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1

Preferential Transfers

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Argus Mgmt. Group v. J-Von N.A. (In re CVEO Corp.),

327 B.R. 724, 2005 Bankr. LEXIS 1494, 45 Bankr. Ct. Dec. 41 (Bankr. D. Del. 2005)

3

Facts:

- The Debtor CVEO Corporation designed, manufactured, and marketed athletic footwear, apparel, and accessories.
- CVEO purchased goods from the Defendant J-Von, N.A. Those goods were used in its operations.
- During the 90-day preference period, CVEO transferred nine checks totaling $258,915.58 to J-Von.
- After CVEO filed for bankruptcy, the Court confirmed CVEO's Second Amended Chapter 11 Plan which authorized the Creditors Reserve Trust (Plaintiff) to bring avoidance actions on behalf of the estate.
- The Plaintiff filed a motion for summary judgment, seeking to recovery the nine transfers as alleged preferential transfers. J-Von did not file a response.

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Arguments:

- The Plaintiff maintained that it had met its burden by presenting evidence that satisfied the requirements of section 547(b). It relied on J-Von's Answer, selected portions of a deposition of one of J-Von's employees, an affidavit from CVEO's former Chief Financial Officer ("CFO") and copies of several returned checks.
- J-Von admitted that it was a creditor of CVEO at the time the transfers were made and that they were made to or for its benefit within ninety days before the bankruptcy filing.
- J-Von, however, denied that the transfers were made on account of an antecedent debt owed by CVEO, that CVEO was insolvent at the time of the transfers, and that the transfers amounted to more than it would have received if the case were a chapter 7 proceeding.

5

Issues:

- Were the nine transfers made on account of an antecedent debt and while the debtor was insolvent?
- Did the transfers amount to more than the amount J-Von would have received if CVEO's case was liquidated under chapter 7?

6

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

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a) 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—
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10

Court's ruling:

- As to the "antecedent debt" issue, the Plaintiff attached an affidavit for James Lawlor, CVEO's former CFO. Lawlor stated that the transfers were made to J-Von on account of an outstanding pre-petition debt that CVEO owed J-Von.
- In contrast, the Court noted that J-Von failed to offer any affidavits or evidence to contradict the Plaintiff's evidence.
- Consequently, the Court accepted the undisputed facts offered by the Plaintiff as true and concluded that the payments were on account of an antecedent debt.
- The Court next found that J-Von did not present the Court with any evidence to rebut the presumption of CVEO's insolvency at the time the transfers were made.
- Thus, the Court concluded that section 547(b)(3) was satisfied.

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HN9 To satisfy the requirements of § 547(b)(5), the trustee must establish that the transfer yielded the creditor a greater return on its debt than it would have received if the transfer had not taken place and it had received a distribution under a Chapter 7 liquidation. . . . In other words, when a trustee commences a § 547 preference action, the court is to compare what the creditor actually received and what it would have received under the chapter 7 distribution provisions of the Code in order to determine whether the creditor received more than its fair share.

Kimmelman v. The Port Auth. of N.Y. & N.J. (In re Kiwi Int'l Airlines, Inc.), 344 F.3d 311, 317 (3d Cir. 2003) (citations omitted).

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Court's ruling:

- Lawlor attested in his affidavit that, based upon his work with CVEO and a review of the claims asserted against CVEO, the transfers at issue amounted to more than the amount J-Von would have received if CVEO's case was liquidated under chapter 7.
- As J-Von failed to present the Court with any evidence that could lead this Court to an alternative conclusion, the Court found that the Plaintiff met its burden of proof under section 547(g).
- Therefore, the Court held that the nine transfers were preferences and granted the Plaintiff's motion for summary judgment.

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Conclusion:

- 11 U.S.C.S. § 547(f) creates the presumption that a debtor is insolvent for the ninety days preceding the petition date. This places the burden of going forward with evidence of the debtor's solvency on the recipient of the alleged preferential transfer.
- An adverse party to a summary judgment motion may not rest upon the mere allegations or denials of the adverse party's pleading, but must set forth specific facts showing that there is a genuine issue for trial.

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In re Fisher,

100 B.R. 351, 1989 Bankr. LEXIS 841, 10 U.C.C. Rep. Serv. 2d (Callaghan) 761 (Bankr. S.D. Ohio 1989)

15

Facts:

- On December 12, 1984, the Defendant Almiro Fur Fashion Design shipped a "gray flannel black cross mink coat" and a "natural ranch mink coat," having approximate wholesale values of $ 3,295. and $3,500., respectively, to the Debtor Julius Fisher.
- Both mink coats were returned to Almiro by the Debtor on December 18, 1984.
- On December 17, 1984, Almiro shipped a "steel blue black cross mink coat," with an approximate wholesale value of $ 2,995 to the Debtor.
- The mink coat was transferred by the Debtor back to Almiro on December 19, 1984.

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Facts:

- The minks received by the Debtor (collectively, the "Minks") were to be sold on consignment—*i.e.,* if the goods received were sold, the Debtor was to remit a portion of the sale proceeds back to Almiro in payment of the goods. Unsold goods could be returned to Almiro for credit.
- Almiro did not take a security interest in any of the Minks shipped to the Debtor.
- The Debtor filed a voluntary petition for bankruptcy on March 7, 1985.
- The Trustee sought summary judgment in adversary proceeding to avoid the transfers of the Minks by the Debtor back to Almiro as preferential transfers.

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Arguments:

- According to the Trustee, the transfers of the Minks satisfy each and every element of 11 U.S.C. § 547(b) and, therefore, such transfers may be avoided.
- In response, Almiro contended that it was not a creditor of the Debtor. And, no transfer of property of the Debtor was made, Almiro argued, inasmuch as the Debtor had no property interest in the Minks to transfer.
- This argument was premised upon Almiro's contention that the shipments of the Minks "were not for the purpose of transferring property, but for the sole purpose of consigning the goods to the Debtor for *inspection only."*

18

Issue:

- Whether the Debtor's return of the Minks to Almiro within the ninety days preceding his bankruptcy filing constituted an avoidable preference.

19

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26

"Transfer" is defined in 11 U.S.C. § 101(50) as "every mode direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . ."

27

Court's ruling:

- The Court noted that in returning the Minks to Almiro, the Debtor obviously physically parted with the property in question.
- Further, the Court noted that Almiro's argument that the Debtor never obtained a transferrable property interest in the Minks ignored Ohio law.
- Because the Minks were delivered to the Debtor primarily for resale, and the Debtor could return the Minks to Almiro for credit, pursuant to Ohio law, this transaction was classified as a "sale or return." Ohio Revised Code ("O.R.C.") 1302.39(A)(2).
- Under O.R.C. § 1302.39(B), goods held on a "sale or return" basis are subject to the claims of the buyer's creditors while in the buyer's possession unless compliance with one of the provisions of O.R.C. § 1302.39(C) is demonstrated.

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Under O.R.C. § 1302.39(C), goods held on "sale or return" are subject to the claims of the buyer's creditors while they are in the buyer's possession, unless the seller of such goods does one of the following:

(1) complies with an applicable state law providing for a consigner's interest to be evidenced by a sign;

(2) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods of others; or

(3) complies with the filing requirements of the Revised Code (O.R.C. §§ 1309.01-1309.50).

29

Almiro's failure to comply with any of the requirements of O.R.C. § 1302.39(C) is clear as a matter of fact and law. Ohio has no applicable law providing for a consigner's interest to be evidenced by a sign. And, Almiro does not assert that Debtor was generally known by his creditors to be substantially engaged in the sale of goods of others. Finally, Almiro's failure to file financing statements with respect to the Minks is likewise undisputed. Hence, the relationship between Almiro and the Debtor is not that of consigner-consignee under Ohio law. Rather, the transaction was a "sale or return" within the meaning of O.R.C. § 1302.39(A)(2) and, pursuant to O.R.C. § 1302.39(B), the Minks were subject to the claims of Debtor's creditors while in Debtor's possession. It follows, therefore, that under Ohio law Debtor possessed a transferable property interest in the Minks for purposes of 11 U.S.C. § 547(b). Thus, the initial element of an avoidable transfer -- transfer of an interest of the Debtor in property -- has been established. *See In re A. J. Nichols, Ltd., 21 B.R. at 614-616*; *Matter of Castle Tire Center, Inc., 56 B.R. at 182-184*.

