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1

Preference Clawback In the Transportation and Logistics Industry

2

Carrier's Right to Set-Off Under an Interline Trucking Arrangement

3

In re Mason & Dixon Lines, Inc.,

65 B.R. 973, 1986 Bankr. LEXIS 5117, 15 Collier Bankr. Cas. 2d (MB) 1425 (Bankr. M.D.N.C. 1986)

Defendant St. Johnsbury Trucking, Co.

4

Facts:

- The Debtor Mason & Dixon Lines, Inc. ("M&D") and the Defendant St. Johnsbury Trucking Co. participated in an interline trucking arrangement, wherein carriers cooperated in the transportation of freight so that each hauled freight for the other and the carriers become indebted to one another for these services.
- The regulations for conducting business between carriers (Motor Carrier Freight Claim Rule 132) provided that each carrier had a right of setoff when an account was 30 days delinquent.
- During the 90-day preference period, M&D paid some of St. Johnsbury's invoices.
- After filing for bankruptcy, M&D and its trustee sought to recover these payments as alleged preferential transfers, made pursuant to the interline trucking arrangement.
- A hearing was held on cross motions of Plaintiff Mason & Dixon and Defendant St. Johnsbury for summary judgment.

5

Debtor's Arguments:

- M&D argued that the payments met the section 547(b)(5) standard and thus were preferential because the most an unsecured creditor could have gotten in a Chapter 7 was a 10% dividend (suggested by the dividend to unsecured creditors provided in the Chapter 11 reorganization plan).
- Additionally, M&D contended that there was no right of setoff at the time of filing for St. Johnsbury because it had paid St. Johnsbury's invoices.

6

Defendant's Arguments:

- St. Johnsbury argued that it would not have received more in a hypothetical 547(b)(5) analysis because it was reasonable to assume that if it had not been paid, then St. Johnsbury would have asserted its right to offset the debt pre-petition pursuant to section 553.
- Alternatively, if 30 days had elapsed post-petition, St. Johnsbury would have offset the amount as a secured claim under section 506(a).
- In any event, St. Johnsbury asserted that it would have receive 100% credit for the debt and, thus, had not received more pre-petition than it would have received in a Chapter 7 liquidation.
- St. Johnsbury also argued that the payments were contemporaneous exchange for a new value as the it relinquished its right to setoff by accepting the M&D's payments.

7

Issue:

- Were the payments made by M&D to St. Johnsbury preferential payments when St. Johnsbury held a mutual debt against M&D at the time when regulations provided for a setoff?
- Do the payments qualify as a contemporaneous exchange for new value to the extent that the right to setoff was relinquished?

8

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.

9

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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.

10

Motor Carrier Freight Claim Rule 132

INTERLINE SETTLEMENTS: Interline settlement will be made on a weekly basis. Contra- or off-set settlements will not be made. Balance due bills and/or resettlements will not be included in current interline settlements.

Exception: 1. In the event either party becomes delinquent, in accordance with the provisions of this part, the other party may require cash settlement until such time as delinquent items are paid, and acceptable proof furnished that future settlements will be maintained on a current basis.

Exception: 2. Contra- or off-set settlements may be made after account becomes thirty days delinquent.

11

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12

Sec. 553(a): Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

13

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14

Sec. 506(a)(1): An allowed claim of a creditor . . . that is subject to setoff under section 553 of this title, is a secured . . . to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that . . . the amount so subject to set off is less than the amount of such allowed claim.

15

Sec. 506(a)(1): An allowed claim of a creditor . . . that is subject to setoff under section 553 of this title, is a secured . . . to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that . . . the amount so subject to set off is less than the amount of such allowed claim.

16

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;

17

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(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;

18

Court's ruling:

- The Court agreed with St. Johnsbury's argument that it was reasonable to assume that if St. Johnsbury had not been paid it would have offset the debt pre-petition pursuant to section 553.
- Pre-petition, M&D had made the payments timely, so St. Johnsbury had no need to offset any amount at the date of filing. The Court noted that M&D was trying to pull back payments from a creditor with a right of setoff which it could not have avoided pre-petition.
- The Court found that M&D incorrectly characterized St. Johnsbury as an unsecured creditor when St. Johnsbury had additional rights to setoff not available to a general unsecured creditor.
- Additionally, if M&D had not made these payments to St. Johnsbury, St. Johnsbury would have had a claim in bankruptcy recognized as secured pursuant to section 506(a) to the extent of St. Johnsbury's right to setoff. Thus, to the extent payments were accepted by St. Johnsbury when St. Johnsbury had corresponding amounts available for offset, St. Johnsbury had not received preferential payments.

19

It appears Mason and Dixon believes that it could cut off defendant's right of setoff pre-petition by payment and then **[978]** recover that payment as preferential and extinguish the creditor's right to setoff which would have arisen absent payment. This appears to be convoluted reasoning. If followed, this tactic would deny a creditor a right to offset which section 553 of the Code says the bankruptcy law does not affect. This Court finds it hard to believe that defendants would have "voluntarily" paid Mason and Dixon if Mason and Dixon had not paid defendants' bills. No factors were presented to the Court to suggest why St. Johnsbury would have relinquished a right to offset had Mason and Dixon not paid St. Johnsbury. The regulations, common trade practice, and logic suggest that the payments were reciprocal in nature and that absent payments from Mason and Dixon the creditor would have taken an offset and not "voluntarily" relinquished this right.

20

Court's ruling:

- The Court noted that to the extent that St. Johnsbury had a corresponding mutual debt to M&D which would have been available for offset upon 30 days delinquency, St. Johnsbury had not received a preference when it accepted payment.
- Upon receipt of payment, St. Johnsbury relinquished its right to setoff M&D's debt and thus gave new value for the payment.
- The Court cited cases that have recognized that a creditor provided new value for a payment if the creditor had relinquished its right to perfect a mechanic's or materialman's lien by acceptance of the payment.
- Because the Court viewed the facts here as analogous to a materialman with an inchoate lien, the Court found that St. Johnsbury's relinquishment of the right to setoff by accepting M&D's payments constituted new value.
- The Court granted the St. Johnsbury's motion for summary judgment and held that the payments were not preferential payments.

21

With interline payments between carriers, the creditor carrier has a right of setoff if the debt is 30 days delinquent. If the debtor pays the debt, the creditor relinquishes the right of setoff. This Court feels that the creditor carrier's relinquishment of the right of setoff by accepting the debtor's payments should constitute new value as does the relinquishment of an inchoate lien right. As long as the creditor carrier has a debt at least equal to the debtor's payment, the creditor instantaneously relinquishes its right to offset upon acceptance of payment. The right to offset is a right protected by section 553 and the relinquishment of that right should constitute "new value" within the meaning of section 547(c)(1).

22

Conclusion:

- Payments to a fully secured creditor are not preferential because the creditor does not receive more than he would in a Chapter 7 liquidation.
- As long as the creditor carrier has a debt at least equal to the debtor's payment, the creditor instantaneously relinquishes its right to offset upon acceptance of payment.
- The North Carolina bankruptcy court has held that the right to offset is a right protected by section 553 and the relinquishment of that right should constitute "new value" within the meaning of section 547(c)(1).

23

Paid New Value Defense

24

Miller v. JNJ Logistics LLC (In re Proliance Int'l, Inc.),

514 B.R. 426, 2014 Bankr. LEXIS 3460, 72 Collier Bankr. Cas. 2d (MB) 108, 59 Bankr. Ct. Dec. 274, 2014 WL 3956485 (Bankr. D. Del. 2014)

25

Facts:

- The Defendant, JNJ Logistics LLC provided freight transport services to the Debtors Proliance International, Inc., *et al.* Specifically, the Defendant transported auto parts for the Debtors.
- During the 90-day preference period, Proliance paid $548,035.66 to JNJ for its transportation services.
- The Trustee sought to recover the payments as alleged preference payments.
- The parties agreed that the JNJ was entitled to a subsequent new value defense in the amount of $49,366.28, resulting from invoices "open" (i.e. unpaid) as of the Petition Date ("Unpaid SNV").
- The parties disagreed regarding the validity of JNJ's asserted subsequent new value defense for invoices that were paid prior to the Petition Date in the amount of $222,045.11 ("Paid SNV").

26

Facts:

- JNJ filed its Motion for Partial Summary Judgment regarding the validity of its Paid SNV defense to the preference action.
- The Trustee responded with his own Cross-Motion for Partial Summary Judgment on the same issue.

27

Arguments:

- JNJ argued that the payments received were in exchange of new value provided to Proliance and urged the Court to adopt the subsequent advance approach which would reduce the alleged preference by the Unpaid SNV and the Paid SNV.
- The Trustee argued that the Court should adopt the "remains unpaid" approach which would only reduce the preferential claim by the Unpaid SNV.

28

Issue:

- Can an alleged preferential transfer be reduced by subsequent new value regardless of whether it was paid or unpaid prior to the petition date?

29

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;

30

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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;

31

“New value" is defined under section 547(a)(2) as "money or money's worth in goods, services, or new credit . . . that is neither void nor voidable by the debtor or the trustee under any applicable law.” 11 U.S.C.§547(a)

32

The subsequent new value defense is intended to encourage creditors to work with companies on the verge of insolvency. In addition, it is designed to ameliorate the unfairness of allowing the trustee to avoid all transfers made by a debtor to a creditor during the preference period without giving any corresponding credit for advances of new value that benefitted the debtor.

Friedman's Inc. v. Roth Staffing Cos., L.P. (In re Friedman's Inc.), 2011 Bankr. LEXIS 4500, 55 Bankr. Ct. Dec. 228, 2011 WL 5975283 (Bankr. D. Del. Nov. 30, 2011)

33

In addition to these policy considerations, section 547(c)(4) "codifies the concept that the estate, and consequently the other creditors, are not harmed by the transfers. If the transfer is within this exception, it was made in exchange for new value and the new value augments the estate in the same proportion as the value of the transfer; therefore, the estate does not suffer any injury.”

Friedman's Inc. v. Roth Staffing Cos., L.P. (In re Friedman's Inc.), 2011 Bankr. LEXIS 4500, 55 Bankr. Ct. Dec. 228, 2011 WL 5975283 (Bankr. D. Del. Nov. 30, 2011)

34

Remains Unpaid Approach vs. Subsequent Advance Approach

35

Jurisdictional Split:

Some courts conclude that section 547(c)(4)(B) should be read to mean that new value *must remain unpaid* at the end of the preference period in order to be used as a defense to a preferential claim.

Other courts have concluded that section 547(c)(4)(B) does not contain a "remains unpaid" requirement, rather the court must determine if "subsequent advances" were made by the creditor.

36

The unpaid new value line of cases say that the new value, the product or service that was not paid for, returns the preference to the estate. The Defendant provided value, and that value replaced the preference.

37

Because the Defendant was continuing to do business with the Debtors (i.e., shipped product and received payment), the Defendant was benefiting the Debtors to the extent of the new credit and the value of the products or services which presumably could be resold or used for a profit.

