using the services it received from the defendant-appellees.

363

548 (a) (1) (B)

(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii)

(I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.

364

Burden of Proof As To the Debtor's Insolvency

365

Actual fraud –

- Proof of insolvency is irrelevant.
- A trustee may recover under an actual fraud claim even if the debtor is solvent.

Constructive fraud –

- Proof of insolvency is relevant.

366

Flemmer v. Weiner (In re Vill. Concepts, Inc.),

2015 Bankr. LEXIS 4100 (B.A.P. 9th Cir. Dec. 4, 2015)

367

Facts:

- This case was before the Bankruptcy Appellate Panel for the Ninth Circuit.
- The debtor was in the business of selling new and used manufactured homes and managing mobile home parks.
- The defendants were shareholders of the debtor.
- Prior to the bankruptcy filing, the debtor transferred certain stocks to the defendants.
- The trustee sought to avoid the transfers of stocks as actually and constructively fraudulent.

368

Arguments:

- The trustee maintained that the transfers were actually fraudulent as they were made with a fraudulent intent.
- The trustee also maintained that the transfer were constructively fraudulent because they were made without receiving reasonably equivalent value in exchange of the transfers and that the debtor was insolvent at the time the transfers were made
- The defendants argued that the debtor was solvent at the time of making the transfers and that they provided reasonably equivalent value to the debtor.

369

Court's ruling:

- As to the constructive fraud count, the court noted that the trustee had the burden to prove that the debtor was insolvent and did not receive a reasonably equivalent value.
- The court found that the trustee did not meet his burden of proof on the issue of insolvency because the trustee's reliance on liquidation value as conclusive evidence of insolvency was misplaced, and the fact that debtor operated at a loss for a period of time was not an indication of the potential value of the company.
- As the debtor was found to be solvent, the court noted that it was unnecessary for the court to reach the issue of "reasonable equivalent value". Both factors were required to prove constructive fraud.
- The court held that the transfers were not constructively fraudulent.

370

Court's ruling:

- As to the actual fraud count, the court noted that insolvency was only one of the badges of fraud.
- The court stated as follows, "although Trustee had not proved Debtor was insolvent on the date of the transfer, proof of actual fraud does not require proof of insolvency."
- Although the trustee had failed to prove insolvency of the debtor, the trustee succeeded in proving a few other badges of fraud that established actual fraud.
- The court held that the explanation by debtor's president for the transfers as a tax spinoff was credible and sufficient to rebut the circumstantial inference of actual intent arising from the few badges of fraud that were present.
- The transfers were found to be actually fraudulent.

371

Burden of Proof As To Fraudulent Conveyances

372

- Burden to prove under § 548– Plaintiff
- Burden to prove the affirmative defenses - Defendant

The Trustee indisputably has the burden of proving the transfers were fraudulent or constructively fraudulent, and this burden never shifts to the defendant.

373

What Must Be Proved to Prove an Actual Fraud?

374

Bayou Superfund, LLC v. WAM Long/Short Fund II, L.P. (In re Bayou Group, LLC)

362 B.R. 624, 2007 Bankr. LEXIS 635, 47 Bankr. Ct. Dec. 262 (Bankr. S.D.N.Y. 2007)

375

Facts:

- The debtors were three hedge funds allegedly operated by their pre-petition principals (a massive Ponzi scheme as alleged by the Plaintiff in the complaint)
- The defendants were the investors in the debtors' hedge funds.
- The debtors made payments to the investors of non-existent principal and fictitious profits in redemption of the investors' purported but non-existent interests in the funds as reflected in the funds' false financial reports.
- The plaintiff filed 95 adversary proceedings against the defendants alleging that the transfers were actually and constructively fraudulent pursuant to § 548 of the Bankruptcy Code and the applicable New York state law.