30

Court's ruling:

- First, relying on the definition of "creditor" under 11 U.S.C. § 101(9) as an "entity that has a claim against a debtor that arose at the time of or before the order for relief concerning the debtor," the Court found that Almiro was a creditor and that the transfers in question were to or for Almiro's benefit.
- Almiro had a right to payment for the Minks or to an equitable remedy for their return.
- Second, the Court concluded that the transfers were for or on account of an antecedent debt because the Debtor had the obligation to either pay for the Minks or return them to Almiro.
- Third, because Almiro failed to provide evidence to overcome the statutory presumption of insolvency, the Court found that the Debtor was insolvent at the time of the transfer of the Minks.

31

Court's ruling:

- Fourth, the invoices attached to the Trustee's summary judgment motion as well as Almiro's interrogatory answers established that the transfers of the Minks occurred during the 90-day preference period.
- Finally, the Court noted that the Trustee's affidavit established that there were insufficient assets in the estate for payment of a 100% dividend to general unsecured claimholders.
- Thus, because the transfer of the Minks permitted Almiro to recover the entire amount of its claim, and because it did not have a perfected security interest in the Minks, the Court concluded that Almiro received more by virtue of the transfers than it would have under a Chapter 7 liquidation.
- Therefore, the Court held that the transfer of the Minks were preferential and granted the Trustee's motion for summary judgment.

32

Conclusion:

- 11 U.S.C.S. § 547(f) creates the presumption that a debtor is insolvent for the ninety days preceding the petition date. This places the burden of going forward with evidence of the debtor's solvency on the recipient of the alleged preferential transfer.
- Failure to plead an affirmative defense results in the waiver of that defense and its exclusion from the case.

33

Ordinary Course of Business Defense

34

Terry Mfg. Co. v. Bonifay Mfg. (In re Terry Mfg. Co.),

332 B.R. 630, 2005 U.S. Dist. LEXIS 28350 (M.D. Ala. 2005)

35

Facts:

- Appellant Bonifay Manufacturing, Inc., a sewing contractor, and the Debtor Terry Manufacturing Company, Inc. began their business relationship in 1986, when Terry hired Bonifay to produce shirts.
- During their relationship, although the invoices required payment to be made within 30 days, Terry rarely paid within this 30-day period.
- From July 23, 2001 to March 24, 2003, the time between the invoice and date of payment ranged anywhere from 98 to 321 days.
- On January 9, 2003, Bonifay sent Terry a letter setting forth a payment schedule under which Terry "could get 'current' with Bonifay by Mid-May of 2003 by paying $ 21,500 per week."
- Terry made these weekly payments for two months, but reverted to paying off specific invoices as it could sometime in March 2003.

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- During the 90-day preference period, Terry made six payments to Bonifay, totaling $ 107,713.15.
- These payments were made anywhere from 138 to 182 days after the invoice date.
- The median for outstanding invoices in the garment industry, according to Risk Management Association and Credit Research Foundation, was 39 to 41 days and 55 days, respectively.
- The Trustee sought to avoid and recover the six payments made during the 90-day preference period.
- The bankruptcy court ruled in favor of the Trustee, holding that the payments were inconsistent with ordinary business terms in the garment industry because they were so much later than the industry norm and because Bonifay attempted to put Terry on a payment schedule. Bonifay appealed.

37

Arguments:

- The Trustee argued that the payments were inconsistent with ordinary business terms in the garment industry because they were much later than the industry norm.
- Bonifay argued that longstanding business relationships can and should alter the court's inquiry under § 547(c)(2)(C). Thus, because significantly late payments was the norm in the parties 18-year relationship, Bonifay asserted that it still qualified for the safe harbor of § 547(c)(2) even though it departed from the industry norm.
- The parties agreed that these six transfers were preferential under § 547(b) unless they fell within the statutory exception created by § 547(c)(2).

38

Issue:

- Whether the bankruptcy court gave appropriate weight to the long-standing business relationship between Bonifay and Terry in determining whether the six payments were made according to ordinary business terms.

39

§ 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;

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

(C) made according to ordinary business terms;

(amended 2005)

40

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(amended 2005)

41

Court's ruling:

- The Court found that Bonifay satisfied the first two elements of § 547(c)(2).
- First, Terry incurred the debts satisfied by these six payments in exchange for sewing work performed by Bonifay, so the debt arose in the ordinary course of business between the debtor and transferee.
- Second, Bonifay regularly allowed Terry to make payments substantially later than the invoice required, so Bonifay's decision to accept these six payments was in the ordinary course of business of the transferee.
- However, the Court concluded that Bonifay did not satisfy the third element--§ 547(c)(2)(c).

42

HN7 A three-step analysis guides courts in determining whether transactions in long-standing business relationships are exempted under § 547(c)(2). First, the **[635]** terms between the parties are compared to the range of terms on which firms similar to the transferee provide credit to firms similar to the debtor. *Molded Acoustical Products, 18 F.3d at 226-27*. If the terms between the parties fall outside this industry norm, the court creates a "customized window surrounding the industry norm," which takes into account the "length of the parties' relationship predating the debtor's insolvency." *Id. at 227*. Finally, the court determines "whether the relationship remained relatively stable leading into and throughout the insolvency period." *Id.* A relationship is not stable for these purposes if the terms of payment during the preference period vary considerably from the terms throughout the longstanding relationship or if the creditor has made efforts to accelerate repayment or otherwise collect the debt. *Id. at 227-28*. If the transfers in question fit within the customized window and the relationship was stable leading up to the insolvency, the transfers are not preferential even if they vary from the industry norm. *Id. at 226*.

43

Court's ruling:

- The Court noted that the six payments were 138 to 182 days past the invoice date, more than three times later than the industry standard of 39 to 55 days late.
- Additionally, no comparable firms allowed payments anywhere near that late.
- Accordingly, the Court found that the payments departed substantially from the industry norm.
- Furthermore, while the 18-year relationship seemed to entitle Bonifay to considerable leeway when crafting a window surrounding the industry norm, Bonifay departed from the industry norm by more than 300 percent, which the Court characterized as a "gross departure."

44

Court's ruling:

- The Court determined that the bankruptcy court's conclusion that no typical period of payment existed either prior to or during the preference period was not clearly erroneous because the lack of typicality of payments was sufficient to show that the relationship was unstable.
- And even if the relationship had been stable, the Court noted that the relationship deteriorated when Bonifay attempted to place Terry on a payment schedule.
- Therefore, the Court held that the six payments made during the preference period were not according to ordinary business terms.
- The bankruptcy court's judgment was affirmed.

45

Conclusion:

- A long-standing business relationship may allow a creditor to depart from the industry norm and still qualify for the safe harbor of § 547(c)(2)(c) . A particularly long-term relationship will allow a creditor even greater leeway from the industry norm. However, instability in the relationship leading up to the debtor's insolvency, manifested either as inconsistent payment terms or attempts to put the debtor on a payment plan, will prevent the creditor from invoking § 547(c)(2).

46

Bohm v. Golden Knitting Mills, Inc. (In re Forman Enters.),

293 B.R. 848, 2003 Bankr. LEXIS 543, 41 Bankr. Ct. Dec. 116 (Bankr. W.D. Pa. 2003)

47

Facts:

- The Debtor Forman Enterprises, Inc. was in the business of selling casual attire through retail outlets it operated known as American Eagle.
- The Defendant Golden Knitting Mills, Inc. was in the business of selling sweaters and other knitted apparel to retailers such as the Debtor.
- Forman placed a purchase order for sweaters with Golden. This was the first transaction between them.
- Golden shipped the sweaters to Forman per its instructions. That same day Golden issued and sent to Forman an invoice which stated that the terms were "NET 30".
- Forman did not pay for the sweaters by the due date specified on the invoice.

48

Facts:

- Rather, four days after the due date indicated on the invoice had passed, Forman placed a second order for sweaters with Golden and promised to pay for the first shipment.
- Based on Forman's promise to pay, Golden shipped the second order of sweaters.
- Nineteen days after the due date specified on the invoice for the first shipment of sweaters and during the 90-day preference period, Forman issued a check payable to Golden in the amount of $ 114,720.00 as payment in full for the first shipment of sweaters.
- The Trustee sought to avoid and recover the $ 114,720.00 payment as a preference.