38

Thereafter in *Sierra Concrete Designs, Inc.*, **[**23]** this Court continued with a descriptive chart explanation — which the Court will expand on herein:

Date	Preference Payment	New Value	Preference Exposure as calculated in ***In re Sierra Concrete Design, Inc.***	Remains Unpaid Approach	Subsequent Advance Approach[42]
January 1	$1,000	-	$1,000	$1,000	$1,000
January 5	-	$1,000	$0		$0
January 10	$1,000	-	$1,000	$2,000	$1,000
January 15	-	$2,000	$0 (not -$1,000)		-$1,000
January 30	$3,000	-	$3,000	$5,000	$2,000
February 5	-	$1,000	$2,000		$1,000
February 10	$1,500	-	$3,500	$6,500	$2,500
February 15		$1,000			$1,500
Results			**$2,500**	**$5,500**	**$1,500**

39

When there is a subsequent advance of a product or service and it is paid for, the Court reasoned that the prior transfers should also be deemed protected by that new transaction because it protects a creditor who continues to extend revolving credit to the debtor. The creditor is acting in reliance on the debtor's ability to pay.

40

The subsequent new value defense protects creditors who provide new credit after an old invoice is paid off. Suppose a supplier ships $1,000 of goods with payment due within 30 days and the debtor pays the invoice at the end of those 30 days. Because the debtor is timely paying its debts, the supplier continues to provide goods with payment due in 30 days. Suppose further that, at the time the debtor files its bankruptcy petition, the creditor has shipped $1,000 worth of goods three times and has been paid for those goods all three times. Under the bright line preference rule, each of the transactions would be preferential as each was made on account of an antecedent debt and each made the creditor better off than it would have been if it not been repaid and everything else remained the same. It makes no sense, however, to allow recovery of all three $1,000 payments. The purpose of the creditor's supply arrangement was to limit its risk to $1,000 or so at any one time. The creditor made subsequent shipment of goods only because the debtor was paying for the earlier shipments. The transfers made the creditor better off only to the extent of $1,000, the most it would have lost if any of the transfers had not been made. Thus, one looks at the net result—the extent to which the creditor was preferred, taking account of the new value the creditor extended to the debtor after repayment of old credit, i.e., loans.

41

The new value is the preferred creditor's extension of credit of services and product regardless of whether it was paid or not.

Therefore, the Court concluded that it should look at the net result, that is, the Defendant's continued act of doing business with the Debtors, to calculate the new value.

42

The Court specifically found that the paid new value transfers were "otherwise avoidable" and therefore protected. They were payments on an antecedent debt and represented payments of continued unsecured credit based on the payment from the Debtors that had come before. In other words, the second payment was based on the first payment. Thus, neither payment should be avoidable.

43

Court's ruling:

- In applying the subsequent advance approach, the Court found that the net result of the preferential transfers and subsequent new value (paid and unpaid) never resulted in JNJ's preference exposure falling below $0.
- As a result, JNJ was entitled to full credit for all subsequent new value it provided to Proliance, including Paid SNV and Unpaid SNV.
- The Court held that the alleged payments in the amount of $271,411.39 were not avoidable as preference.

44

Conclusion:

- The Delaware bankruptcy court has adopted the subsequent new value approach to calculate the amount of a creditor's subsequent new value defense.

45

Wallach v. Ford Motor Co. (In re Performance Transp. Servs.),

486 B.R. 62, 2013 Bankr. LEXIS 544, 69 Collier Bankr. Cas. 2d (MB) 103, 57 Bankr. Ct. Dec. 147, 2013 WL 489029 (Bankr. W.D.N.Y. 2013)

46

Facts:

- The Debtors Performance Transportation Services, Inc., *et al.* hauled automobiles produced by the Defendant Ford Motor Co. to distribution centers.
- Performance owed Ford for damages suffered by the vehicles while in the custody of the Performance.
- During the 90-day preference period, Performance paid Ford $300,000 for vehicle damage.
- During the preference period and after this damage, Ford entered into an agreement to place new hauling orders in the amount of $14,000,000.
- The Trustee sought to recover the $300,000 payment made to Ford as a preference.
- Ford filed a motion for summary judgment.

47

Arguments:

- Ford argued that the $14,000,000 worth of new hauling orders placed with Performance by Ford during the preference period constituted new value. Thus, the $300,000 paid to it by Performance for vehicle damage during the 90-day preference period was not avoidable as preference.
- The Trustee argued that the new orders did not constitute new value, and the $300,000 was avoidable as preference.

48

Issue:

- Did the new orders, submitted by Ford, constitute new value?

49

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;

50

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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;

51

First, the Court believed that there was a setoff argument pursuant to section 553 available to Ford.

52

Sec. 553(a): Except as otherwise provided in this section and in sections 362 and 363 of this title, this title does not affect any right of a creditor to offset a mutual debt owing by such creditor to the debtor that arose before the commencement of the case under this title against a claim of such creditor against the debtor that arose before the commencement of the case, except to the extent that—

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54

Litig.) 811 F. Supp. 2d 883, 894 (S.D.N.Y. 2011); Nat'l Commc'ns. Ass'n, Inc. v. AT&T Corp., 238 F.3d 124, 130-31 (2d Cir. 2001). If § 553 did not exist, the Court might agree with Ford Motor Company. **[**11]** However, that statute does exist, and exists for a reason. All other things being equal, no-one may question the "value" **[*66]** of mutual receivables that are unpaid, or their setoff. Here, however, the Debtor's actual payments for vehicle damages diminished the Debtor's operating funds, and no one knows how that compares with what benefits flowed to the Debtor, if any, from the new orders placed by Ford.

55

holding.

[7] One might ask "What's the difference? If what these parties practiced would have had a 'safe haven' in setoffs, then why not a 'safe haven' in the 'new value' defense to a § 547 preference attack?"

The hypothetical answer is that "payment **[**10]** in cash" by the Debtor reduced the Debtor's operating funds. Big receivables from Ford were certainly a good thing, but did not necessarily improve the Debtor's operating ability. The payments out to Ford might have been fatal to the Debtor and its other creditors. Who can know where a balance might tip? And who can know whether other creditors extended more than they otherwise might have extended had they known that good looking "accounts-receivable" from Ford, and new orders from Ford, were subject to cash outflow to Ford under the "Damage Program."

56

Court's ruling:

- The Court noted that Ford had provided Performance new purchase orders, not money. Ford had merely obligated itself to pay for services to be rendered in the future by Performance, provided that Performance actually performed those services.
- Ford's provision of new orders did not consist of new value under the definition of new value, which is "money or monies worth in goods, services, or new credit," because Ford did not take on any risk.
- For example, the following transactions constitute new value because the transferee has taken on a risk.
- Assuming that forbearing from collecting an obligation may constitute "new value," it is clear that the recipient of an otherwise preferential transfer who thereafter forbears from collecting a sum that is due and owing is taking the risk that that obligation will never be paid. (E.g. Buffalo Auto Glass , 187 B.R. 451 (Bankr.W.D.N.Y. 1995).)

57

Court's ruling:

- Similarly, to the extent that a recipient of an otherwise preferential transfer who later signs a personal guarantee that enables a debtor to obtain new credit has taken on the risk of being held personally liable on that new debt. (E.g. In re Kumar Bavishi & Assoc ., 906 F.2d 942 (3d Cir. 1990).)
- Whereas, here, the Court found that the risk was minimal because all of the damage payments that were made during the preferential period were miniscule compared to the new business that Ford ordered from Performance.

58

Conclusion:

- The new orders placed by Ford did not constitute new value for the above reasons.
- Therefore, the Court denied Ford's motion for summary judgment as to its "new value" defense.

59

Contemporaneous Exchange For New Value

60

Weisfelner v. LR2 Mgmt., K/S (In re Lyondell Chem. Co.),

2015 Bankr. LEXIS 3156, 74 Collier Bankr. Cas. 2d (MB) 619, 2015 AMC 2321, 2015 WL 5560283 (Bankr. S.D.N.Y. 2015)

61

<u>Facts:</u>

- Equistar Chemicals, LP, a subsidiary of Debtor Lyondell Chemical Company, entered into a charter party contract with Defendant LR2 Management, K/S to charter a vessel to transport 80,000 metric tons of petroleum condensate from Algeria to ports in Texas.
- The parties agreed to incorporate the terms of the standard form of contract published by the Association of Ship Brokers & Agents (U.S.A.), Inc., which provided that payment was due upon delivery of the cargo at the final destination.
- During the transportation of the cargo, Lyondell experienced a "severe cash shortage." Lyondell's senior management decided to stop its customary practice of paying its vendors through its automated system and prioritized payments to certain critical vendors, including LR2.
- After discharging the cargo and during the 90-day preference period, Equistar made two wire transfers to LR2 in the amounts of $2,057,851.25 ("Freight Charges Transfer") and $12,298.08 ("Quay Dues Transfer").

62

<u>Facts:</u>

- The Freight Charges Transfer accounted for the cost of shipping, and the Quay Dues Transfer represented reimbursement for a payment made by LR2 to the loading port in Algeria on behalf of Equistar.
- LR2's expert testified that payment within three or four days after the discharge of the cargo was consistent with industry-wide practice.
- A week after the transfers, the Debtor and its affiliates filed a chapter 11 petition.
- The Trustee sought to avoid and recover these two allegedly preferential transfers to LR2.

63

<u>Arguments</u>:

- LR2 did not dispute that the transfers were preferential since all the requirements of section 547(b) were satisfied; rather, it asserted that there were valid defenses to prevent those transfers from being avoided as preference.
- LR2 argued that Equistar received new value (the cargo) in exchange for the Freight Charges Transfer, that the terms of the contract showed that the parties intended Equistar's payment to be contemporaneous with the delivery of the cargo (payment due upon delivery), and that the payment was made promptly so the exchange was substantially contemporaneous.
- The Trustee asserted that the payment must be given before the new value is provided. Because payment was rendered after the cargo was delivered, the transaction did not constitute new value.

64

<u>Arguments</u>:

- Additionally, LR2 argued that the Freight Charges Transfer was according to ordinary business terms because it was typical for the petrochemical industry to have a 3 business day grace period after cargo discharge and for payment to be made during that 3-day grace period. The Freight Charges Transfer was made 2 days after discharge of the cargo.
- Lastly, LR2 asserted that the Quay Dues Transfer was made in the ordinary course of business because it was common practice for a charterer to reimburse a vessel owner for any expenses incurred during the voyage and pay those expenses around the same time as the freight payments.

65

<u>Issue</u>:

- Was the Freight Charges Transfer protected from avoidance by the contemporaneous exchange exception?
- Was the Freight Charges Transfer protected from avoidance by the ordinary course of business defense?
- Was the Quay Dues Transfer protected from avoidance by the ordinary course of business defense?

66

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(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;

67

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69

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(B) in fact a substantially contemporaneous exchange;

70

§ 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;

71

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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

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72

§ 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;

73

Court's ruling:

- The Court rejected the Trustee's analysis that the payment must be given before the new value is provided because that analysis applied to situations where there was a transfer but it was a late payment and then new value came after the payment.
- The Court opined that the Trustee was confusing 547(c)(1) with the subsequent new value section 547(c)(4).
- Therefore, because the parties made an exchange of equally-valued consideration consistent with the terms of the contract, the Court found that the Freight Charges Transfer met the "new value" requirement.

74

majority of those cases involved the payment of *overdue* obligations, as opposed to current obligations, as is the case here.[40] The payment of a current obligation does not **[*13]** implicate the underlying policy rationale of the preference provisions to prevent harm to a debtor's "financial position on the eve of bankruptcy to the detriment of [its] other creditors," because the debtor is receiving value directly in exchange for such payment.[41]

75

Circumstantial evidence can be used to determine the parties' intent.