376

Arguments:

- The plaintiff argued that the debtors had fraudulent intent behind the transfers, there was an assumption of fraudulent intent in a Ponzi scheme and that the defendants did not provide any reasonable equivalent value to the debtors.
- Relying on the F.R.C.P Rule 9(b) which provides that that fraud be pled with particularity, the defendants argued that the complaints did not sufficiently allege that the alleged payments were made with the "actual intent" to hinder, delay and defraud required under Section 548(a)(1)(A)
- The defendants asserted that the debtors' business did not constitute a classic Ponzi scheme, therefore, the "Ponzi scheme presumption" did not apply, and that plaintiff had not alleged "badges of fraud" sufficient to give rise to an inference of actual intent.
- The defendants also contended that the provided reasonably equivalent value to the Debtor and received the transfers in good faith.

377

Court's ruling:

- Noting that the trustee alleged that the debtors operated a ponzi scheme, the court held that the presumption of "actual intent" to hinder, delay and defraud was both intuitive and inescapable on the facts which were alleged in the complaint.
- However, putting aside the Ponzi scheme presumption in this case, the court held that the "badges of fraud" alleged in the complaints were more than ample to comply with the requirement of Rule 9(b) that fraud be pleaded with particularity.

378

Court's ruling:

- The badges of fraud as alleged in the complaint were as follows:

  1. the Hedge Funds never earned a profit and suffered heavy trading losses.

  2. former principals siphoned money from the Hedge Funds for their own personal use.

  3. the debtors intentionally disseminated false financial statements and performance reports misrepresenting that the Funds had earned substantial investment gains.

- The court held that the alleged transfers were actually fraudulent.

379

Statutory badges of fraud with regards to actual fraud:

(1) the transfer or obligation was to an insider;

(2) the debtor retained possession or control of the property transferred after the transfer;

(3) the transfer or obligation was disclosed or concealed;

(4) before the transfer was made or obligation was incurred, the debtor had been sued or threatened with suit;

380

(5) the transfer was of substantially all the debtor's assets;

(6) the debtor absconded;

(7) the debtor removed or concealed assets;

(8) the debtor was insolvent or became insolvent shortly after the transfer was made or the obligation was incurred;

(9) the transfer occurred shortly before or shortly after a substantial debt was incurred;

381

(10) the debtor transferred the essential assets of the business to a lienor who transferred the assets to an insider of the debtor;

(11) the existence or cumulative effect of a pattern or series of transactions or course of conduct after the incurring of debt, onset of financial difficulties, or pendency or threat of suits by creditors;

(12) lack or inadequacy of consideration; and

(13) the general chronology of the events and transactions under inquiry.

382

Not all of the badges need be proved and if several of these badges of fraud are present, the court may properly infer fraudulent intent.

383

What Must Be Proved To Prove a Constructive Fraud?

384

- less than reasonably equivalent value
- the debtor was insolvent

385

Defenses to Fraudulent Conveyance Claims

386

Reasonably Equivalent Value

387

Janvey v. Golf Channel, Inc.,

2016 Tex. LEXIS 241, 59 Tex. Sup. J. 587 (Tex. 2016)

(The Supreme Court of Texas, No. 15-0489, Opinion dated April 1, 2016)

388

Facts:

- The debtor operated a ponzi scheme.
- Appellee/ Defendant Golf Channel Inc., a TV company provided advertising services to the Debtor.
- Pursuant to the business agreement between them, the debtor paid $5.9 million to Golf Channel.
- Later, SEC uncovered debtor's ponzi business and filed a lawsuit against the debtor. The court seized debtor's assets and appointed the plaintiff as the receiver.
- The Appellant receiver sought to avoid the $5.9 million in payments to the defendant as fraudulent transfer under Texas Uniform Fraudulent Transfer Act. (TUFTA).

389

Arguments:

- Golf Channel argued that it took the transfers in good faith and was an innocent trade creditor.
- Golf Channel also argued that it gave the debtor reasonably equivalent value in exchange of its advertising services, the market value of which was $5.9 million.
- The receiver did not challenge Golf Channel's good faith defense.
- However, receiver argued that Golf Channel did not provide any value to the debtor as Golf Channel furthered debtor's ponzi business.