49

Arguments:

- With the exception of § 547(b)(3), Golden conceded that the requirements of § 547(b) were satisfied in this case. It denied, in other words, that Forman was insolvent when it paid Golden for the first shipment of sweaters.
- The Trustee conceded that § 547(c)(2)(A) was satisfied in this case. However, he denied that § 547(c)(2)(B) was satisfied because both parties admitted to having never done business with each other before.

50

Issue:

- Was the debtor insolvent for purposes of § 547(b)(3) when the contested transfer occurred?
- If the transfer was a preference for purposes of § 547(b), did the "ordinary course" exception apply?

51

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

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(amended 2005)

54

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(C) made according to ordinary business terms;

(amended 2005)

56

HN4 An entity other than a partnership or a municipality is "insolvent" for purposes of the Bankruptcy Code when its financial condition is such that the sum of its debts is greater than all of its property at fair valuation. 11 U.S.C. § 101(32). Property transferred, concealed or removed with intent to hinder, delay, or defraud creditors along with property that may be exempted under § 522 is excluded from this calculation. This is known as the "balance sheet test": assets and liabilities are tallied at fair valuation to determine whether the entity's debts exceed its assets. In re RML, Inc., 92 F.3d 139, 154-55 (3d Cir. 1996).

57

Court's ruling:

- The Court noted that Golden's denial that Forman was insolvent was based on the the fact that Forman's schedules erroneously listed both Citizens Bank and PNC as having separate secured claims in the amount of $ 13,850,848.00 apiece when in reality they were joint participants in a single secured claim in that amount.
- The Court found that Goldman's argument was without merit because Forman also failed to schedule approximately $ 6 million in general unsecured debt for loans from insiders.
- Lastly, the Court determined that Forman overstated the value of its inventory by over $ 6 million.

58

Court's ruling:

- The Court concluded that, once these adjustments were taken into account, the total value of Forman's assets as of its bankruptcy petition should be reduced from $ 26,789,902.32 to $ 19,789,902.32, which was $ 9,656,041.55 less than the adjusted amount of its liabilities at that time.
- Thus, the Court held that Forman was insolvent when it filed its bankruptcy petition and that all of the the requirements of § 547 (b) were satisfied.

59

Jurisdictions are split on whether the first and only transaction between parties can establish an ordinary course of business between those parties.

Some courts have articulated a *per se* rule that the transfer in question as a matter of law *cannot* qualify as an ordinary course transaction for purposes of § 547 (c)(2)(B).

Most courts addressing this issue have rejected this approach and have held instead that a transaction may be in the "ordinary course" even if it is the very first transaction between the debtor and the creditor.

60

Court's ruling:

- The Court rejected the *per se* rule because it would discourage rather than encourage first-time creditors from doing business with a struggling debtor during the ninety-day preference window.
- Additionally, the Court determined that looking at the terms of the parties' agreement to decide whether the transfer was ordinary as between the debtor and creditor was not "very illuminating" in the present context because there was no evidence that the parties had been able to agree on terms.
- Rather, the Court noted that other courts that have rejected the *per se* rule have held that courts should examine the conduct of the parties. If nothing unusual or untoward occurred, then there would be no good reason to conclude that the transfer was out of the ordinary.

61

The invoice in this case was issued some five weeks *after* debtor ordered the sweaters and contemporaneously with their shipment. There is no basis for concluding that debtor and Golden had agreed by then that payment was due no later than thirty days from the date of shipment. It is more likely that no due date for payment had been agreed to either prior to or at the time of shipment. Moreover, the subsequent conduct of debtor and Golden is consistent with the conclusion that they were proceeding "by the seat of their pants" and worked out mutually acceptable payment terms along the way.

Finally, even if the invoice were illuminating in this regard, nothing would have prevented debtor and Golden from agreeing to different payment terms after the sweaters were shipped and the invoice was issued.

62

Court's ruling:

- Because there was no evidence of any unusual conduct between the parties, the Court found that the payment for the first shipment of sweaters was not a departure from the ordinary course of business between Forman and Golden.

63

The course of their dealings evolved over time. That course of dealing had not been established when Golden issued its invoice for the first shipment of sweaters. It was established only when debtor and Golden agreed to and did make the second shipment. When viewed from this perspective, it follows that the transfer at issue was not made outside of the ordinary course of their business relationship and that Golden has met it burden of proof with respect to § 547(c)(2)(B).

64

Court's ruling:

- As to § 547(c)(2)(C), the Court noted that Forman paid for the first shipment of sweaters nineteen days after the "NET 30" due date.
- Both the Trustee and Golden stipulated that payments Golden received from its customers in the United States were typically received after the due date specified on the invoice. On average, payment from these other customers were eighteen days late.
- Finally, testimony from Golden's general manager and others familiar with the knitted apparel industry revealed that payment received fifteen to twenty days after the 30-day due date was common.
- Therefore, the Court held that Golden established its "ordinary course" defense and that the $ 114,720.00 was not avoidable as preference.

65

Conclusion:

- It is presumed for purposes of § 547(b)(3) that the debtor was insolvent during the 90-day period immediately preceding the filing of the bankruptcy petition. 11 U.S.C. § 547(f).
- The creditor has the burden by a preponderance of the evidence of proving that an otherwise preferential transfer is excepted from avoidance by any of the provisions found at § 547(c).
- A first-time transaction between a debtor and a creditor in certain circumstances may qualify as an ordinary course transaction for purposes of § 547(c)(2)(B).
- Only dealings that are so unique as to fall outside the broad range of practices engaged in by businesses similar in some general way to the creditor in question should be considered extraordinary and beyond the scope of § 547(c)(2)(C).

66

Youthland, Inc. v. Sunshine Girls (In re Youthland, Inc.),

160 B.R. 311, 1993 Bankr. LEXIS 1578 (Bankr. S.D. Ohio 1993)

67

Facts:

- The Debtor Youthland, Inc. was in the business of selling children's' apparel at retail.
- The Defendant Sunshine Girls of Florida, Inc. manufactured and supplied lines of girls' wearing apparel to Youthland beginning in 1978.
- Sunshine usually shipped its product on either "net 30 days" or E.O.M. (end of month) payment terms. There was no dispute that Youthland's payments were regularly made after the time provided by these terms.
- During the 90-day preference period, Youthland transferred ten payments to Sunshine.
- After filing for bankruptcy, Youthland sought to avoid and recover these ten payments as alleged preferences.

68

Arguments:

- The parties stipulated that the transfers at issue met all requirements for preferential transfers as set forth in 11 U.S.C. § 547(b)(1)-(5).
- Because both parties ignored the express payment terms without consequence, Sunshine argued that all admittedly late payments made during the 90 day period before the bankruptcy filing were ordinary in the parties' course of business.
- Youthland asserted that the average days past due during the 90 day preference period increased significantly to the point that the questioned payments became outside the ordinary course of business between Youthland and Sunshine.
- It was not disputed that Youthland was a smaller specialty shop account and that such accounts typically paid late.

69

Issue:

- Were the transfers excepted from avoidance as transfers made in the ordinary course of business between Youthland and Sunshine?

70

§ 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;

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

(C) made according to ordinary business terms;

(amended 2005)

71

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(amended 2005)

72

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(amended 2005)

73

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(amended 2005)

74

The purpose for the "ordinary course" exception is to encourage creditors to engage in normal financial relations with a financially troubled debtor. Such encouragement does not, however, protect unusual actions by a debtor or its creditors which might "hasten" a debtor's "slide" into bankruptcy. *See, generally*, 4 *Collier on Bankruptcy*, P 547.10 (15th ed. 1991); S.Rep. No. 989, 95th Cong., 2d Sess. (1988).

75

Court's ruling:

- As there was no significant dispute that that the transfers in this instance were for debts incurred by Youthland in the ordinary course of its business, and no evidence was presented that the specific debts for which the questioned transfers were made were incurred by either party in any unusual activity, the Court concluded that Sunshine established the first element of the ordinary course defense for all the payments it received from Youthland during the preference period.
- As to the second element, Sunshine offered testimony that Youthland paid its accounts with Sunshine Girls on a "consistently late" basis, generally between 60 to 90 days past the terms specified for payment. In some instances those payments exceeded 100 days.
- Additionally, the Court noted that except for normal transmission of monthly account statements and occasional telephone calls, Sunshine never made extraordinary attempts to collect.