76

Court's ruling:

- The Court noted that the delivery of the cargo and the transfer of the Freight Payment had occurred close enough in time (2 days) and according to the terms of the contract (within 3 days).
- The fact that the parties agreed to a three-day grace period did not change that the payment was intended by the contract to be contemporaneous.
- Both parties intended for the payment to be made at the time of the delivery of the cargo.
- Even when there is delay between delivery and payment, the Court concluded that the delay did not defeat the intention of contemporaneousness when the parties acted with reasonable promptness.
- Finally, LR2 demonstrated that the exchanges were substantially contemporaneous.

77

HN11 Courts have held exchanges to be substantially **[17]** contemporaneous "even when taking 7, or even 20, days to complete."46 Rather than providing a bright line test, "contemporaneity is a flexible concept" requiring "a case-by-case inquiry" into the circumstances.47 This inquiry examines a variety of relevant circumstances, including "(1) the length of delay, (2) the reason for the delay, (3) the nature of the transaction, (4) the intentions of the parties, and (5) the possible risk of fraud."48 Courts also consider whether the exchange occurred consistent with the time frame established by the parties.49

78

Here, payment was made promptly after the Cargo was delivered, with a delay of only two business days. The logistics of verifying delivery and moving such substantial sums understandably took time, which is why Equistar's and the industry's norm was to allow a 3 day grace period after delivery for payment to be made before incurring any penalty. [50] Equistar had to review the discharge documents, conduct an independent inspection to verify delivery, and then arrange with its bank for payment to be made. [51] Weighing all of the factors identified in *Ames-Revere*, the Court concludes that the Freight Charges Transfer was part of an exchange **[18]** that was substantially contemporaneous.

79

Court's ruling:

- Additionally, in prioritizing its payments, Lyondell appeared to show that there was a specific intent to show preference to LR2.
- The Court found that the parties were not engaged in the ordinary course of business under 547(c)(2)(A) because LR2 was specifically preferred. Nonetheless, the parties met the industry standard under 547(c)(2)(B).
- The measure for ordinariness under 547(c)(2)(B) is the creditor's industry.
- Here, the payment was made within the 3-day grace period and that period was typical in the petrochemical industry; thus, the Court found that the Freight Charges Transfer was consistent with the ordinary business terms of the industry.

80

Court's ruling:

- Finally, the Court found that the Quay Dues Transfer was consistent with industry norms because Equistar did not provide contrasting evidence on the industry norm and LR2 did not take any extraordinary collection efforts to expedite payment.
- Therefore, the Court held that the Freight Charges Transfer and the Quay Dues Transfer could not be avoided as preference payments.

81

Conclusion:

- A transfer made within three days of a provision of a service is a contemporaneous exchange.
- Contemporaneity is a flexible concept requiring a case-by-case inquiry into the circumstances. A relevant circumstance for inquiry includes the length of delay.
- Even if there is a judicial ruling that a defendant was preferred intentionally, the defendant can still use the industry standard defense under section 547(c)(2)(B) as a safe harbor to stop a transfer from being avoided as a preference.

82

Conduit Defense

83

Tidewater Designs, Inc. v. Evergreen Am. Corp. (In re Tidewater Designs, Inc.)

276 B.R. 733, 2002 Bankr. LEXIS 378, 39 Bankr. Ct. Dec. 134, 2002 AMC 1540 (Bankr. E.D.N.C. 2002)

84

Facts:

- The Plaintiff-Debtor Tidewater Designs, Inc. was an importer of gift items from vendors in China, Taiwan, and Hong Kong.
- The Defendant, Evergreen America Corporation ("Evergreen") was a New Jersey corporation that was engaged in the shipping business in North Carolina as the exclusive general agent for Evergreen Marine Corp. (Taiwan) Ltd. ("EMC"), a Taiwanese ocean carrier.
- EMC transported cargoes in international trade and was compensated by the payment of ocean freight charges.
- During the 90-days preference period, Tidewater paid $123,329.50 to Evergreen for payment of ocean freight charges due to its principal EMC for shipments transported from the Far East to the United States.
- It was undisputed that Tidewater did not have a contract with Evergreen, and that EMC, not Evergreen, provided all transportation services for the cargoes that were shipped.

85

Facts:

- The relationship between Evergreen and EMC was controlled by an Agency Agreement. Under the agreement, Evergreen had a duty to collect freight payments for EMC and bore a degree of risk if freight payments were not collected.
- Testimony from Evergreen's representative indicated that Tidewater paid its freight charges with checks made payable to Evergreen, and that Evergreen initially deposited the collected funds into an ocean freight account maintained in Evergreen's name.
- Cargoes were released to Tidewater only after the payments were credited in Evergreen's freight receivable system.
- After the collection of freight charges and release of cargo, the funds were transferred from Evergreen's account to EMC's account in New York.
- Tidewater sought to recover the payments to Evergreen as preferences.

86

Arguments:

- Evergreen argued that it was not the initial transferee of the payments under section 550, and therefore Tidewater could not recover those payments from it. Although Evergreen was the initial recipient of the payments, the payments were exclusively for Evergreen's principal EMC.
- Tidewater argued that, as the initial recipient of the payments, Evergreen was also the initial transferee. As a result, Tidewater could recover the allegedly preferential payments from Evergreen.

87

Issue:

- Was Evergreen, as the initial recipient of the payments, the initial transferee for purposes of section 550?

88

Sec. 550(a): Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

89

Sec. 550(a): Except as otherwise provided in this section, to the extent that a transfer is avoided under section 544, 545, 547, 548, 549, 553(b), or 724(a) of this title, the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from—

(1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or

(2) any immediate or mediate transferee of such initial transferee.

90

Many decisions have concluded that “a party acting merely as a conduit who facilitates the transfer from the debtor to a third party is not a 'transferee' . . . ." 5 LAWRENCE P. KING, ED., COLLIER ON BANKRUPTCY P 550.02[4][a] (15th ed. rev. 2001).

91

The Fourth Circuit Court of Appeals has recognized that “a party cannot be an initial transferee if he is a mere conduit for the party who had a direct business relationship with the debtor." *Lowry v. Security Pacific Business Credit, Inc. (In re Columbia Data Prods., Inc.)*, 892 F.2d 26, 28 (4th Cir. 1989), citing *In re Fabric Buys of Jericho, Inc.,* 33 B.R. 334 (Bankr. S.D.N.Y. 1983).

92

In *Bowers v. Atlanta Motor Speedway, Inc. (In re Southeast Hotel Properties Ltd. Partnership)*, 99 F.3d 151 (4th Cir. 1996), the Fourth Circuit surveyed the available case law, concluding that the majority of reported decisions have held that an agent is not the initial transferee if the agent is "acting in his or her representative capacity, even if the agent . . . has physical dominion or control over the funds." Id. at 155.

93

Bowers then follows the Fifth, Seventh, Ninth, and Tenth Circuits in holding that ***HN6*** an agent is not an initial transferee for purposes of § 550 unless the agent possesses both physical *and legal* dominion and control over the funds. See Security First Nat'l Bank v. Brunson (In re Coutee), 984 F.2d 138 (5th Cir. 1993); Bonded Fin. Servs. Inc. v. European Am. Bank, 838 F.2d 890 (7th Cir. 1988); Danning v. Miller (In re Bullion Reserve of North America), 922 F.2d 544 (9th Cir. 1991); Rupp v. Markgraf, 95 F.3d 936 (10th Cir. 1996). Under these decisions, mere physical control over the funds does not make the agent an initial transferee. Indeed, without more, physical control of the funds simply opens the door for the agent to breach the fiduciary duty owed to the principal by taking the money for its own purposes. To become the initial transferee, the agent must also have "the right to put those funds to one's own purpose," or legal control over the funds. 99 F.3d at 155, quoting Rupp, 95 F.3d at 941.

94

Court’s ruling:

- The Court noted that Tidewater’s contractual relationship was with Evergreen's principal EMC, and not with Evergreen. Tidewater’s dealings with Evergreen were limited to the release of cargo in exchange for payment.
- Under the facts of this case, the Court found that Evergreen was acting as an agent for EMC because the relationship between EMC and Evergreen was established by a formal agency agreement.
- Under the agreement, Evergreen had a duty to collect Tidewater’s payment for EMC before the corresponding cargo was released and then transmit the payment to EMC.
- As a result, Evergreen had no right to use those funds for its own purposes; thus, the Court concluded that Evergreen did not have legal control over Tidewater’s payment and was not the initial transferee.

95

Court’s ruling:

- Therefore, because Evergreen was not the initial transferee for purposes of section 550, the Court held that Tidewater could not recover the preferential payments from Evergreen.

96

Conclusion:

- An agent may not be an initial transferee for purposes of § 550 unless the agent possesses both physical and legal dominion and control over the funds.
- The right to use funds for ones own purposes suggests legal dominion over those funds.

97

Possessory Lien Defense

98

Triad Int'l Maint. Corp. v. Southern Air Transp., Inc. (In re Southern Air Transp., Inc.)

511 F.3d 526, 2007 U.S. App. LEXIS 28896, 2007 FED App. 0479P (6th Cir.), Bankr. L. Rep. (CCH) P81,073, 58 Collier Bankr. Cas. 2d (MB) 1849, 49 Bankr. Ct. Dec. 56 (6th Cir. Ohio 2007)

99

Facts:

- The Debtor Southern Air Transport (SAT) was engaged in the air transportation of cargo. As part of its operation, it also leased aircrafts.
- The Creditor, Triad Maintenance Corporation, was primarily engaged in the business of service, repair, maintenance, and storage of aircrafts.
- Triad provided its services to SAT under an aircraft maintenance agreement as to a McDonnel Douglas DC8-73 Aircraft (Aircraft).
- During the 90-days preference period, SAT paid Triad a $100,000 payment for its services.
- The Trustee sought to recover this amount as preference payment.
- The bankruptcy court ruled in favor of the Trustee, and the district court affirmed. Triad appealed.

100

Creditor's Arguments:

- Triad argued that it was a fully secured creditor at the time of the $100,000 payment by virtue of an artisan's lien against the Aircraft.
- Triad also asserted that it was not required to file a notice of its interest in the Aircraft with the Federal Aviation Administration ("FAA") because North Carolina state law did not require a formal written filing to perfect such a lien.

101

Debtor's Arguments:

- SAT argued that an artisan's lien cannot attach to a leasehold interest. Thus, there was no artisan's lien on the Aircraft because SAT was leasing the Aircraft.
- SAT contended that notice of a lien must be filed with the FAA in order to be valid against third parties.

102

Issue:

- Whether the transfer enabled Triad to receive more than it would have received under a hypothetical Chapter 7 liquidation.

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

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;

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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.

105

Security interests in most goods are governed entirely by state law. North Carolina and the vast majority of states have adopted, some with minor revisions, Article 9 of the Uniform Commercial Code ("UCC") as their law governing secured transactions. Under the UCC, a creditor ordinarily files with the state a financing statement giving notice of its lien, thus perfecting the lien, and such filing puts future purchasers or creditors on notice of the prior encumbrance. The ability to search the state UCC filings provides a convenient way for future purchasers or creditors to ensure that they are buying or accepting goods as collateral with full knowledge of any earlier encumbrance.