390

- The Fifth circuit had previously held that Golf Channel did not provide reasonable equivalent value to the debtor. (780 F.3d 641 (5th Cir. 2015).
- On rehearing, the Fifth Circuit court vacated its ruling. (792 F.3d 539 (5th Cir. 2015) (per curiam) *(Golf Channel I))*.
- Observing that TUFTA, unlike the model Uniform Fraudulent Transfer Act (UFTA), specially defines the term "reasonably equivalent value" to include consideration having value from a marketplace perspective, the Fifth Circuit certified the following question to the Supreme Court of Texas:

  "Considering the definition of "value" in section 24.004(a) of [TUFTA], the definition of "reasonably equivalent value" in section 24.004(d) of [TUFTA], and the comment in [UFTA] stating that "value" is measured "from a creditor's viewpoint," what showing of "value" under TUFTA is sufficient for a transferee to prove the elements of the [good-faith] affirmative defense under section 24.009(a) of [TUFTA]?"

391

Answer of the Supreme Court of Texas to the certified question as sent by the Fifth Circuit:

- TUFTA, unlike the model Uniform Fraudulent Transfer Act (UFTA), specially defines the term "reasonably equivalent value" to include consideration having value from a marketplace perspective, as provided under TEX. BUS & COM. CODE Section 24.004(d).
- Construing the relevant statutory provisions, "reasonably equivalent value" requirement can be satisfied with evidence that the transferee:

  (1) fully performed under a lawful, arm's-length contract for fair market value,
  (2) provided consideration that had objective value at the time of the transaction, and
  (3) made the exchange in the ordinary course of the transferee's business.

392

- The court observed that Golf Channel's media-advertising services had objective value and utility from a reasonable creditor's perspective at the time of the transaction, regardless of the debtor's financial solvency at the time.
- In exchange for its payments, the debtor received not merely speculative, emotional consideration, but accepted full performance of services with objective, economic value that were provided in the ordinary course of Golf Channel's business.
- Even if the media-advertising services utterly failed in their ostensible purpose of attracting more business—and thus only served to deplete debtor's assets—the inherent value of those services nonetheless existed at the time of the transaction.

393

- Moreover, as services were fully provided, each payment also had value under TUFTA by extinguishing claims against the estate for the value of those services.
- For purposes of the "reasonably equivalent value" requirement in section 24.009(a), proof that an exchange occurred for market-value rates in an arm's-length transaction conclusively established that the value exchanged was "reasonably equivalent."

394

Current Status of the Fifth Circuit case:

- The Texas Supreme Court's decision has been filed in the Fifth Circuit case. The Fifth Circuit will render a new opinion soon or schedule a rehearing. There is an order on the docket stating that a rehearing has been granted.

395

Conclusion:

- The Supreme Court of Texas answered the certified question of the Fifth Circuit holding that advertising services sold at fair market value in an arm's-length transaction had objective value and utility from a reasonable creditor's perspective at the time of the transaction, and a later discovery that the debtor was operating a Ponzi scheme did not render the exchange valueless.
- Pursuant to the case of *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938), the federal courts have to apply the substantive law of the state. As such, the Fifth Circuit will apply the interpretation of the Texas Supreme Court with respect to TUFTA.

396

§ 548(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545 or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

397

Cuthill v. Greenmark, LLC (In re World Vision Entm't, Inc.)

275 B.R. 641, 2002 Bankr. LEXIS 288 (Bankr. M.D. Fla. 2002)

398

Facts:

- This case was before the Bankruptcy Court for the Middle District of Florida which is under the Eleventh Circuit.
- The debtor promoted itself as an entertainment investment company. The debtor started selling nine-month promissory notes with annualized interest rates varying between 10.9 and 11.9 percent.
- The debtor actively solicited and recruited a network of brokers, primarily agents, to sell the notes in exchange for a generous commission. Commission rates ranged from 12 to 15 percent.
- The brokers received a commission payment both when notes were sold and also when notes were renewed.