76

Court's ruling:

- Because the testimony consistently suggested that Sunshine regularly accepted and Youthland regularly tendered payments up to 90 days past due, the Court found that those payments received by Sunshine which were made within 90 days past due were within the ordinary course of business between the parties.
- Lastly, the Court noted that Sunshine's expert witness testified that "anything under 120 days (past due) [was] not considered late" where the account debtor was a "specialty shop" in the children's apparel business.
- Such shops have limited capitalization and pay more slowly than large institutional account debtors.

77

The Court believes that the relevant industry to be examined is the childrens' apparel industry, rather than the apparel industry generally. Information concerning this industry is easily obtainable and children's apparel appears to be a recognized "business". However, when business terms are being determined under the objective test of § 547(c)(2)(C), the business under scrutiny should not be divided further between large and small accounts. That consideration is appropriate as part of the subjective test of § 547(c)(2)(B), but not for the objective analysis required by § 547(c)(2)(C). Courts "should not look to only the manner in which one particular creditor interacted with similarly situated debtors, but rather analyze whether the particular transaction in question comports with the standard conduct of business within the industry." *Fred Hawes, 957 F.2d at 246*. Because the childrens' wear industry consists of competitors of all sizes, an objective analysis should include observation of payment trends generally.

78

The use of a calculated average or median, however, without identifying and considering the elements which comprise the range from which the number is calculated, may not produce a reliable indicator of ordinariness in a given business. While the Court should avoid subclassification of the industry for the reasons set forth above, it must be fully cognizant of all factors which might otherwise influence an average or median. Likewise, the Court must consider any evidence that a reported statistic is unrepresentative of an entire industry.

79

Court's ruling:

- Conversely, Youthland offered information from three financial reporting services to establish that the median number of days outstanding for accounts in the apparel industry generally was approximately 58 days.
- After considering the testimony and exhibits, the Court determined that a suitable range for ordinary business terms in the children's' apparel industry, within the meaning of 11 U.S.C. § 547(c)(2)(C), was between 30 and 80 days past due.
- Thus, as five transfers were made outside the 80-day range, the Court found that five of the ten transfers made by Youthland to Sunshine within the preference period were preferential payments not excepted from avoidance by the ordinary course defense.
- The remaining five transfers were excepted under the defense.

80

Conclusion:

- Determining whether a payment is made in the ordinary course of business and according to ordinary business terms is a factual question. The timing, amount, manner of payment and the circumstances under which the transfer was made should all be examined.
- The fact that payments are made late or on an irregular basis does not establish that such payments are unusual or extraordinary if such payments are consistent with an otherwise established course of dealings.
- When business terms are being determined under the objective test of § 547(c)(2)(C), the business under scrutiny should not be divided further between large and small accounts.

81

In re Thomas W. Garland, Inc.,

39 B.R. 412, 1984 Bankr. LEXIS 5861, 84-2 U.S. Tax Cas. (CCH) P9625, 54 A.F.T.R.2d (RIA) 5676 (Bankr. E.D. Mo. 1984)

82

Facts:

- Plaintiff Thomas W. Garland, Inc. (Garland), a clothing retailer, had a lease and sales agreement with Cheldon Shoes, Inc., a shoe manufacturer.
- Garland was to collect sales receipts for the manufacturer and send the proceeds to Cheldon monthly.
- Defendant, the United States Internal Revenue Service (IRS), made assessments against Cheldon for taxes owed.
- The IRS served Garland with a notice of levy upon all property belonging to Cheldon that was in Garland's possession to a maximum of $24,251.78.
- During the 90-day preference period, Garland made two payments of $2500 out of its general accounts to the IRS.

83

Facts:

- Shortly thereafter, Garland filed for bankruptcy. Garland sought to avoid and recover these transfers as preference payments.

84

Arguments:

- Garland argued that the two $2500 payments to the IRS made just three weeks prior to the Bankruptcy were preferential transfers and recoverable pursuant to 11 U.S.C. § 547.
- The IRS contended that the payments were made in satisfaction of a debt secured by a statutory lien for taxes, transfers not avoidable by reason of the provisions of 11 U.S.C. § 547(c)(6).
- Alternatively, the IRS argued that the ordinary course of business exception pursuant to § 547(c)(2) applied.

85

Issues:

- Was the IRS a creditor as that term is used in the Bankruptcy Code at the time of the payments?
- Were the payments made in payment of a debt to the IRS?
- Were the payments made in satisfaction of a debt secured by a statutory lien for taxes?
- Were the preferential transfers exempted under the ordinary course of business exception?

86

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.

87

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88

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89

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

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

90

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91

§ 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;

(B) made not later than 45 days after such debt was incurred;

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

(D) made according to ordinary business terms;

(amended 2005)

92

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(D) made according to ordinary business terms;

(amended 2005)

96

Court's ruling:

- The Court noted that the service of the notice of levy created a right to payment to the IRS of any and all sums owed by Garland to Cheldon up to the amount of levy.
- Because Garland owed at least $23,369.35 to Cheldon on the date the notice of levy was served, Garland was obligated to pay such sum to the IRS.
- In fact, if Garland did not pay the sum, then it could be held personally liable for failing or refusing to respond.
- Thus, the Court concluded that the IRS, upon its service of the notice of levy, became a creditor of Garland, and that Garland became indebted thereby to the IRS.
- The Court held that all five elements of a preferential transfer were present.

97

The debt to the IRS arose on May 1, 1980, when the Notice of Levy was served. The transfers were made subsequent to May 1, when the checks, dated May 6 and May 9, were delivered to the IRS. Thus the first two elements of a preferential transfer have been satisfied. The transfers were made to the IRS, a creditor of Garland's [§ 547(b)(1)], and they were made for or on account of an antecedent debt owed by Garlands, which arose on May 1, 1980, before the transfers were **[415]** made [§ 547(b)(2)]. The transfers were made within ninety days before the filing of the Petition [§ 547(b)(4)], so that the Debtor's insolvency on the date of transfer is presumed [§§ 547(b)(3) and 547(f)]. The parties did not present evidence to rebut this presumption of insolvency.

98

The payments made to the IRS enabled the IRS to receive more than it would have received had the transfers not been made and the IRS paid to the extent provided by the provisions of Chapter 7 of the Bankruptcy Code, as required by § 547(b)(5). The approved plan of reorganization provides for the liquidation of the Debtor's business and provides for a fifteen percent distribution to general unsecured creditors. Assuming a comparable distribution to general unsecured creditors in a Chapter 7 liquidation and assuming Debtor's debt to the IRS is measured by the full amount of the taxes embraced by the levy, (rather than by some lesser sum, as the amount of debt shown in Debtor's books), the IRS would receive approximately $3637.77 (15% of $24,251.78), if the transfers had not been made. With the transfers, the IRS would receive approximately $7887.77 ($5000 plus 15% of $19,251.78). All five elements of a preferential transfer having been proved, the transfer is recoverable by the Debtor-in-Possession unless it falls into one or more of the exceptions to avoidability set forth at 11 U.S.C. § 547(c).

99

Court's ruling:

- The Court rejected the IRS's argument that the transfers were not avoidable by reason of the provisions of 11 U.S.C. § 547(c)(6).
- 11 U.S.C. § 547 permits the avoidance of certain kinds of statutory liens; however, statutory liens for unpaid taxes are not embraced by Section 545, so that they are not avoidable under 545, and a transfer that constitutes the fixing of such statutory lien is not recoverable under 547(c)(6).
- Thus, the Court concluded that § 547(c)(6) did not apply.
- As Garland's debt to the IRS arose on the date when the notice of levy was served, and the payments were made within 45 days thereafter, the Court found that element B of the "ordinary course" defense was satisfied.

100

Court's ruling:

- The Court also found that a debt arising from the service of a notice of levy is incurred in the ordinary course of a debtor's business.
- The Court opined that Garland's amenability to the reach of the levy arose from its contractual, business relationship with Cheldon, the delinquent taxpayer.
- This relationship existed in the ordinary course of Garland's business affairs and was a relationship by which a debtor-creditor relationship between Garland and Cheldon came into existence
- Finally, this relationship permitted the employment of the tax collection process, to collect Cheldon's delinquencies, against Garland.