Triad Int'l Maint. Corp. v. Southern Air Transp., Inc. (In re Southern Air Transp., Inc.), 511 F.3d 526, 532 (6th Cir. Ohio 2007)

106

Sec. 503 of the Federal Aviation Act of 1958:

(a) Establishment of system.—The Administrator of the Federal Aviation Administration shall establish a system for recording—

(1) conveyances that affect an interest in civil aircraft of the United States

(2) leases and instruments executed for security purposes . . . .

(amended and renumbered to 49 U.S.C. § 44107)

107

purchasers or creditors on notice of the prior encumbrance. The ability to search the state UCC filings provides a convenient way for future purchasers or creditors to ensure that they are buying or accepting goods as collateral with full knowledge of any earlier encumbrance. In passing Section 503 of the Federal Aviation Act of 1958 ("the Act"), 1 Congress made the determination that due to the inherent mobility of airplanes, something more convenient than state-by-state UCC filing was warranted. The purpose of Congress in enacting the Act was to establish a single national filing system for the recordation of documents evidencing title and security interests in civil aircraft, and not to legislate priorities among holders of various interests in aircraft; Congress did not intend to supercede state laws that would otherwise govern priorities between perfected security interests. *See* Cessna Fin. Corp. v. Skyways Enter., Inc., 580 S.W.2d 491, 493 (Ky. 1979) (applying state version of UCC in holding that a buyer in the ordinary course takes priority over lien filed with FAA). Its goal was to "eliminate the confusion engendered by a multitude of state recording systems by providing a single national filing system for . . . documents of the kind normally comprehended by state laws. . . . Congress did not intend, however, to create affirmative priority of federally recorded interests as against the competing rights declared by state law." Haynes v. General Elec. Credit Corp., 432 F. Supp. 763, 765 (W.D. Va.), *aff'd,* 582 F.2d 869 (4th Cir. 1978).

108

HN5 With respect to the state filing system, the UCC drafters made a deliberate policy choice that the possession by the secured party of property subject to a lien is sufficient for perfection because, like the filing of a financing statement, the possession of goods by a creditor is an effective means of putting future creditors or purchasers on notice that the property is encumbered. White & Summers, *Uniform Commercial Code*, § 31-8 (5th ed. 2002) ("[C]reditor's possession (and the debtor's lack of it) puts third parties on notice . . . .") Nothing in the Act's

109

Therefore, the Court found that Triad's artisan's lien required possession, rather than filing, to be valid and retain priority.

110

Court's ruling:

- The Court found that where a state law does not require, or even provide for, the filing of an instrument in order for a possessory artisan's lien against an aircraft to be perfected, the failure to file an instrument evidencing the lien with the FAA registry did not invalidate the lien.
- Because Triad held a valid artisan's lien, the Court concluded that the Trustee was unable to establish that the $100,000 payment to Triad was more than it would have received from SAT under the hypothetical Chapter 7 liquidation.
- The Court of Appeals for the 6th Circuit held that the Trustee failed to meet his burden of proving the elements necessary to establish that the payment to Triad was preferential and thus avoidable under 11 U.S.C. § 547(b)(5).
- The Court reversed the judgment and remanded the action to the bankruptcy court for further proceedings.

111

Conclusion:

- Under the UCC, the *possession* by the secured party of property subject to a lien may be sufficient for perfection because the possession of goods by a creditor is an effective means of putting future creditors or purchasers on notice that the property is encumbered.
- Only pre-petition transfers to fully secured creditors are protected under the Bankruptcy Code. Payments to a creditor who is fully secured are not preferential since the creditor would receive payment up to the full value of his collateral in a Chapter 7 liquidation.

112

Ordinary Course of Business Defense

113

Pereira v. UPS (In re Waterford Wedgwood USA, Inc.),

508 B.R. 821, 2014 Bankr. LEXIS 1717, 59 Bankr. Ct. Dec. 121, 2014 WL 1569284 (Bankr. S.D.N.Y. 2014)

114

Facts:

- Debtors Waterford Wedgwood USA, Inc. and Royal Doulton USA, Inc. were in the business of importing, distributing, and selling china, crystal and other consumer goods.
- In connection with this business, the Debtors purchased and obtained shipping and related services from the Defendant United Parcel Service of America, Inc. (UPS).
- Upon providing services to the Debtors, UPS would issue an invoice. The Debtors would pay UPS by check.
- On March 26, 2009, the Debtors sold substantially all of their assets and ceased doing business.
- The Debtors and the Trustee sought to recover the alleged preferential transfers made to UPS in the amount of $897,546.85 by Waterford and $81,828.22 by Doulton within the 90-day preference period.

115

Facts:

- At trial, UPS provided evidence of payments and invoice records between itself and the Debtors to demonstrate that the payments were similar to those in the industry.
- The only other evidence presented at trial was the testimony of Thomas Salutric, an employee of UPS.
- Salutric testified that while UPS's stated invoice terms were 32 days, the Debtors paid their invoices later than their stated terms: approximately 51 days during the preference period and 56 days during the historical period.
- Salutric also testified on the transportation industry practices. Based upon data collected from the Credit Risk Monitor database (CRMZ), he compiled a list of forty businesses in the domestic shipping industry and calculated the average number of days that these companies received payment after a sale.
- He then ranked those businesses according to the average days sales outstanding for the year.

116

Facts:

- Salutric testified that he relied on 90% of the data, removing the top and bottom five percent in his analysis as outliers and concluded that the normal industry pay range in 2008 was from 14 to 70 days and from 16 to 72 days in 2009.

117

Issue:

- Were the payments made in the ordinary course of business between the Debtors and UPS?

118

§ 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;

119

§ 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;

120

The creditor must establish a "baseline of dealings" between the parties in order to "enable the court to compare the payment practices during the preference period with the prior course of dealing." *In re M. Fabrikant & Sons, Inc.*, 2010 Bankr. LEXIS 3941, 2010 WL 4622449, at *3 (citations omitted); *see also Cassirer v. Herskowitz (In re Schick)*, 234 B.R. 337, 348 (Bankr. S.D.N.Y. 1999).

121

"To determine whether a late payment may still be considered ordinary between the parties, a court will normally compare the degree of lateness of each of the alleged preferences with the pattern of payments before the preference period to see if the alleged preferences fall within that pattern." 5 COLLIER ON BANKRUPTCY ¶ 504.04[2][ii], at 547-55. Generally, this involves a comparison of the average number of days between the invoice and payment dates during the pre-preference and preference periods. *See In re M. Fabrikant & Sons, Inc.*, 2010 Bankr. LEXIS 3941, 2010 WL 4622449, at *3; *see also Hassett v. Altai, Inc. (In re CIS Corp.)*, 214 B.R. 108, 120 (Bankr. S.D.N.Y. 1997).

122

HN7 Subsection (B) is an objective test which "looks not to the specifics of the transaction between the debtor and the particular creditor, but rather focuses on general practices in the industry, in particular the industry of the creditor." *Abovenet, Inc. v. Lucent Technologies, Inc. (In re Metromedia Fiber Network, Inc.)*, 2005 Bankr. LEXIS 3168, 2005 WL 3789133, *5 (Bankr. S.D.N.Y. Dec. 20, 2005). It is well established that the creditor's industry is the measure for ordinariness under this subsection. *See, e.g.*, *Matter of Midway Airlines*, 69 F.3d 792, 797 (7th Cir. 2004); *Sigmon v. Butner (In re Johnson Bros. Trucker, Inc.)*, 9 Fed. Appx. 156, 2001 WL 520649 *4 (4th Cir. 2001); *Sass v. Vector Consulting, Inc. (In re Am. Home Mortgage Holdings, Inc.)*, 476 B.R. 124, 140-41 (Bankr. D. Del. 2012); *Hechinger Liquidation Trust v. James Austin Co. (In re Hechinger Inv. Co. of Delaware, Inc.)*, 320 B.R. 541, 550 (Bankr. D. Del. 2004).

123

In *In re Roblin Indus., Inc.*, the Second Circuit held that "'ordinary business terms' refers to the general practices of similar industry members and that 'only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection C.'" *Roblin*, 78 F.3d at 39-40 (quoting *In re Tolona Pizza Products Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993). "Under this standard, a creditor must show that the business terms of the transaction in question were 'within the outer limits of normal industry practices. . . .'" *Id.*; *see also* *In re Carled*, 91 F.3d 811, 818 (6th Cir. 1996) (holding that late payments are made according to ordinary business terms so long as they are not "aberrational, unusual or idiosyncratic" for creditors in the defendant's **[829]** industry). The "statutory language should not be construed to place businessmen in a straitjacket." *In re Gulf City Seafoods*, 296 F.3d 363, 368 (5th Cir. 2002). "Some latitude exists under the objective prong, as the courts should not impose a single norm for credit transactions within the industry; the inquiry is whether 'a particular arrangement is so out of line with what others do' that it cannot be said to have been made in the ordinary course." *G.G. Leidenheimer Baking Co., Ltd. v. Sharp (Matter of SGSM Acquisition Co.)*, 439 F.3d 233, 239 (5th Cir. 2006) (citing *In re Gulf City Seafoods*, 296 F.3d at 369).

124

The Trustee made four arguments.

125

Argument 1: The Trustee argued that the average days sales outstanding fluctuated over time and divided the history of payments into three periods. These periods were: 1) November 24, 2007 to September 30, 2008, which was more than six months before the bankruptcy filing; 2) October 2, 2008 to February 28, 2009, which was over one month into the 90 day Preference Period; and 3) March 1, 2009 to April 7, 2009, which includes some 38 days of the 90 day Preference Period.

According to the Trustee, UPS received payments from the Debtors on its invoices on average within 49 days during the first period, 44 days during the third period, and 72 days during the second period. The trustee argued that this was evidence that these were different terms upon which UPS routinely collected his invoices.

126

UPS argued that these were arbitrary groupings and were result oriented. Furthermore, UPS asserted that the Trustee provided no case law to support this methodology, which largely disregarded whether payments were made during the preference period.

127

The Trustee's argument fails, however, because it improperly conflates the subjective and objective components of Section 547(c)(2). It is essentially asking the Court to rule that the objective defense cannot be met if the parties' relationship changes over time. 7 But *HN8* under Section 547(c)(2)(B), a creditor need only "show that the business terms of the transaction in question were 'within the outer limits of normal industry practices.'" *Roblin Indus., 78 F.3d at 40* (quoting *Tolona Pizza Products, 3 F.3d at 1033*)). "The conduct of the debtor and creditor are considered objectively in light of industry practice." *Roblin Indus., 78 F.3d at 40*. And "only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of" the defense. *Id*. (quoting *Tolona Pizza Products, 3 F.3d at 1033*). As the focus of the objective test is the standard in the industry, the historical experience between the Debtor and UPS should be of little to no import under Subsection (B).

128

Argument 2: The Trustee argued that because the payments had not corresponded with the written agreement of terms, those payments were out of the ordinary business terms.

129

Such a reading is inconsistent with the Second Circuit's interpretation of the ordinary business terms test. ***HN11*** In **[833]** *Roblin*, the Second Circuit ruled that a payment made pursuant to a debt restructuring agreement could be considered an ordinary business term if evidence is provided that it is within the industry practice. The Second Circuit stated that

> [t]o apply properly the . . . standard, "ordinary business terms" must include those terms employed by similarly situated debtors and creditors facing the same or similar problems. *If the terms in question are ordinary for industry participants under financial distress, then that is ordinary for the industry*. In this way, a creditor that agrees to restructure a debt in a manner consistent with industry practice in those circumstances does not lose the benefit of the exception.