399

- The defendants in this case were the brokers who sold notes for the debtor. They received commissions for their services from the debtor averaging 14 percent of the total notes sold. Commissions received by the defendant brokers were in the amount $569,595.00.
- The trustee alleged that commission payments made by debtor to the corporate defendants totaling $ 569,595.00 were avoidable as actually or constructively fraudulent.
- The trustee sought to recover those transfers from the individual defendant pursuant to 11 U.S.C.S. § 548(a), and applicable state law.

400

Trustee's arguments:

- As to the actual fraud count, the trustee argued that the debtor's note program was a textbook ponzi scheme and therefore there was fraudulent intent on part of the debtor.
- As to the constructive fraud count, the trustee argued that the debtor received no value in exchange of the transfers.

401

Defendants' arguments:

- The defendant brokers denied the allegations arguing that even if the transfers were deemed fraudulent conveyances, the transfers were not avoidable under 11 U.S.C.S. § 548(c) and applicable state law because they gave reasonably equivalent value and acted in good faith.
- The defendants also contended that they did not know how to complete the required due diligence as they were financially unsophisticated and had previously never sold promissory notes.

402

Court's ruling:

- As to the actual fraud count, the court found that the transfers were made with a fraudulent intent and for an improper purpose.
- The defendants did not perform minimal due diligence steps needed to demonstrate that they acted in good faith.

403

- As defined by the court, the following were the minimum due diligence or reasonable investigation steps required by a prudent broker acting in good faith :
    i. Before selling the notes, a reasonable broker must review available investment ratings from qualified financial rating services.
    ii. The broker also must request and review with a critical eye audited financial statements of the company as well as other literature provided by the company discussing its sales history and the background of key employees.
    iii. A broker cannot rely only on slick, marketing brochures or insurance coverage, refrain from asking hard questions about the legitimacy of the product, and then assume a proper investigation was completed.
- The court noted that in some cases, other types of investigation may be merited. However, the court held, unless these minimal steps are taken, a broker selling a short-term promissory note is not performing the minimum due diligence required throughout the United States.

404

- As to the constructive fraud count, the court held that the defendant brokers provided reasonably equivalent value to the debtor because of the following reasons:
    i. The brokers were performing their usual jobs for roughly their usual rates.
    ii. The debtor received the benefit of its bargain--the sale of a mortgage, albeit a fraudulent one, in exchange for the payment of a reasonable commission.
- Therefore, the court held that the transfers were avoidable as actual fraud but not as constructive fraud.

405

Acted In Good Faith

406

§ 548(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545 or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

407

First Commer. Mgmt. Group v. Reinhardt (in Re First Commer. Mgmt. Group),

279 B.R. 230, 2002 Bankr. LEXIS 676, 39 Bankr. Ct. Dec. 160 (Bankr. N.D. Ill. 2002)

408

Facts:

- The debtor was engaged in a Ponzi scheme in which the debtor purported to sell pay telephones to investors who were identified by brokers. The scheme operated from 1995 until 1998.
- The debtor contracted to sell more than 6,000 pay telephones to more than 2,000 investors nationwide, but fewer than 1,500 of the pay telephones were actually placed and operated.
- The defendant served as a broker for the debtor, recruiting individuals (investors) who paid hundreds of thousands of dollars to purchase pay telephones from the debtor.
- As inducement, investors were promised certain benefits, one of which was an annual return exceeding twelve percent of their investment.
- Investors were also guaranteed all of their money back if they decided to withdraw from the enterprise after three years.

409

- The debtor made payments to investors from a pool of funds received from new investors rather than from profits derived from operating the pay telephones.
- The trustee filed a complaint against the defendant broker for the debtor to avoid the payments from the debtor as fraudulent transfers under 11 U.S.C.S. §§ 544, 548, and applicable state law.
- The complaint pled constructive fraud and actual fraud.

410

Arguments:

- On cross motions for summary judgment, the broker argued that in serving as a broker and recruiting purchasers of pay telephones from the debtor, he had no knowledge of the fraudulent scheme and acted in good faith.