101

Court's ruling:

- Additionally, the Court found that receipt of the payments, upon demand made, was in the ordinary course of business of the IRS because that was the response which was sought to be evoked by the collection process.
- Lastly, the Court noted that there was nothing in the Internal Revenue Code which specifically provides when a person is to respond by payment or surrender of property to the demand of the levy.
- Rather, because the substantive operative effect of the levy is immediate, and any liability incurred continues indefinitely, the Court concluded that payment within 5 or 8 days of receipt could not be said not to be according to ordinary business terms.
- Therefore, the Court held that all four elements of the "ordinary course" exception were satisfied and that the payments to the IRS were not avoidable.

102

Conclusion:

- A debtor can be held personally liable for failing or refusing to so respond to a notice of levy under 26 U.S.C. § 6332(c).
- 11 U.S.C. § 547(c)(2) immunizes a transfer, otherwise voidable under § 547(b).

103

Fraudulent Conveyance

104

McKloskey v. Galva Foundry Co. (In re Art Unlimited, LLC),

356 B.R. 700, 2006 Bankr. LEXIS 3405, 47 Bankr. Ct. Dec. 162 (Bankr. E.D. Wis. 2006)

105

Facts:

- The Debtor, Art Unlimited, LLC (AU) manufactured artistically decorated sports apparel, such as tee shirts, sweatshirts, and fleece items.
- AU began experiencing cash problems in November 1996, so in March 1997, Defendant Walter Nocito transferred his interest in the LLC to Defendant Galva Foundry Company, formerly an operating entity but then a shell holding company.
- Defendant Wells Fargo Bank Wisconsin, NA provided replacement financing to AU.
- In 2001, Mr. Nocito decided that AU should liquidate some of its assets in an effort to pay down its debt to Wells Fargo. Negotiations took place between Mr. Nocito and Steve Scharpf, who had formed and owned Art Unlimited Sportswear, LLC, (AUS) for the purchase of assets.

106

Facts:

- Mr. Nocito insisted that he be paid a substantial portion of the purchase price by way of a "Consulting Agreement." The parties agreed that the amount to be paid for this part of the transaction was $600,000 at closing.
- Although the $600,000 was for AU's assets, it was transferred to Galva and then to Wells Fargo.
- The Trustee sought to recover this $600,000 payment as both an actual fraudulent conveyance and as a constructively fraudulent conveyance.
- It was undisputed that the transfer occurred within a year of AU's filing for bankruptcy.

107

Arguments:

- The Trustee argued that Mr. Nocito and Galva transferred the $600,000 with the intent to hinder, delay, or defraud because Mr. Nocito structured the transaction to put his personal obligations ahead of AU's obligations to trade creditors.
- Additionally, the Trustee argued that AU was insolvent at the time of the sale transaction because his expert testified that Mr. Nocito grossly over estimated the worth of AU's inventory. Since the fabric was not current, the expert estimated it was worth only about 10% of cost and the finished garments should have been written down to 40% of cost.
- Both Mr. Nocito and Wells Fargo asserted that they believed that the liquidation of AU's assets would be more than enough to pay all the creditors, making AU a solvent entity.

108

Issues:

- Was the transfer of the $600,000 an actual fraudulent conveyance?
- Was the transfer of the $600,000 a constructively fraudulent conveyance?

109

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—

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

110

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(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.

112

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113

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.

114

Sec. 550(b): The trustee may not recover under section (a)(2) of this section from—

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

115

Sec. 550(b): The trustee may not recover under section (a)(2) of this section from—

(1) a transferee that takes for value, including satisfaction or securing of a present or antecedent debt, in good faith, and without knowledge of the voidability of the transfer avoided; or

(2) any immediate or mediate good faith transferee of such transferee.

116

Court's ruling:

- As to Section 548(a)(1)(A), the Court first noted that Mr. Nocito structured the deal and controlled the bank account to which the $600,000 was deposited.
- The Court was also skeptical of Mr. Nocito's belief that there would be enough money to pay unsecured creditors, given the age and condition of what he was trying to sell and what he actually did.
- Rather, the Court noted that Mr. Nocito made sure he received as much as possible as early as possible before the $800,000 to $1,000,000 in unsecured trade creditors received a dime.
- The Court found that Mr. Nocito may have had no intention to defraud trade creditors, but he did intend to hinder and delay them.

117

Court's ruling:

- The Court concluded that the Trustee met his burden of proof by clear and convincing evidence and was entitled to judgment against Mr. Nocito for $600,000. Likewise, the actual intent to hinder and delay creditors was imputed to Galva Foundry Company, Inc., and the Trustee was entitled to judgment against it.
- As to Section 548(a)(1)(B), the Court noted that funds from the sale of AU's assets went to pay the debts of the principal, and the trade creditors were left completely out of the mix.
- Thus, the Court concluded that the transfer of the $600,000 was not for "reasonably equivalent value."

118

HN7 Whether an entity is insolvent at the time of a challenged transfer under 11 U.S.C. § 548(b), or becomes insolvent as a result of the transfer, is a balance sheet determination; that is, whether the entity's debts exceed its assets. 11 U.S.C. § 101(32). Generally Accepted Accounting Principles require that inventory of finished goods and raw materials be valued at the lower of cost or market, and this issue was vigorously contested at trial. The debtor showed all of its inventory at cost and apparently did not make it a practice to write down the cost of merchandise not sold or raw materials remaining at the close of a season.

119

Court's ruling:

- The Court found that the sheer magnitude of the older garment inventory, approximately 153,000 items, indicated that Mr. Nocito would be very hard pressed to recover the cost at which they were carried, even if they were offered at an attractive discount.
- The Court noted that it was also important that no manufacturing was taking place to use up the prior years' fabric, thus justifying a substantial writedown.
- Therefore, the Court concluded that at the time of the transfer the raw materials and finished goods should have been valued at the $1,574,512 estimated by the Trustee's expert.
- Thus, AU had a negative value of ($ 652,550) and was insolvent at the time of the sale transaction.

120

Court's ruling:

- Lastly, the Court found that Wells Fargo was not liable for the same $600,000 under Section 550(b).
- The initial transferee of the $600,000 under the "Consulting Agreement" was Galva, and Wells Fargo was an immediate transferee or a mediate transferee.
- The Court determined that Wells Fargo acted merely as a financial intermediary which held the check only for the purpose of fulfilling an instruction to make the funds available to someone else.
- Finally, the Court concluded that Wells Fargo, through its representative Mr. Neary, acted in good faith.
- The Court held that the Trustee was entitled to judgment for the $600,000 against the defendants Mr. Nocito and Galva under Sections 548(a)(1)(A) and (B).

121

Consignment Defense

122

Steege v. Affiliated Bank/North Shore Nat'l,

147 B.R. 140, 1992 Bankr. LEXIS 1787, 19 U.C.C. Rep. Serv. 2d (Callaghan) 752 (Bankr. N.D. Ill. 1992)

123

Facts:

- The Debtor Alper-Richman Furs, LTD was a retail furrier in Chicago.
- Alper-Richman first began borrowing money from the Defendant Affiliated Bank/North Shore National (Bank) in 1980.
- Over the next eight years, the Bank increased its loans to Alper-Richman. The Bank also made personal loans to Burton Alper, president and sole shareholder of Alper-Richman, and his wife. All of the Bank's loans were unsecured.
- Alper formed Just Furs, Inc. to do business as a discount furrier. Just Furs obtained its inventory directly from Alper-Richman.
- The Bank financed Just Furs' operation with a loan secured by a blanket lien on all of Just Furs' inventory and receivables.

124

- After an involuntary bankruptcy was filed against Alper-Richman, the Bank and Burton Alper entered into an agreement under which Alper-Richman released the inventory located at Just Furs to the Bank, and the Bank agreed not to assert a claim to any future inventory located at Just Furs.
- The Trustee initiated the adversary proceeding against the Bank in order to reclaim the inventory.
- The Trustee also sought to recover all payments made by Alper-Richman to the Bank within the year preceding the involuntary petition, claiming: (1) the $ 662,188.65 in trade acceptances were avoidable preferences; (2) the $ 116,517.88 in commercial loan payments were avoidable preferences; and (3) the $ 775 payment made by Alper-Richman to the Bank on a personal loan of Alper's wife was both a fraudulent conveyance and preferential.
- Both the Trustee and the Bank have moved for summary judgment.