Roblin Indus., 78 F.3d at 42 (emphasis added); *see also* *Ganis Credit Corp. v. Anderson (In re Jan Weilert Rv, Inc.), 315 F.3d 1192, 1198 (9th Cir. 2003)* ("[C]reditors are not required to prove a particular uniform set of business terms, rather, "ordinary business terms" refers to the broad range of terms that encompasses the practices employed by those debtors and creditors, *including terms that are ordinary for those under financial distress*.") (emphasis added).

130

HN12 The Trustee's view would also require a creditor to steadfastly adhere to the same business practices throughout the entirety of its relationship with a debtor. That would unduly tie the hands of the creditor to deal with the exigencies of business in a real world setting and discourage creditors from continuing to do business with a company in distress. 10 It would not allow a creditor to work with a debtor within the bounds of normal practices in the industry, which is contrary to the Second Circuit's understanding of how the defense should operate:

> A creditor taking such steps should not be viewed as taking "unusual action" when it does no more than follow usual industry practice—precisely the kind of behavior the ordinary course of business exception was intended to protect. Restricting a creditor to courses of action typical in untroubled times leaves no room for realistic debt workouts and unfairly penalizes those creditors that take conventional steps to institute a repayment plan.

Roblin, 78 F.3d at 42. The Second Circuit's flexible approach bolsters the two-fold purpose of preference law: "the concern for the equitable treatment of all creditors as well as the desire to discourage creditors from hastily forcing troubled businesses into bankruptcy." *Id. at 40*. The

131

The Court has declared as irrelevant any analysis of historical variation in the parties' prior course of dealings. It was not relevant as to what the terms were. 547(b) does not analyze the relationship between the parties.

132

Argument 3: The Trustee argued that UPS should not compare its payments from the Debtors with payments made by customers to other domestic shipping companies.

133

The Court disagreed and stated that that was exactly how the analysis under 547(c)(2)(B) should be done.

Neither party cited case law on how to perform an ordinary terms analysis. The Court rejected the total range analysis because it has been criticized as including outliers that skew the analysis of what is ordinary.

However, the Court agreed that the objective analysis should be a comparison of two periods like the subjective analysis.

134

In the subjective analysis, courts do this by using the "average lateness" method, "which looks to the average time of payment after the issuance of the invoice during the historical and [P]reference [P]eriods. In deciding what payments are ordinary, a court reviews the range of payments centered around the average and also groups the payments in buckets by age." Quebecor, 491 B.R. at 388. By contrast, courts have criticized the "total range" method, which considers a transfer during the preference period to be ordinary if it is paid within the minimum and maximum days in the range of all payments during the historical period. *See* id. at 387-88. Total range analysis has been rejected because it "impermissibly expand[s] the ranges of ordinary transactions . . . [and] captures outlying payments that skew the analysis of what is ordinary." *See id.* (citing *In re M. Fabrikant & Sons, Inc.*, 2010 Bankr. LEXIS 3941, at *3 n.2 (Bankr. S.D.N.Y. 2010); *In re CIS Corp.*, 214 B.R. 108, 120 (Bankr. S.D.N.Y. 1997)).

135

The Court agreed with the Trustee's methodology of standard deviation and found that a more accurate description of the industry's pay range was a single standard deviation from the mean. In this case, the Court accepted the Trustee's computation of a 42-day average with a standard deviation of 12 days.

136

Argument 4: The Trustee argued that the preference payments were not made pursuant to ordinary business terms because UPS was paid in full prior to the Debtor's bankruptcy.

137

Payment in full does not remove a fact pattern from the safe harbor of an ordinary course defense.

138

Conclusion:

- A late payment is usually not ordinary but the defendant can rebut this presumption if late payments were the standard course of dealing between the parties.

- In analyzing sec. 547(c)(2)(B), some courts use the "average lateness method," which looks to the average time of payment after the issuance of the invoice during the historical and preference periods. The "total range" method, which considers a transfer during the preference period to be ordinary if it is paid within the minimum and maximum days in the range of all payments during the historical period, is suspect because it impermissibly expands the ranges of ordinary transactions.
- Standard deviation is the best method. Captures 67.5% of all numbers.

139

Davis v. R.A. Brooks Trucking, Co. (In re Quebecor World (USA), Inc.),

491 B.R. 379, 2013 Bankr. LEXIS 1664, 2013 WL 1741946 (Bankr. S.D.N.Y. 2013)

140

Facts:

- The Debtor Quebecor World (USA), Inc. ("Quebecor") was engaged in industrial and commercial printing.

- The Defendant R.A. Brooks Trucking Co., Inc. ("Brooks") supplied transportation services to Quebecor .

- During the 90-day preference period, Quebecor made ten transfers to Brooks totaling $156,130.05 for services rendered.

- The Trustee sought to avoid and recover a portion of the ten alleged preferential transfers in the amount of $117,370.05.

- The Trustee filed a motion for summary judgment.

141

Trustee's Arguments:

- The Trustee argued that the appropriate pre-preference time period to use in establishing a baseline of dealings between the parties was the historical data for two years reaching back to October 2005.

- The Trustee contended that the weighted average during the preference period was 57.16 days from invoice to payment and the weighted average during the historic period was 27.57 days.

142

Defendant's Arguments:

- First, Brooks argued that the appropriate pre-preference time period to use in establishing a baseline of dealings between the parties was the historical data for approximately one year reaching back to November 2006.

- Brooks contended that the weighted average during the preference period was 52 days from invoice to payment and the weighted average during the historic period was 35 days.

- Additionally, in determining how payments during the preference period measure up against payments made during the historical period, Brooks argued that the total range method should be applied.

143

Issue:

- Were the payments made in the ordinary course of business between Quebecor and Brooks?

144

§ 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;

145

§ 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;

146

The weighted average method is a manner of calculating the average days to payments taking into account the sum of each payment by multiplying the amount of the invoice by the days it took to make payment then dividing that value by the total amount of the invoices in the data set. *Forklift LP Corp. v. Spicer Clark-Hurth (In re Forklift LP Corp.)*, 2006 U.S. Dist. LEXIS 50264, 26-27 (D. Del. July 20, 2006). The weighted average takes into account the relative invoice amount and generates an average based on the days to payment and the amount of payments.

147

The total range method considers any Preference Period payment ordinary as long as it was paid within the minimum and maximum days to pay during the historical period.

148

during the historical period. Defendant applied the total range method, which considers any Preference Period payment ordinary as long as it was paid within the minimum and maximum days to pay during the historical period. Such a theory, however, has previously been rejected as impermissibly expanding the ranges of ordinary transactions. *See In re M. Fabrikant & Sons, Inc.*, 2010 Bankr. LEXIS 3941, 2010 WL 4622449, *3 n. 2.; *In re CIS Corp.* 214 B.R. at 120 (Bankr. S.D.N.Y. 1997). The Court rejects it here as well because that proposed methodology captures **[388]** outlying payments that skew the analysis of what is ordinary. The Court turns instead to the more commonly used "average lateness" method, which looks to the average time of payment after the issuance of the invoice during the historical and Preference Periods. *In re M. Fabrikant & Sons, Inc.*, 2010 Bankr. LEXIS 3941, 2010 WL 4622449 at *3. ***HN13*** In deciding what payments are ordinary, a court reviews the range of payments centered around the average and also groups the payments in buckets by age. *See In re Hechinger Inv. Co. of Delaware, Inc.*, 489 F.3d 568, 578 (3d Cir. 2007); *Chapter 11 Estate Liquid. Trust v. Inserts East, Inc. (In re Philadelphia Newspapers, LLC)*, 468 B.R. 712, 2012 WL 983594, *2 (Bankr. E.D. Pa. 2012).

149

Court's ruling:

- The Court determined that although the difference between looking back one or two years was not substantial, the Court adopted the longer period because it more accurately reflected the parties' ordinary course of dealings during the period when Quebecor was in better health.

- The Court noted that more than 88 percent of the historical payments were made within 11 to 40 days of the invoice date. During the preference period, however, most payments ranged from 46 to 60 days after the invoice.

- Considering that the average payment time was about 27 days during the historical period compared to about 57 days during the preference period, the Court found this disparity to be significant and, thus, not ordinary.

150

Court's ruling:

- Using the average payment time of about 27 days during the historical period and the grouping of payments by buckets, the Court concluded that payments up to 45 days should be considered ordinary and not subject to avoidance. These payments totaled approximately $38,760.00.
- The remaining payments totaling $117,370.05 were subject to avoidance.

151

Conclusion:

- The ordinary course of business exception protects recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the creditor.
- The starting point of a sec. 547(c)(2)(A) analysis involves consideration of the average time of payment after the issuance of the invoice during the pre-preference and post-preference periods.
- The historical baseline of dealings between the parties in the ordinary course defense should be based on a time frame when the debtor was financially healthy.

152

Gresk v. Adams Removal & Hauling, Inc. (In re Am. Restoration Corp.),

2008 Bankr. LEXIS 1388 (Bankr. S.D. Ind. Apr. 28, 2008)

153

Facts:

- The Defendant Adams Removal & Hauling, Inc. provided services to Debtor American Restoration Corporation (ARC).
- During the 90-day preference period, ARC made three payments totaling $46,685 to Adams for services rendered.
- The Trustee sought to recover, as preferential transfers, the alleged payments.
- At trial, as evidence of ARC's adherence to ordinary business terms, Adams presented three unsworn letters from persons purporting to have various experiences with commercial hauling.

154

Court's ruling:

- The Court noted that the three letters that Adams submitted failed to address the "due on receipt" provisions of its invoices.
- The letters generally stated that "established customers" qualified for "net 30 days" invoicing treatment. In contrast, the Court found that an express demand for immediate payment—which is the plain meaning of "due on receipt"—is entirely inconsistent with a supposed industry-wide practice of net 30-days for established customers.
- The Court concluded that Adams failed to prove by a preponderance of the evidence that the transfers were made according to ordinary business terms.
- Therefore, the Court held that the transfers amounting to $46,685 were avoided as preference payments.

155

Conclusion:

- For an industry standard to be useful as a rough benchmark, the Fifth Circuit has held that the creditor should provide evidence of credit arrangements of other debtors and creditors in a similar market, preferably both geographic and product.

156

Richardson v. Pana Limestone Quarry Co. (In re Leprechaun Trucking, Inc.),

356 B.R. 190, 2007 Bankr. LEXIS 44 (Bankr. C.D. Ill. 2007)

157

Facts:

- The Debtor Leprechaun Trucking Co. was a trucking company and, in the course of its business, purchased crushed limestone for use in road construction projects and for resale.
- Pana Limestone Quarry Co. ("Pana Quarry") and Truman L. Flatt & Sons Co., Inc. ("Truman Flatt") had a common principal and shared headquarters in Springfield, Illinois.
- Pana Quarry sold limestone to a number of trucking companies. Truman Flatt was engaged in the construction business.
- Pana Quarry sold limestone to Leprechaun, and Leprechaun hired Truman Flatt hired to perform hauling services.
- Upon the Debtor's financial difficulties, the parties entered into a "check swap" arrangement.

158

Facts:

- Under the arrangement, Truman Flatt paid the Debtor to perform hauling services and Pana Quarry received payments from the Debtor for crushed limestone.
- Truman Flatt would pay Leprechaun for performing hauling services, but Leprechaun was to simultaneously pay on its account with Pana Quarry every dollar Truman Flatt would pay to Leprechaun. The mechanics involved an actual check swap.
- During the 90-day preference period, the Debtor made payments to Pana Quarry which totaled $99,394.33.
- The Trustee sought to avoid and recover those payments as alleged preference.