411

Court's ruling:

- The court held that the actual fraud count was not sufficiently pled by the trustee in the complaint. The complaint did not specifically allege actual fraud under Section 548 (a) (1) (A). As per the allegations in the complaint, there was nothing to alert the defendant to a charge of actual fraud.
- As to the constructive fraud count, the court found that the defendant provided value of the debtor by recruiting investors and performing follow up services with the recruited investors. There was no depletion of the bankruptcy estate when the commissions were paid to the defendant.
- The court held that even if the transfers were held to be actually fraudulent or constructively fraudulent, Section 548(c) would shelter the alleged transfers from being avoidable as fraudulent transfers.

412

Even if a transfer were to fall within section 548(a)(1)(A) or (B), section 548(c) of the Bankruptcy Code could shelter the commission payments from the trustee's avoidance powers if the defendant took the commissions "for value and in good faith." [11] Consequently, even if the trustee had successfully pleaded a section 548(a)(1)(A) cause of action, or proved a section 548(a)(1)(B) claim, he would still be unable to recover the commissions paid if the defendant received the commissions in exchange for value and in good faith.

HN18 In addition to this analytic difference between profits and commissions, there is also an ethical difference between an innocent broker who performed services and less than innocent investors who, at best, tried to take advantage of a "deal" that should have been seen as too good to be true.

413

- The court held that the broker acted in good faith in receiving the commissions for the following reasons:
  - The commissions paid to the defendant for locating investors for the debtor were within the range of commissions earned by others for performing similar services in the pay telephone industry.
  - The defendant performed his services without any knowledge that the debtor's activities were fraudulent or that the debtor was operating a Ponzi scheme.
- The court granted the broker's motion for summary judgment. The trustee's motion for summary judgment was denied.

414

- As it was not disputed that the defendant performed his services without any knowledge that the debtor's activities were fraudulent or that the debtor was operating a Ponzi scheme, therefore, the court did not go into the issue of due diligence.

415

Discovery Rule and Equitable Tolling of the Limitation Period

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Wing v. Dockstader

2010 U.S. Dist. LEXIS 128571, 2010 WL 5020959 (D. Utah Dec. 3, 2010)

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Facts:

- The debtor operated an alleged ponzi scheme.
- The defendant provided contact information for the debtor to individuals interested in investing in the debtor's business.
- The debtor paid the defendant $146,140 for providing this information in the form of commissions or referral fee.
- The defendant along with three of his affiliates also invested in the debtor's business.

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- The United States Securities and Exchange Commission (SEC) filed suit against the debtor alleging violations of the Securities Act of 1933 and the Securities and Exchange Act of 1934.
- Thereafter, the plaintiff receiver was appointed on May 5, 2008.
- The Receiver filed this case on October 6, 2008, alleging that the defendants received fraudulent transfers from the debtor.

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Arguments:

- Among other arguments, the defendants argued that the plaintiff receiver was barred by the statute of limitations from pursuing the claims against the defendants as the claims were filed out of the statutory limitation period for four (4) years under the applicable state law (Uniform Fraudulent Transfer Act).

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Court's ruling:

- The court relied on a decision in the case Wing v. Kendrick, No. 2:08-cv-1002, 2009 U.S. Dist. LEXIS 41923 (D. Utah May 14, 2009) which held that the receiver in that case was entitled to the benefit of the discovery rule, which requires an action to be filed "within one year after the transfer or obligation was or could reasonably have been discovered." Utah Code Ann. § 25-6-10.
- The could held that the claim was not barred by limitation and discovery rule applied was applicable in the case for the following reasons:
  - The plaintiff receiver filed his claims against the defendants five months after his appointment.
  - Although the exact date of when the plaintiff receiver discovered the allegedly fraudulent transfer was not presented in the materials before the court, it defied reason that the plaintiff receiver could discover the transaction before his own appointment on May 5, 2008.

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- The court concluded that the statute of limitations should be tolled until the appointment of the Receiver.
- All the evidence in this case established that the owner of the debtors controlled the debtor entities and used them as part of a scheme to defraud investors.
- In such circumstances, the entities themselves were party to the wrongdoing and could not be expected to have brought claims against themselves.
- Accordingly, the court rejected the defendants' arguments and concluded that the Receiver's action was filed within the applicable statute of limitations.