125

Arguments:

- The Trustee argued that she should be granted summary judgment because, as a matter of law, Alper-Richman's interest in the inventory seized by the Bank was superior to the Bank's lien.
- The Trustee's claim was based on the allegation that Alper-Richman consigned the inventory seized to Just Furs and Ill. Rev. Stat. § 2-326 worked to give Alper-Richman, as a consignor, priority over the Bank.
- The Bank argued that the Trustee failed to prove any consignment arrangement, and, even if there was a consignment, that the Bank retained a superior interest in the inventory seized under Ill. Rev. Stat. § 9-114.

126

Issue:

- Was Alper-Richman's interest in the inventory seized by the Bank superior to the Bank's lien?

127

Ill. Rev. Stat. § 2-326 provides, in pertinent part:

(2) Except as provided in subsection (3), . . . goods held on sale or return are subject to [the claims of the buyer's creditors] while in the buyer's possession.

(3) Where goods are delivered to a person for sale and such person maintains a place of business at which he deals in goods of the kind involved, under a name other than the name of the person making delivery, then with respect to claims of creditors of the person conducting the business the goods are deemed to be on sale or return. The provisions of this subsection are applicable even though an agreement purports to reserve title to the person making delivery until payment or resale or uses such words as "on consignment" or "on memorandum". However, this subsection is not applicable if the person making delivery

(a) complies with an applicable law providing for a consignor's interest or the like to be evidenced by a sign, or

(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods to others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

128

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(b) establishes that the person conducting the business is generally known by his creditors to be substantially engaged in selling the goods to others, or

(c) complies with the filing provisions of the Article on Secured Transactions (Article 9).

129

Ill. Rev. Stat. § 9-114 provides, in pertinent part:

(1) A person who delivers goods under a consignment which is not a security interest and who would be required to file under this Article by paragraph (3)(c) of Section 2-326 has priority over a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee . . . if

(a) the consignor complies with the filing provision of the Article on Sales with respects to consignments (paragraph (3)(c) of Section 2-326) before the consignee receives possession of the goods; and

(b) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor; and

(c) the holder of the security interest receives the notification within 5 years before the consignee receives possession of the goods; and

(d) the notification states that the consignor expects to deliver goods on consignment to the consignee, describing the goods by item or type.

(2) In the case of a consignment which is not a security interest and in which the requirements of the preceding subsection have not been met, a person who delivers goods to another is subordinate to a person who would have a perfected security interest in the goods if they were property of the debtor.

130

Ill. Rev. Stat. § 9-114 provides, in pertinent part:

(1) A person who delivers goods under a consignment which is not a security interest and who would be required to file under this Article by paragraph (3)(c) of Section 2-326 has priority over a secured party who is or becomes a creditor of the consignee and who would have a perfected security interest in the goods if they were the property of the consignee . . . if

(a) the consignor complies with the filing provision of the Article on Sales with respects to consignments (paragraph (3)(c) of Section 2-326) before the consignee receives possession of the goods; and

(b) the consignor gives notification in writing to the holder of the security interest if the holder has filed a financing statement covering the same types of goods before the date of the filing made by the consignor; and

(c) the holder of the security interest receives the notification within 5 years before the consignee receives possession of the goods; and

(d) the notification states that the consignor expects to deliver goods on consignment to the consignee, describing the goods by item or type.

(2) In the case of a consignment which is not a security interest and in which the requirements of the preceding subsection have not been met, a person who delivers goods to another is subordinate to a person who would have a perfected security interest in the goods if they were property of the debtor.

131

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.

132

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

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a) the case were a case under chapter 7 of this title;
b) the transfer had not been made; and
c) such creditor received payment of such debt to the extent provided by the provisions of this title.

133

Court's ruling:

- First, the Court concluded that there was no genuine issue of material fact with respect to the arrangement between Alper-Richman and Just Furs: it was a consignment arrangement.
- Alper unequivocally testified at his deposition that Alper-Richman owned all of the merchandise located at Just Furs.
- Further, the Bank produced no evidence sufficient to challenge the Trustee's evidence with respect to a consignment arrangement.
- Next, the Court noted that § 2-326(3) and § 9-114 of the Uniform Commercial Code (as adopted by Illinois) seemed to lead to absolutely contradictory results in the instant proceeding, so the only logical conclusion was that § 9-114 did not apply where § 2-326(3) did.

134

The plain language of § 9-114 leads to the conclusion that § 9-114 is meant to apply only where the two exceptions listed in § 2-326(3) do not apply. When that is so, the language of the rest of § 9-114 comes into play, and the consignor is required to file under Article 9 to prevent the consigned goods from becoming subject to security interests of the consignee's creditors. In other words, as against the consignee's creditors, the consignor who fails to file a financing statement has priority to the consigned goods if either of the § 2-326(3) exceptions applies; otherwise, § 9-114 applies, and the consignee's secured creditors have priority.

135

Court's ruling:

- Lastly, the Court noted that, even if Alper-Richman and the employees of Just Furs represented 79% of the total unsecured claims against Alper-Richman, the Trustee failed to provide evidence as to what Just Furs' other, unrelated creditors believed the nature of Just Furs' business was.
- Thus, the Court found that summary judgment was inappropriate with respect to whether Alper-Richman's interest in the consigned goods seized by the Bank prevailed over the Bank's security interest in those goods.
- As to the preferential claims and the fraudulent conveyance claim, the Court noted that there was a genuine issue of material fact with respect to Alper-Richman's insolvency.
- Therefore, the Court concluded that summary judgment was not appropriate at the present time.

136

Lien Defense

137

SGS Studio, Inc. v. CIT Group/Commercial Servs. (In re SGS Studio, Inc.),

2001 Bankr. LEXIS 2263 (Bankr. N.D. Tex. Dec. 5, 2001)

138

Facts:

- The Debtor SGS Studio, Inc. was in the business of manufacturing and selling women's apparel.
- The Defendant CIT Group/Commercial Services, Inc. provided factoring, loans, and other financial services to SGS.
- After SGS filed for bankruptcy, and pursuant to three court orders, CIT advanced $ 1,034,894.54 to SGS.
- The Court also granted CIT a lien on the property of the bankruptcy estate for the post-petition advances.
- CIT collected post-petition proceeds of $ 1,290,477.00.

139

Facts:

- After repayment of the post-petition advances, the bankruptcy estate had approximately $ 255,583, in cash, CIT held about $ 195,900 of that amount, while the Trustee held the remainder.
- The Trustee asserted that the $ 255,583 should be available for payment of administrative expenses and distribution to the general unsecured creditors.
- CIT asserted a pre-petition lien on the cash, making it cash collateral, which should be applied to CIT's pre-petition advance balance.

140

Defendant's Arguments:

- CIT argued that it had a perfected first priority security interest in all of SGS's pre-petition receivables, accounts, instruments, chattel paper, contract rights, general intangibles, as well as certain inventory.
- CIT contended that the cash it held derived post-petition from that pre-petition collateral.

141

Arguments:

- The Trustee argued that CIT did not perfect its liens and that CIT's security interest did not reach pre-petition inventory.
- Alternatively, the Trustee contended that CIT's lien only extended to inventory imported pursuant to letters of credit, which was typical with industry practice not to provide blanket liens on all inventory.
- The Trustee contended that payments to CIT during the ninety days preceding the bankruptcy petition amounted to avoidable preferences under 11 U.S.C. §547(b).

142

Issues:

- Did CIT have a perfected lien in all of SGS's pre-petition receivables, accounts, instruments, chattel paper, contract rights, general intangibles, as well as certain inventory?
- Were the payments to CIT avoidable as preferences?

143

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.

144

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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.

145

Court's ruling:

- The Court noted that in 1987, SGS and Barclays American/Commercial, Inc. entered into an agreement whereby SGS granted a security interest to Barclays in all of its receivables, all proceeds from its receivables, and in all returned merchandise.
- Subsequently, Barclays filed a UCC-1 financing statement with the Texas Secretary of State for its lien on SGS's accounts and receivables.
- In 1997, Barclays assigned its interests to CIT, who filed a statement with the Texas Secretary of State reporting Barclays assignment of "All Collateral" to CIT and, later, filed an amendment to the financing statement, adding a new security interest in SGS's inventory.