159

Defendants' Arguments:

- The Defendants argued that Leprechaun orally assigned to Pana all of its rights to future payments from Truman Flatt when Leprechaun agreed to the "check swap" arrangement.
- Consequently, the Defendants argued, the $99,460.33 received by Pana Quarry from Leprechaun during the preference period was absolutely assigned and transferred by Leprechaun outside of the preference period and, thus, was not subject to the claim of the Trustee.
- Additionally, Pana Quarry asserted that the alleged preferential payments were paid in the ordinary course of business.

160

Issue:

- Whether Leprechaun's rights to payment from Truman Flatt for its services were the subject of a valid oral assignment.
- Were the payments between Leprechaun and Pana Quarry made in the ordinary course of business?

161

§ 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;

162

§ 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;

163

§ 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;

164

HN8 An assignment operates to transfer to the assignee all of the assignor's right, title, or interest in the thing assigned; the assignee, by acquiring the same rights as the assignor, stands in the shoes of the assignor. In re Estate of Martinek, 140 Ill.App.3d 621, 629-30, 488 N.E.2d 1332, 1337-38, 94 Ill. Dec. 939 (Ill. App. 1986) (citations omitted). There must be a present transfer of the assignor's right, which is so far complete as to deprive the assignor of his or her control over the subject of the assignment, and the assignor must not retain any power of revocation. 6A C.J.S. *Assignments* § 57 (2006) (citations omitted). An assignor no longer **[197]** has any rights in the property assigned. People v. Wurster, 97 Ill.App.3d 104, 106, 422 N.E.2d 650, 652, 52 Ill. Dec. 648 (Ill. App. 1981) (citation omitted).

165

Court's ruling:

- As to the assignment issue, the Court noted that no one used the term "assignment" or any other relevant legal term before entering into the "check swap" arrangement.
- Additionally, the Court found nothing in the record to support the contention that Leprechaun relinquished and Pana Quarry acquired the rights to future payments which became due to Leprechaun from Truman Flatt.
- If an assignment had occurred, then Leprechaun would have given up its rights to be paid directly. Because Truman Flatt continued to pay Leprechaun directly, and there was no evidence supporting the creation of an assignment, the Court concluded that the "check swap" did not create an absolute assignment.

166

The record, even when viewed in a light most favorable to the Defendants, cannot sustain a finding that a valid assignment occurred here. The "check swap" arrangement does not bear any of the markings of an absolute, unconditional transfer of Debtor's rights. Debtor did not relinquish to Pana Quarry any interest in its accounts receivable from Truman Flatt. Rather, Debtor engaged in a revocable-at-will arrangement which allowed it to continue doing business with Defendants. If Debtor had ceased the "check swap" and stopped doing business with Defendants, Debtor would still have an enforceable claim against Truman Flatt for any amounts owing to Debtor for services provided. In addition, if, hypothetically, a **[198]** non-wage garnishment had been served on Debtor's bank after Debtor had deposited a check from Truman Flatt but before Debtor's corresponding check to Pana Quarry had cleared, the garnishment would be executed against those funds in Debtor's account, and Pana Quarry would have no claim superior to that of the garnishing creditor.

167

The Court concluded that Truman Flatt would not pay Leprechaun until Leprechaun paid Pana Quarry. Thus, it is not an assignment; rather, it was just a mechanism for Pana Quarry to get paid.

168

Court's ruling:

- As to the ordinary course of business exception, the parties did not dispute that the transfers were made in payment of debts which were incurred in the ordinary course of business of Leprechaun and Pana Quarry. The dispute was whether the payments were made in the ordinary course of business of Leprechaun and Pana Quarry and according to ordinary business terms.
- The Court noted that the "check swap" arrangement differed from past practices and constituted an "unusual" payment or collection activity.
- None of Pana Quarry's other 20 customers were subject to such an arrangement, and Leprechaun was not subject to such an arrangement until April 2005, when its payables to Pana Quarry became so far past due as to raise serious concern. Also, Leprechaun did not pay any of its other creditors by "check swap."

169

Court's ruling:

- Lastly, the Court found that the "check swap" could not be an ordinary business term.
- The Court noted that businesses could not exist if they were required to pay all receipts from specific customers to specific creditors because businesses need to be able to pay their employees, taxes, utilities, etc.
- The Court found that the payments were not made in the ordinary course of business or according to ordinary business terms.
- Therefore, the Court held that the payments were avoidable as preference.

170

Conclusion:

- The Trustee may not avoid payments to a creditor made as a result of a transfer of rights to that payment from the Debtor to the Creditor.
- Payments made as a result of economic pressure are generally not made in the ordinary course of business.
- The Seventh Circuit has held that only dealings so idiosyncratic as to fall outside that industry standard should be deemed extraordinary and therefore outside the scope of ordinary business terms.

171

The defendants might have been able to assert a set-off defense under sec. 553, but then both defendants would have had to argue that they were one company. Under that defense, they would assert that they set-off the amount that Truman Flatt owed the debtor against the amount that the debtor owed Pana Quarry.

172

Official Comm. of Unsecured Creditors of the Estate of CCG 1355, Inc. v. CRST, Inc. (In re CCG 1355, Inc.),

276 B.R. 377, 2002 Bankr. LEXIS 355, Bankr. L. Rep. (CCH) P78,646 (Bankr. D.N.J. 2002)

173

Facts:

- The Debtor CCG 1355, Inc. had been in the business of selling nationwide furniture and related partitions and equipment.
- The Defendant CRST, Inc., a trucking company, picked up CCG's product and delivered it to CCG's customers.
- During the 90-day preference period, CCG issued three payments totaling $40,340.60.
- Payment I amounted to $2000. Payment II amounted to $21,505.60. Payment III, totaling $16,835, was found to contain $6,050 in advance payments.
- CRST's witness indicated that at some time in March 1999, a representative of CCG had advised him that the company was about to be sold and that payments would cease. CCG needed certain important shipments to be undertaken by CRST, and agreed to pay "in advance."

174

Facts:

- These payments appeared to have been made between 7 and 11 days after the shipment dates and 3 to 6 days after the delivery dates, all in advance of the invoice dates, and as part of Payment III ("Advance Payments").
- Plaintiff, the Official Committee of Unsecured Creditors of the Estate of CCG 1355, Inc., ("Committee"), claimed that these three payments were voidable transfers subject to recovery under Sec. 547.

175

Arguments:

- CRST contended that it had satisfied the requirements of § 547(c)(2)(B), in that the transfers in question were "made in the ordinary course of business or financial affairs of the debtor and the transferee" because the average payment interval before and during the preference period fell within the 60 to 90-day range agreed upon before the parties began doing business with each other.
- CRST claimed to have satisfied the requirement that the subject transfers were "made according to ordinary business terms" because its witness testified that 20 to 25 percent of the industry paid in the 60 to 90-day period.
- The Committee argued that CRST failed to satisfy the requirements of an "ordinary course" defense.

176

Issue:

- Were the transfers made in the ordinary course of business between CCG and CRST?

177

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

(2) to the extent that such transfer was—

(A) 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—

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

(C) made according to ordinary business terms;

(amended April 20, 2005)

178

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

(2) to the extent that such transfer was—

(A) 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—

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

(C) made according to ordinary business terms;

(amended April 20, 2005)

179

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

(2) to the extent that such transfer was—

(A) 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—

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

(C) made according to ordinary business terms;

(amended April 20, 2005)

180

Court's ruling:

- The Court noted that all of the preference period payments were 80 days or more beyond the invoice dates.
- The Court looked at the average invoice-to-payment interval. The interval in 1995 was 68.11 days, in 1996 was 54.41 days, in 1997 was 59.86 days and in 1998 was 73.44 days. Throughout the entire CCG-CRST business relationship, the average payment interval was 66.47 days.
- The court calculated the average in 1999 to be 84.40 days, made up of the average in the preference period of 89.09 days, and in the two months preceding March 1999 of 79.50 days.
- Additionally, the Court applied a bucket analysis to reach a similar result. Before the preference period, and throughout the totality of the relationship between CCG and CRST, only 66 of 409 payments (about 16%) were made against invoices which had aged 80 days or more.
- In the last nine months before the preference period, payments lagged, with 33 of 77 payments (about 43%) being against 80 day or older invoices.

181

Court's ruling:

- However, in the first two months of 1999 and just prior to the beginning of the 90-day preference period on March 5, the total of 22 paid invoices included only five which had aged 80 days or more (about 23%).
- Thus, the Court concluded that the inquiry as to § 547(c)(2) could end with this finding, but other factors support the numbers-based conclusion.
- First, Payment III involved a less usual manual check, which was issued in an amount that exceeded the norm.
- Second, the advance payment deal and discussion of CCG's financial distress raised the specter of creditor pressure or debtor "fawning" in the preference period payment process. Although no testimony was offered to show either, the Court found that payment of old invoices along with the advance payment was very questionable.
- Third, Payment I was unusual as a partial payment and made against a single 101 day old invoice.

182

Court's ruling:

- Fourth, Payment II was grossly higher in total amount than the usual CCG payments. The Court found it reasonable to conclude that CCG had favored CRST with this large payment of old invoices.
- Fifth, while analysis of § 547(c)(2)(C) was not necessary, given CRST's failure to establish its (B) course of dealing requirement, the Court noted that the industry standard could not extend the more particularized history of dealing between the parties.
- Therefore, although CRST's witness testified that 20 to 25 percent of shippers pay in the 60 to 90 day range, which could arguably support payments against invoices in the 80 to 90 day range, that general standard would not impact on or satisfy the (B) requirement.
- For the above reasons, the Court held that the payments were not made in the ordinary course of business. The Court awarded the Committee a partial recovery of $30,665.60.

183

Conclusion:

- The controlling factor in an "ordinary course" determination is whether the transactions between the debtor and the creditor, both before and during the ninety-day period, were consistent.
- Late payments may be ordinary course if analysis finds them to be consistent, both before the preference period and during that period.

184

Roberts v. Service Transp. (In re Ideal Sec. Hardware Corp.),

186 B.R. 237, 1995 Bankr. LEXIS 1332, 27 Bankr. Ct. Dec. 1033 (Bankr. E.D. Tenn. 1995)

185

Facts:

- The Defendant Service Transport, Inc. ("Service"), an intrastate carrier, hauled freight on an open account for the Debtor Ideal Security Hardware Corp. ("Ideal").
- The Trustee sought to avoid and recover the alleged preferential transfers in the amount of $14,886.73 made by Ideal to Service.
- Service filed a motion for summary judgment, contending that it was entitled to judgment as a matter of law based on the ordinary course of business defense.

186

Arguments:

- Relying on its controller's testimony, Service argued that the payments made by Ideal during the preference period were excepted from avoidance because it was not uncommon for large volume shippers, like Ideal, to pay their freight bills late.
- The Trustee asserted that Service's evidence was insufficient because there was no evidence regarding the shipping industry standard.

Issue:

- Were the transfers made in the ordinary course of business between Ideal and Service?