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Jurisdiction of Bankruptcy Courts With Respect to Fraudulent Transfer Claims

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Bankruptcy Court has no jurisdiction to render final rulings over fraudulent conveyance claims under state law as made applicable under 11 U.S.C 544 and claims under 11 U.S.C 548

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- Following the case of *Stern v. Marshall*. 131 S. Ct. 2594, 180 L. Ed. 2d 475 (2011) *reh'g denied*, 132 S. Ct. 56, 180 L. Ed. 2d 924 (U.S. 2011) and its subsequent interpretation by *Raul Galaz et al. v. Lisa Ann Galaz, et al. (In re Lisa Ann Galaz)*, No. 13-40781 (5th Cir., Aug. 25, 2014), a bankruptcy court has no jurisdiction to try these claims.
- However, the bankruptcy court can acquire jurisdiction if the defendants knowingly and voluntarily consent to jurisdiction. *See Wellness International Network, Ltd. et al. v. Sharif,* 575 U.S. (2015), No. 13-935.
- If the reference of the adversary proceeding is not earlier withdrawn, bankruptcy courts can, in lieu of rendering a judgment, render a proposed findings of facts and conclusions of law at the close of discovery for the district court's de novo review.

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Fraudulent Conveyance Issues in the Oil & Gas Industry

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Whyte v. C/R Energy Coinvestment II, L.P. (In re SemCrude, L.P.),

Nos. 08-11525 (BLS), 10-50840, 10-51808, 2013 Bankr. LEXIS 2351 (U.S. Bankr. D. Del. June 10, 2013)

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Facts:

- The Debtors SemGroup, L.P. and certain of its affiliates were engaged in a number of different business segments in the energy industry and traded in derivatives.
- The Defendants Ritchie SG Holdings LLC, et al. ("Ritchie") and Cottonwood Partnership, LLP ("Cottonwood") owned equity interests in certain debtors.
- In 2008, the Defendants received a portion of the equity distributions totaling approximately $29 million due to their ownership interest ("2008 Distributions").
- The Trustee sought to avoid and recover the 2008 Distributions made to the Defendants as constructively fraudulent transfers.

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Arguments:

- The Trustee argued that the Debtors received no value in exchange for the 2008 Distributions because those distributions were equity distributions, which do not confer value on the transferor.
- Additionally, the Trustee asserted that the Debtors were insolvent at the time of the 2008 Distributions and, thus, the transfer was constructively fraudulent.
- The Defendants argued that the Debtors were solvent at the time of the 2008 Distributions because their approach to evaluate solvency (the Income Approach) was more reliable than the Trustee's approach. The Trustee's approach failed to account for the Debtors' goodwill and going concern values.

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Issue:

- Did the Debtors receive a reasonably equivalent value from the 2008 Distributions?
- Were the Debtors insolvent at the time of the 2008 Distributions?

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Sec. 548 (a)(1): The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(B)(i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and

(ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

431

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Court's ruling:

- Based on section 548's definition of value, the Court noted that no debt or property was transferred to the Debtors in exchange for the 2008 Distributions because both parties agreed that they were made on account of Defendants' equity interests. The Court found that no reasonably equivalent value was provided to the Debtors.
- As to the insolvency issue, the Court noted that Goldman's valuation of the Debtors was contemporaneously prepared in 2008 and not made in anticipation of litigation. Further, the record indicated that Goldman did significant due diligence in preparing its analysis. The Court found Defendant's reliance on Goldman's valuation of $670 million to $2.683 billion sufficiently reliable to prove that the Debtors were solvent at the time of the 2008 Distribution.
- Therefore, the Court held that the 2008 Distributions were not avoidable because the Trustee failed to prove that the Debtors were insolvent at the time of the 2008 Distributions.