146

Court's ruling:

- The Court concluded that CIT had an uninterrupted perfected security interest in SGS's accounts and receivables, and the proceeds therefrom.
- Moreover, the Court also noted that as of the petition date, SGS's inventory consisted of fabric that was primarily located in Guatemala.
- Because the inventory held in Guatemala at the petition date constituted collateral as defined in the parties' Letter of Credit Agreement, the Court found that CIT held a perfected security interest in that inventory at the petition date.
- As to the Trustee's preference argument, the Court concluded that the Trustee had not met his burden of proof under section 547(b).

147

Court's ruling:

- The Court found that by applying all of its secured collateral to the debt, CIT was still under-secured at the petition date. Consequently, CIT had not received more from the transfers than CIT would have received in a liquidation under Chapter 7.
- Therefore, the Trustee's complaint was dismissed, and CIT's cash collateral was released.

148

Conclusion:

- It is the burden of the trustee to prove all six elements of § 547(b) to have a transfer set aside as a preference.
- Payments to a creditor with a perfected security interest in the debtor's assets are not preferences avoidable by section 547.

149

Reclamation Defense

150

Phoenix Rest. Group, Inc. v. Proficient Food Co. (In re Phoenix Restaurant Group, Inc.),

373 B.R. 541, 2007 U.S. Dist. LEXIS 57980 (M.D. Tenn. 2007)

151

Facts:

- The Debtor Phoenix Restaurant Group, Inc. (PRG) and its affiliates operated numerous Denny’s and Black-Eyed Pea Restaurants in several states.
- Defendant/Appellant Proficient Foods Company served as a vital supplier of food products to PRG’s Denny’s Restaurants prior to and during PRG’s bankruptcy proceeding.
- On November 2, 2001, Proficient sent a letter to counsel for PRG, pursuant to 11 U.S.C. § 546 and Uniform Commercial Code § 2-702, demanding reclamation of food products supplied to Denny's Restaurants in the ten days preceding the filing of the involuntary bankruptcy petition
- On November 16, 2001, PRG filed a motion seeking discretionary authority to make payments to Proficient as a critical vendor ("the Critical Vendor Motion").

152

Facts:

- The Bankruptcy Court entered an agreed Order, which provided that the "total to be paid to Proficient . . . on account of its prepetition claims, PACA claims, and Reclamation claims [was] $900,000 ("Critical Vendor Payment").”
- Of particular importance, the Order provided that "[a]ll Critical Vendor Payments will be applied first to payment of the reclamation claim of approximately $540,000." In return for these payments, Proficient agreed to continue to sell goods to PRG through March 30, 2002.
- The Plan Administrator, acting as trustee, sought to avoid and recover payments totaling approximately $3.7 million made to Proficient during the 90-day preference period.
- Proficient appealed the rulings of the Bankruptcy Court.

153

Arguments:

- Proficient argued that it provided “new value” to PRG in the form of ongoing inventory in return for PRG’s pre-petition payments.
- Proficient challenged the Bankruptcy Court's holding that satisfaction of Proficient's reclamation claim in the amount of $540,000 precluded Proficient's "new value" defense to that amount.

154

Issue:

- Did satisfaction of Proficient's reclamation claim in the amount of $540,000 preclude Proficient's "new value" defense to that amount?

155

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;

156

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;

157

Section 546(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

158

Section 546(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under sections 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9).

159

The Bankruptcy Court did not accept the trustee's position that the post-petition payments made by the debtor-in-possession to Proficient under the Critical Vendor Order were "otherwise unavoidable" transfers that could be used to offset the pre-petition "new value" given by Proficient. The Bankruptcy Court reasoned that the preference window of § 547 closed on the date of the filing of the bankruptcy petition and post-petition payments could not be used to deplete pre-petition "new value." The Bankruptcy Court further held, however, that the amount of Proficient's reclamation claim could be used to deplete Proficient's pre-petition "new value" because Proficient essentially kept strings on those goods and thus, the goods subject to reclamation did not enhance PRG and did not constitute "new value" under § 547(a)(2). In so holding, the Bankruptcy Court

160

However, goods shipped on the eve of bankruptcy that are subject to reclamation are not the same "money or money's worth, as goods shipped free of the seller's strings. *See* 11 U.S.C. § 547(a)(2). In the same sense that goods subject to a PACA trust do not enhance the debtor because the value of those goods is held in trust for the growers and shippers, goods subject to reclamation do not enhance the debtor to the extent the value of those goods can be reclaimed.

Here, the new value given by Proficient must be reduced to reflect its reclamation claim-not because it received an otherwise avoidable payment after the petition-but because the new value given to the Debtors prepetition must be discounted to reflect the right of reclamation preserved by § 546(c). Put another way, the [trustee] cannot use post petition payments under the Critical Vendor Order as "otherwise unavoidable" transfers that deplete the prepetition new value given by Proficient; but Proficient in its calculations failed to adjust new value during the preference period to reflect goods subject to reclamation.

(Docket Entry No. 1, Part 24, Memorandum at 20-21.)

161

Court's ruling:

- The Court agreed with the Bankruptcy Court's holding that new value during the preference period must be reduced to reflect goods subject to reclamation.
- Whatever benefit PRG obtained by Proficient's shipment of goods to PRG was negated by Proficient's right of reclamation in those same goods.
- The Court noted that Proficient had the right either to reclaim goods of a value of $540,000 or have its reclamation claim enhanced in priority over other creditors to that amount.
- Either way, Proficient's reclamation claim would not add "new value" to the debtor; as the Bankruptcy Court put it, these goods were not "shipped free of the seller's strings."

162

Court's ruling:

- Proficient could not assert a reclamation claim of $540,000 and then also characterize that same $540,000 as "new value" to the debtor to reduce any preference.
- Otherwise, the Court concluded, Proficient could count the same amount in its favor twice, and doing so would clearly place Proficient ahead of other creditors, defeating the purpose of § 547.
- Therefore, the Court held that Proficient had not replenished PRG in the amount of the reclamation claim, $540,000, and the Bankruptcy Court properly held that $540,000 did not constitute "new value" for the purpose of Proficient's statutory defense under § 547(c)(4).
- Thus, the Court affirmed the Final Judgment of the Bankruptcy Court in favor of the Plan Administrator.

163

Conclusion:

- Goods shipped on the eve of bankruptcy that are subject to reclamation are not the same "money or money's worth" as goods shipped free of the seller's strings. In the same sense that goods subject to a trust do not enhance the debtor because the value of those goods is held in trust for others, goods subject to reclamation do not enhance the debtor to the extent the value of those goods can be reclaimed.

164

In re Maloney Enterprises, Inc.,

37 B.R. 290, 1983 Bankr. LEXIS 4989, 11 Bankr. Ct. Dec. 764, 38 U.C.C. Rep. Serv. (Callaghan) 498 (Bankr. E.D. Ky. 1983)

165

Facts:

- The Plaintiff Aventura Sportswear, Limited, shipped certain sportswear clothing products, invoiced at a total of $32,940.00, to the Defendant-Debtor Maloney Enterprises, Inc.
- The goods were shipped F.O.B. Seattle, Washington and arrived at Maloney's Mt. Sterling, Kentucky warehouse on December 7, 1982.
- Maloney, already insolvent, filed a petition under Chapter 11 of the Bankruptcy Code on December 8, 1982.
- Upon learning of the bankruptcy filing, Aventura sent a telegram demanding reclamation of the sportswear which was received by Maloney on December 10, 1982. Maloney refused to return the goods.
- Aventura filed an action demanding reclamation of goods shipped to defendant debtor pursuant to 11 U.S.C. § 546(c) and Ky. Rev. Stat. Ann. § 355.2-702.

166

Plaintiff's Argument:

- Aventura asserted that its demand for reclamation was timely because Maloney received the goods in question on December 7, 1982, the day the goods arrived at Maloney's warehouse, which was less than ten days before Aventura made a written demand for reclamation on December 10, 1982.