§ 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;

§ 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;

Court's ruling:

- The Court noted that the fact that it is not uncommon for Service's customers to pay late does not establish that receiving payments late is the industry norm for freight shippers generally.
- Additionally, the Court noted that Service's witness's testimony was inherently suspect because it was to be expected that the testimony of an officer of Service would be favorable to its position.
- The Court concluded that Service had not met its burden to establish the ordinary course defense.
- Therefore, the Court denied Service's motion for summary judgment.

Conclusion:

- The Sixth Circuit has held that a court may consider the manner in which the parties conduct their business with other, unrelated parties in determining industry standards, but this equivalence alone is insufficient to prove ordinary business terms by a preponderance of the evidence.
- When the only evidence is self-serving testimony of the defendant's officer, the court may not say that the defendant has established the element of proof of the ordinary business terms of the industry in the defendant's favor.

Lovett v. St. Johnsbury Trucking

931 F.2d 494, 1991 U.S. App. LEXIS 7100, Bankr. L. Rep. (CCH) P73,926 (8th Cir. Minn. 1991)

193

Facts:

- Appellant, St. Johnsbury Trucking, a common carrier of freight, had a business agreement with the Debtor, Transportation Systems International (TSI), a freight forwarder, consolidator, and distributor. TSI did not own any trucks, but used the trucks of others to pick up and deliver freight.
- The parties operated under this agreement until an involuntary bankruptcy petition was filed against TSI.
- According to the agreement, St. Johnsbury obligated the freight-forwarding party to pay the freight-receiving party a percentage of the amount the freight-forwarding company collected from the shipping customer "on or before the 30th day after the shipment."
- During the 90-day preference period, TSI paid St. Johnsbury $245,883.96 for services rendered under the agreement.
- The bankruptcy Trustee brought suit against St. Johnsbury to recover the payment as a voidable preference under 11 U.S.C.S. § 547(b).

194

After trial, the bankruptcy court found that the payments during the 90-day period had not been made in the ordinary course of business and constituted a preference. It also found that the trustee was entitled to collect another $ 102,000.00 that St. Johnsbury owed International in accounts payable. The court further ruled that St. Johnsbury was entitled to a set-off of $ 148,456.33, which constituted amounts receivable from International when the bankruptcy petition was filed. The bankruptcy court accordingly entered judgment for the trustee against St. Johnsbury for $ 199,427.63 ($ 245,883.96 plus $ 102,000.00, minus $ 148,456.33).

195

Facts:

- The bankruptcy court found for the Trustee and accordingly entered judgment against St. Johnsbury.
- The bankruptcy court found St. Johnsbury's proof of history of payment receipts by the defendant in the year prior to the bankruptcy, and an assertion that late payments, usually 60 to 70 days after invoice, were ordinary and usual, to be "inadequate."
- The district court affirmed, holding that the bankruptcy court's conclusion that St. Johnsbury had "failed to meet" its burden of showing that the payments were made in the ordinary course of business "[was] not clearly erroneous."
- St. Johnsbury appealed.

196

First, the transportation agreement itself defined the ordinary course of business between the parties, and it specified the terms governing those transactions. The agreement specifically provided that it could be modified only in writing; it further specifically provided that payments were to be made by the debtor within 30 days of the date of issue. Moreover, the debtor's officers and employees have testified that the debtor ran into significant financial problems in early 1986, and was delaying payments as much as possible to all creditors; that payments to the defendant were made because the defendant was insisting on the 30 day time period contained in the transportation agreement; that meetings were held and telephone conversations were engaged in during which the defendant insisted that payments be accelerated as much as possible; and that at some point in early 1987, representatives of the plaintiff and the defendant met, the defendant insisted on accelerated payments, and the defendant suggested that if payments were not made within 30 days the business relationship could be jeopardized. The evidence appears to show, therefore, that the ordinary course of business was for payments to in fact be made within 30-45 days of invoice and that the defendant never consented to payments on any other terms.

Lovett v. St. Johnsbury Trucking (In re Transportation Systems International, Inc.), Adv. No. 4-88-227 (Bankr. Minn. May 23, 1989) (Findings of Fact, Conclusions of Law and Order for Judgment).

197

Arguments:

- St. Johnsbury argued that the payments were made in the ordinary course of business of the Debtor and the Creditor as well as per the ordinary terms of the trucking industry.
- St. Johnsbury asserted that it was an ordinary practice to make the payments after more than 30 days.

198

Issue:

- Were the payments made in the ordinary course of business between TSI and St. Johnsbury?

199

§ 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;

200

§ 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;

201

The Court first ruled that the bankruptcy court erred in basing the ordinary course of business between the parties on the terms of the transportation agreement.

202

1. a. The first ground on which the bankruptcy court rested its decision was that "the transportation agreement itself defined the ordinary course of business between the parties, and it specified the terms governing those transactions," namely, payment within 30 days of delivery. The ordinary course of business, however, was the way the parties actually conducted their business dealings, not the conditions specified in the agreement that the parties in fact rarely followed (as shown below). The bankruptcy court's reliance on the provision in the agreement that payment would be made within 30 days was misplaced, and provides no support for that court's conclusion that the payments were not made in the ordinary course of business. Indeed, if all the payments within the 90-day period had been made within 30 days of delivery, presumably the bankruptcy court would have held that they were made in the ordinary course of business, even though such payments would have been a drastic departure from the previous practice and presumably would have preferred St. Johnsbury over the other creditors.

203

Court's ruling:

- Comparing invoices paid during the 12 months preceding the 90-day period and the invoices paid during the 90-day period, the Court noted that the ordinary course of business between the parties in paying the invoices was that TSI consistently paid St. Johnsbury substantially later than the 30-day period in the contract.
- Additionally, the fact that TSI had "significant financial problems" in early 1986 and that St. Johnsbury insisted that TSI accelerate its payments "as much as possible" did not undermine the Court's conclusion that the 12-month period fairly reflected the parties' ordinary course of business.

204

payments "as much as possible," do not undermine our conclusion that the 12-month period fairly reflected the parties' ordinary course of business. It is hardly unusual for a creditor to urge its debtor to pay more promptly. There is not present here the kind of "economic pressure to obtain payment as soon as possible" that led the court to hold that payments were not made within the ordinary course of business in *In re Seawinds Ltd.*, 888 F.2d 640, 641 (9th Cir. 1989).

205

Court's ruling:

- Although the bankruptcy court stated that the ordinary course of business was for payments to be made within 30-45 days of invoice, the Court noted that the evidence set forth showed that only 21.2% of the invoices were paid within 45 days; thus, the bankruptcy court's finding was "clearly erroneous."
- Finally, the Court found that TSI's payments to St. Johnsbury during the 90-day period were made "according to ordinary business terms" because the manner, form, and timing of those payments were consistent with the practice both parties followed previously.
- TSI regularly sent checks covering a number of invoices and most payments were not made within 30 days.

206

To the extent, if any, that subsection (c)(2)(C) requires comparison between the payment record of the particular debtor and the general practice in the industry regarding the time of payment, St. Johnsbury introduced testimony by two of its officials that it is "common" in the trucking industry -- even when 30-day payment terms are required by contract -- for payments "to be made over a 30-day period" (i.e., after 30 days from the date of invoice) and that it is "very common" in the industry "that people pass the 30 day period." In the absence of any contrary evidence, this was sufficient to carry whatever burden St. Johnsbury may have had on this issue.

207

Court's ruling:

- The Eighth Circuit Court of Appeals concluded that the evidence demonstrated that the payments were made in the ordinary course of business and that the bankruptcy court's findings to the contrary were erroneous.

208

Conclusion:

- There is no precise legal test which can be applied in determining whether payments by a debtor during the 90-day period are "made in the ordinary course of business;" rather, a court will engage in a "peculiarly factual" analysis.
- Late payments may be held to be made in the ordinary course of business, when such payment practices were well-established between the parties.

209

Indirect Transfer Theory

210

Instrumentation & Controls, Inc. v. Northeast Union, Inc. (In re Instrumentation & Controls, Inc.),

506 B.R. 677, 2014 Bankr. LEXIS 1042, 59 Bankr. Ct. Dec. 73 (Bankr. E.D. Pa. 2014)

211

Facts:

- During the 90-day preference period, the Plaintiff-Debtors Instrumentation and Controls, Inc. and ICI Green, LLC transferred $31,950.00 (the Transfer) to the Defendant Northeast Union, Inc.
- Northeast was a general contractor for the cell tower industry and provided services to the Debtors.
- Before the bankruptcy court was the Debtors' Motion for Judgment on the Pleadings.
- There was no dispute that the Debtors transferred $31,950.00 to Northeast and that the Transfer was avoidable as a preference.
- There was no dispute that, in connection with the Transfer, the Defendant waived its right to file mechanics' liens against two separate third parties.

212

Facts:

- Northeast alleged that the Debtors had been frozen out from third party contracts as a result of Northeast serving those third parties Notices to File a Mechanics Lien.
- The Debtors' payments of Northeast's invoices were to insure that Northeast would waive any Mechanics Liens rights it would have concerning the third parties and insure that ongoing contracts with these third parties would continue so the transfer was also a contemporaneous exchange for new value under 11 U.S.C. Section 547 (c) (1).

213

Defendant's Arguments:

- Northeast asserted that when it received the payment from the Debtors, the Debtors had waived their rights against or otherwise caused a third party to provide value to the Debtors.
- More specifically, Northeast argued that its waiver of its unperfected mechanic's lien rights caused the third parties to provide the Debtors with contemporaneous new value. Northeast claimed that the value of the third-party contracts that were unfrozen as a result of the payment to Northeast were $88,016.00 and $658,565.40.

214

Debtors' Arguments:

- The Debtors contended that the facts set forth in the Defendant's Answer to the Complaint did not state a defense under Sec. 547(c)(1) and, based on the admissions in the Answer, the Plaintiffs are entitled to judgment as a matter of law.

215

Issue:

- Whether Northeast properly alleged a defense to the preferential transfers based on contemporaneous exchange for new value relying on a theory of indirect benefit.

216

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;

217

The §547(c)(1) defense is rooted in one of the core purposes of bankruptcy preference law, which is to permit the trustee to recover certain transfers made shortly before the filing of the bankruptcy case in order to promote the orderly, equality of distribution among creditors. See 5 Collier on Bankruptcy ¶547.01 (Alan N. Resnick, Henry J. Sommer eds., 16th ed. 2013) ("Collier"); 4 Norton Bankr. L. & Prac. 3d §66:1 (West 2014). 3 Thus, HN4 if the bankruptcy estate was not depleted or diminished by a transfer because the estate received back new value equivalent to the value of the outgoing transfer, there is no detriment to the other creditors, no bankruptcy purpose is achieved by setting aside the transfer, and §547(c)(1) provides a defense to the preference claim. E.g., Collier ¶547.04.[1][c] (citing In re Fuel Oil Supply & Terminaling, Inc., 837 F.2d 224 (5th Cir. 1988)); In re Hatfield Electric Co., 91 B.R. 782, 784 (Bankr. N.D. Ohio 1988); see generally In re Polichuk, 506 B.R. 405, 2014 Bankr. LEXIS 763, 2014 WL 766648, at *19 (Bankr. E.D. Pa. Feb. 27, 2014) (applying same reasoning to fraudulent transfer claims).