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Conclusion:

- Equity interests on account of partnership interests may not confer "value" upon the transferor.
- An entity may be valued as a going concern unless liquidation in bankruptcy is clearly imminent on the date of the transfer. The preferred approach to value a going concern entity is the Income Approach.
- Under a fraudulent transfer claim, the Trustee may bear the burden to prove insolvency by a preponderance of the evidence. There is no presumption of insolvency.

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Soule v. Alliot et al. (In re Tiger Petroleum Co.),

319 B.R. 225 (Bankr. N.D. Okla. 2004)

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Facts:

- Debtor company sold investments in oil and gas wells.
- The defendants were investors who invested with the debtor company.
- The debtor filed for chapter 7 bankruptcy relief.
- The trustee sought to recover all or part of the monies paid to defendant investors for their investments as actual and constructive fraudulent transfers.

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Arguments:

- The trustee alleged that the debtor operated a Ponzi scheme and the transfers were made with a fraudulent intention while the debtor was insolvent and that the debtor received less than equivalent value in exchange of the transfers.
- The trustee moved for partial summary judgment, seeking a determination the company operated a Ponzi scheme.
- The investors sought summary judgment, arguing they were innocent victims who took the alleged transfers in good faith and for a reasonably equivalent value.

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Among others, some of the main issues before the court were as follows:

- Were the alleged transfers made with a fraudulent intent?
- Did the debtor receive anything less than equivalent value in exchange of the transfers?
- Did the defendants take the alleged transfers in good faith and for a reasonably equivalent value?

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§ 548 (a)

(1) The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

(A) made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made or such obligation was incurred, indebted; or

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441

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§ 548(c) Except to the extent that a transfer or obligation voidable under this section is voidable under section 544, 545 or 547 of this title, a transferee or obligee of such a transfer or obligation that takes for value and in good faith has a lien on or may retain any interest transferred or may enforce any obligation incurred, as the case may be, to the extent that such transferee or obligee gave value to the debtor in exchange for such transfer or obligation.

443

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Court's ruling:

- On whether the investors acted in good faith when they invested their money with the company, questions of fact remained as to whether a reasonable person would have been placed on notice of the company's fraudulent purpose or should have done more in the way of due diligence before investing funds.
- The Court held that it was provided little, if any, information regarding the investment experience of the individual Defendants.
- Each of the Defendants claimed to have been introduced to the Debtor by a trusted financial advisor and/or tax accountant, on whom they relied.
- The parties had presented no evidence regarding whether the promised rates of return were excessive, other than one Defendant's statement that his expected rates of return were in line with other investments involving similar risk.

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- As to whether the debtor received less than reasonably equivalent value from the investors in exchange for the monies which the company paid to them, the court held that the investors were entitled to judgment as a matter of law. No evidence was offered proving the investors had any knowledge of the company's malfeasance.
- A comparison of the dollars invested to dollars returned indicated that each investor received less from the company than they put in.

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Defendant	Amount Invested	Amount Returned to Investor by Tiger
Lestrino Baquiran	$ 60,000.00	$ 50,706.13 (84.51%)
Souheil and Ruth Kandalaft	$ 50,000.00	$ 34,695.59 (69.39%)
Woon Soon and Ai Ja Lee	$ 170,000.00	$ 141,758.63 (83.39%)
Patricia Veraldo	$ 205,000.00	$ 170,197.10 (83.02%)
Leon Greenblatt	$ 1,375,000.00	$ 769,652.01 (55.97%)
Andrew Jahelka	$ 550,000.00	$ 358,230.00 (65.13%)
Richard Nichols	$ 410,000.00	$ 247,087.32 (60.26%)

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- The trustee's motion for partial summary judgment was denied. The investors' motion for summary judgment was granted in part and denied in part.
- The constructive fraud count of the amended adversary complaint was dismissed with prejudice

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Conclusion:

- Transfers made to creditors by a ponzi debtor may not be avoidable as actual fraudulent transfers if the creditors were innocent victims of the fraudulent scheme, had no knowledge and carried out minimum due diligence before investing in the debtor's scheme.

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