218

HN5 The "indirect transfer" defense theory is invoked when there is a nexus between the debtor's facially preferential payment to a creditor and the transfer of new value to the debtor by a third party. Reduced to its essence, a creditor-defendant raising this defense theory is asserting that when it received the payment from the debtor, it waived rights against or otherwise caused a third party to provide value to the debtor. If the value the debtor received from the third party equaled the payment the debtor made to the creditor, there was no loss to the estate and §547(c)(1) provides a defense to the preference claim. E.g., Collier ¶ 547.04[1][c]; see generally In re C.P.P. Export & Import, Inc., 132 B.R. 962, 965-66 (D. Kan. 1991) (§547(c)(1) provides a defense when "the debtor receives at least as much in new value as it transfers away").

219

HN6 Commonly, the "indirect transfer" defense theory is asserted when: (1) the debtor owes a debt to its creditor; (2) the creditor has recourse in some form against the third party if the debtor defaults; and (3) after the creditor could exercise its rights against the third party, as a result of which the third party may invoke indemnification rights against the debtor. A significant variable in this three (3) party relationship, insofar as the §547(c)(1) defense is concerned, is whether the third party itself owes an obligation to the debtor giving rise to an ability to setoff its payment to the creditor against amounts that it may owe the debtor. This is illustrated in the examples below:

Example 1 (preference payment results in indirect new value to debtor):

As a result of the debtor's facially preferential payment, the creditor waives or otherwise does not assert its lien rights against the third party. The third party then does not invoke its setoff rights against the amounts it owes the debtor. Consequently, it pays the debtor's invoice in an amount at least equal to the preferential payment to the creditor. **[680]** That payment, in effect, "replaces" the payment the debtor made to the creditor and there is no net loss to the estate. See, e.g., In re Gem Constr. Corp. of Virginia, 262 B.R. 638, 646 (Bankr. E.D. Va. 2000).

Example 2 (preference payment does not result in indirect new value to debtor):

Same facts as Example 1, except that the third party does not owe any money to the debtor, making setoff impossible. In this scenario, the third party is left with only a general unsecured claim against the debtor. The end result is that the third party's claim against the estate replaces the creditor's claim against the estate while the bankruptcy estate has been diminished by the amount of the preferential payment.

220

Split in Case Law:

[T]he split in the case law on whether [the creditor's] release of inchoate lien rights against [a third party] constitutes "new value" is not as wide as it initially appears. A close reading of the cases reveals that the primary variant in these cases is whether, at the time of the preference payment, the [third party] still owed sufficient sums to the debtor on the project to permit a setoff . . . . If the [third party] still owes the debtor, then its indemnity claim can be setoff and is secured. In this context, most courts consider the "indirect transfer" to provide new value. If there is no debt to be setoff, however, then the owner's claim for indemnification is simply an unsecured debt and there is no "new value."

Id. at 103; accord Charwill Constr., 391 B.R. at 12; see also In re Powers Lake Constr. Co., Inc., 482 B.R. 803, 808 (Bankr. E.D. Wis. 2012)(rejecting subcontractor's defense because no payments were due from third party owner to debtor).

221

Court's ruling:

- At the pleading stage, the Northeast's allegations were sufficient to state a defense. Although the three-party relationship described by Northeast differed from the prototypical debtor/subcontractor-creditor/property owner relationship in which the "indirect transfer" theory was frequently invoked, Northeast's position found support in prior decisions in the Third Circuit.
- The Court concluded that the Debtors' ability to retain its contractual relationship with two of its customers, as was alleged by Northeast, could constitute new value.
- The Court held that Northeast had alleged facts sufficient in its pleading to justify giving it the opportunity to conduct discovery and attempt to prove those facts at trial.
- The Court denied the Debtors' Motion for Judgment on the Pleadings.

222

Thus, the Defendant can establish its §547(c)(1) defense under the "indirect transfer" theory if the Defendant can prove:

(1) that SBA 2012 TC Assets, LLC and/or Nextel Communications of the Mid-Atlantic/Sprint, or their subcontractor, Alcatel-Lucent USA, Inc. ("the Third Parties") had no obligation to perform their contractual promises to the Plaintiffs;

(2) that the Defendant's waiver of its lien rights against the Third Parties caused them to enter into new contracts or continue to perform the existing contracts with the Plaintiffs' and

(3) the measure of value those contracts had to the bankruptcy estate.

223

Conclusion:

- The Eleventh Circuit has rejected the "indirect transfer" defense, and some cases in other jurisdictions have suggested that there is a division of authority on the issue.
- A creditor's release of inchoate lien rights against a third party may constitute new value.
- In evaluating a §547(c)(1) defense based on the "indirect benefit" theory, the critical element is whether the defendant can show that it took (or in the three-party context, it caused a third party to take) action that it (or the third party) was not legally obligated to take, which produced a tangible benefit to the bankruptcy estate.

224

Fraudulent Conveyance

225

Yoder v. T.E.L. Leasing,

124 B.R. 984, 1990 Bankr. LEXIS 2818 (Bankr. S.D. Ohio 1990)

226

Facts:

- The Debtor Suburban Motor Freight, Inc. ("Suburban") was a unionized trucking company.
- As a result of existing market conditions and Suburban's collective bargaining agreement with its employees, the Debtor was unable to operate at a profit.
- Its shareholders authorized Suburban's president to sell Suburban's used trucks and trailers to Transportation Equipment Services, Inc. ("TES") and its shares to Continental Trucking Services, Inc. ("CTS") for $2.1 million.
- Upon receiving the $2.1 million, Suburban immediately transferred the payment to an escrow account. The balance of the $2.1 million was then paid to the shareholders in accordance with their ownership interests.
- After Suburban filed for bankruptcy, the Trustee filed a motion for summary judgment, seeking to avoid the transfer as an alleged, constructively fraudulent conveyance.

227

Arguments:

- The shareholders asserted that the $2.1 million transferred to them was not a transfer of an interest of the Debtor in property. Suburban merely held those funds in trust for the benefit of the shareholders.
- The Trustee contended that Suburban received no consideration in exchange for its transfer of the $2.1 million because the transfer was for the benefit of the shareholders and not for itself.
- Additionally, the Trustee maintained that the closing left Suburban with unreasonably small capital because Suburban was operating on a loss and could not meet its financial obligations.

228

Issue:

- Was the transfer of the $2.1 million a constructively fraudulent conveyance?

229

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;

(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.

230

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231

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232

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233

Customarily, the existence and nature of the debtor's interest in property are determined by state law. *White v. White (In re White),* 851 F.2d 170, 173 (6th Cir. 1988); *Luring v. Ohio Public Employees Deferred Compensation Program (Matter of Petrey),* 116 Bankr. 95, 98 (Bankr. S.D. Ohio 1990); *In re North American Coin & Currency, Ltd.,* 767 F.2d 1573, 1575 (9th Cir. 1985), *cert. denied,* 475 U.S. 1083, 106 S. Ct. 1462, 89 L. Ed. 2d 719 (1986); *In re Sierra Steel, Inc.,* 96 Bankr. at 273. However, state law must be applied in a manner consistent with federal bankruptcy law. *In re Sierra Steel, Inc.,* 96 Bankr. at 273. *Id.*

234

Under Ohio law, *HN12* a resulting trust has been defined as follows:

> **[996]** 'One which the court of equity declares to exist where the legal estate in property is transferred or acquired by one under facts and circumstances which indicate that the beneficial interest is not intended to be enjoyed by the holder of the legal title.' 40 O.Jur. 240, § 76. The device has historically been applied to three situations: (1) purchase-money trust; (2) instances where an express trust does not exhaust the *res* given to the trustee; (3) express trusts which fail, in whole or in part. 2A *Bogart on Trusts* 405, § 451.

First Nat'l Bank of Cincinnati v. Tenney, 165 Ohio St. 513, 515, 60 Ohio Op. 481, 138 N.E.2d 15 (1956). Thus, a resulting trust has been limited under Ohio law to express trusts which fail or do not exhaust the *res*, and to purchase-money trusts. The existence of any of these situations may create a resulting trust.

235

Court's ruling:

- As to the transfer of the $2.1 million, the Court noted that there was no evidence that an express trust existed, or had existed and then failed. Nor was there evidence that a purchase-money resulting trust was created by the parties.
- Therefore, the shareholders' argument that the $2.1 million transfer was subject to a resulting trust failed.
- Additionally, the Court concluded that the lack of legal restrictions placed upon the $2.1 million and the commingling of these funds with the other funds in Suburban's checking account indicated that the $2.1 million was property of Suburban's estate.

236

Court's ruling:

- Given the absence of dispute on the reasonably equivalent value issue, the Court found that no consideration was provided to Suburban in exchange for its transfer of the $2.1 million to HNB, the escrow agent under the Contract.
- The Court found that Suburban had unreasonably small capital because it had incurred an operating loss of $1.87 million in 1995 and a year-end loss of approximately $3.5 million in 1996.
- Furthermore, Suburban was experiencing turbulent relations with its trade creditors and was forced to enter into new payment terms with vendors.
- Lastly, Suburban's principal lender refused to extend short-term financing until its debt was paid in full.
- Given that the shareholders failed to provide contrary evidence, the Court was persuaded that Suburban possessed unreasonably small capital at the time of the Closing, and its financial condition worsened as a result of the Closing.

237

Although the record is silent as to any express intention or belief on behalf of the Shareholders that Suburban would incur debts beyond its ability to pay, the record does offer facts and circumstances from which such intention reasonably may be inferred. *See Lackawanna Pants Mfg. Co. v. Wiseman*, 133 F.2d 482 (6th Cir. 1943). On several occasions preceding the March 24, 1990 transfer, the Shareholders expressed serious concerns over Suburban's financial health. The minutes of the board of directors and Shareholders' meetings are replete with references to Suburban's uncertain future viability. At a joint meeting of the Shareholders and directors of SDS, held on June 25, 1985, LeGrand warned that time was running out and Suburban would not be able to maintain operations, "under the present conditions." Trustee's Exh. 42. At a later meeting in August, LeGrand discussed Suburban's "cash flow problems" and recommended that the board authorize the sale of Suburban. Trustee's Exh. 42.

238

Court's ruling:

- Additionally, the Court concluded that the undisputed evidence established that the shareholders were aware of Suburban's economic instability.
- Yet, the shareholders still allowed the shares to be transferred and the proceeds received therefrom to be placed in the Escrow Account for ultimate distribution to the shareholders.
- In light of its sudden inability to pay its debts following the Closing, the Court found that the shareholders intended to incur, or believed that Suburban would incur, debts beyond its ability to pay such debts as they matured.
- Therefore, the Court held that the transfer was a constructively fraudulent conveyance and granted the Trustee's motion for summary judgment.

239

Shareholders allowed Suburban's Rolling Stock to be transferred and the proceeds received therefrom to be placed in the Escrow Account for ultimate distribution to the Shareholders. As the court in *Matter of Process-Manz Press, Inc.*, 236 F. Supp. 333, 346 (N.D. Ill 1964) observed:

> Depriving a financially hard pressed debtor of $ 2,000,000 of working capital could have no other result than to create a belief that the debtor would incur debts beyond its ability to pay as they matured. It would require no guess work on the part of a trier of facts to find such a belief on the basis of this record. (citations omitted).

The observations noted by the *Process-Manz* court are equally applicable to the facts of the present case. The Shareholders knew that Suburban was in desperate need of operating capital. Nevertheless, they robbed Suburban of the Rolling Stock proceeds, which created an immediate inability to pay debts and caused its checking account to become overdrawn.

240

If you own a trucking company, you cannot just pay yourself off if that company owes debts. First, you must pay those debts before you can collect on the remaining proceeds.

241

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242