167

Debtor's Arguments:

- Maloney argued that Aventura failed to make a timely demand for reclamation because Maloney received the goods in question on November 24, 1982, the day the goods were shipped F.O.B. Seattle, which was more than ten days before Aventura made a written demand for reclamation.
- In support of its assertion, Maloney stated that the contract for sale of sportswear garments by Aventura to Maloney was a shipment contract and, therefore, Aventura's delivery of the goods to the carrier was a delivery to Maloney, title passed to Maloney at the moment of tender to the carrier and loss of the shipment was thereafter at Maloney's risk. For these reasons, Maloney argued that Maloney received the goods on November 24, 1982.

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Issue:

- Whether Aventura made a timely demand for reclamation of goods pursuant to section 546(c) of the Bankruptcy Code and section 2-702 of the Uniform Commercial Code, as it appears in KRS 355.2-702.

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§ 546 (c)- The rights and powers of the trustee under sections 544(a), 545, 547, and 549 of this title are subject to any statutory right or common-law right of a seller, in the ordinary course of such seller's business, of goods to the debtor to reclaim such goods if the debtor has received such goods while insolvent, but –

(1) such a seller may not reclaim any such goods unless such seller demands in writing reclamation of such goods before ten days after receipt of such goods by the debtor; and

(2) the court may deny reclamation to a seller with such a right of reclamation that has made such a demand only if court –

(A) grants the claim of such a seller priority as an administrative expense; or

(B) secures such claim by a lien.

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(B) secures such claim by a lien.

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The Kentucky version of the Uniform Commercial Code 2-702, KRS 355.2-702—

(2) Where the seller discovers that the buyer has received goods on credit while insolvent he may reclaim the goods upon demand made within ten days after the receipt, but if misrepresentation of solvency has been made to the particular seller in writing within three months before delivery the ten day limitation does not apply. Except as provided in this subsection the seller may not base a right to reclaim goods on the buyer's fraudulent or innocent misrepresentation of solvency or of intent to pay.

(3) The seller's right to reclaim under subsection (2) is subject to the rights of a buyer in ordinary course or other good faith purchaser or lien creditor under this Article (KRS 355.2-403). Successful reclamation of goods excludes all other remedies with respect to them.

172

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As mentioned above, Congress, in enacting the Bankruptcy Reform Act of 1978 and, specifically, section 546(c) thereof, intended to incorporate the Uniform Commercial Code reclamation provision into the Bankruptcy Code. Senate Report No. 95-989, 95th Cong., 2d Sess. 86-87 (1978), expresses this intention as follows:

> The trustee's rights and powers under the strong arm clause, the successor to creditors provision, the preference section, and the postpetition transaction section *are all subject to any statutory or common-law right of a seller,* in the ordinary course of business, of goods to the debtor to reclaim the goods if the debtor received the goods on credit while insolvent. The seller must demand reclamation **[293]** within ten days after *receipt* of the goods by the debtor . . . . *The purpose of this provision is to recognize, in part, the validity of section 2-702 of the Uniform Commercial Code*, which has generated much litigation, confusion, and divergent decisions in different circuits. (emphasis added)

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Court's ruling:

- The Court noted that determination of this issue depended on the meaning of the term "receipt" for the purposes of 11 U.S.C. § 546(c) and KRS 355.2-702.
- Relying on Congress' intent that a seller's rights under 11 U.S.C. § 546(c) should be construed and interpreted within the context of the language of the reclamation provision of the Uniform Commercial Code and other Uniform Commercial Code provisions clarifying the reclamation provision, the Court determined that it was the concept of "receipt," and not the concept of "delivery," that was embodied in the Uniform Commercial Code reclamation provision and which Congress incorporated in section 546(c) of the Bankruptcy Code.

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Further evidence that "receipt" of goods by the purchaser is not effectuated until such purchaser actually takes physical possession of such goods is provided by KRS 355.2-705. Said section provides, in part, as follows:

> HN7 (1) The seller may stop delivery of goods in the possession of a carrier or other bailee when he discovers the buyer to be insolvent (KRS 355.2-702) and may stop delivery of carload, truckload, planeload or larger shipments of express or freight when the buyer repudiates or fails to make a payment due before delivery or if for any other reason the seller has a right to withhold or reclaim the goods.
>
> (2) As against such buyer the seller may stop delivery until
>
> (a) *receipt of the goods by the buyer;* or
>
> (b) acknowledgement to the buyer by any bailee of the goods *except a carrier* that the bailee holds the goods for the buyer; or
>
> (c) such acknowledgement to the buyer by a carrier by reshipment or as warehouseman; or
>
> (d) negotiation to the buyer of any negotiable document of title covering the goods. (emphasis added)

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Court's ruling:

- The Court opined that Maloney's argument, that the "F.O.B. Seattle" term contained in the contract of sale between Aventura and it meant that Maloney "received" the goods the moment they were delivered to the shipper in Seattle, would convert KRS 355.2-705 into "useless verbiage."
- Under Maloney's interpretation of the term "receipt," Maloney "received" the subject goods in Seattle. If that interpretation were correct, KRS 355.2-705(2)(a) would bar all F.O.B. shipment sellers from ever exercising their rights under this section to stop goods in transit.
- Because the seller's remedies on discovery of a buyer's insolvency, as provided in KRS 355.2-702, include a right to withhold possession of goods from a buyer which runs until the buyer receives possession of the goods and a right to reclaim goods from a buyer under which the ten-day period runs from the time the buyer receives possession of the goods, the Court concluded that a carrier under an F.O.B. shipment contract should not be construed to be a buyer's agent.

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In re Murdock Machine & Engineering Co. of Utah, 620 F.2d 767 (10th Cir. 1980), demonstrates that HN13 the terms of shipment found in a contract of sale, and the passage of title resulting thereunder, are irrelevant to an analysis of a seller's remedy to stop goods in transit or to reclaim such goods. In holding that the seller's right to stop and reclaim steel was not cut off by the intervention of a good faith purchaser from the original buyer of the steel, the Court of Appeals concluded that the F.O.B. term contained in the purchase contract was irrelevant.

> HN14 Under the Uniform Commercial Code, the seller's refusal to deliver goods in his possession to an insolvent buyer, and the seller's order to stop delivery of goods in the possession of a carrier or warehouseman, remain dual aspects of the seller's right to withhold possession of goods from an insolvent buyer. (U.C.C. § 2-702(1)). That right attaches when the buyer becomes insolvent, but *generally speaking, it is enforceable at any time until the goods have come into the buyer's actual or constructive possession.* (U.C.C. § 2-705(2)). *Who has "title" to the goods is a matter of no relevance whatsoever.* (U.C.C. § 2-401. *Id.* at 773. (emphasis added)

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The above analysis demonstrates that HN19 a carrier, under an F.O.B. shipment contract, should not be construed to be a buyer's agent. HN20 Subsection (b) of section 2-705(2) explicitly provides that a carrier can not tender acknowledgement to a buyer that the carrier holds goods for said buyer and thus cut off a seller's rights of stoppage. HN21 Subsection (c) of section 2-705(2) provides the only means whereby a carrier's acknowledgement to a buyer will serve to terminate a seller's right of stoppage: acknowledgement by reshipment or as a warehouseman. As in the above discussed case, neither condition has been satisfied in the case at bar. HN22 KRS 355.2-702 provides two remedies to a seller on discovery of a buyer's insolvency: the right to stop delivery of goods and the right to reclaim goods. HN23 A carrier under an F.O.B. shipping contract that is not the buyer's agent for the purpose of cutting off the seller's right to the first remedy surely should not be construed as the buyer's agent for the purpose of cutting off the seller's right to the second remedy.

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Court's ruling:

- The Court found that, for the purposes of 11 U.S.C. § 546(c) and KRS 355.2-702, the receipt of the goods by Maloney occurred December 7, 1982, the day the goods arrived at Maloney's warehouse and it took actual, physical possession of the goods.
- Therefore, because Aventura demanded the reclamation of the goods during the requisite ten-day period, the Court held that Aventura made a timely demand for reclamation of certain sportswear garments from Maloney.

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Conclusion:

- The date of delivery of the goods to a carrier pursuant to an F.O.B. contract, passage of title, or risk of loss does not control in determining the date of "receipt" for purposes of 11 U.S.C. § 546(c).
- For the purposes of 11 U.S.C. § 546(c), the receipt of the goods by the debtor occurs when the debtor takes actual, physical possession of the goods.
- A carrier, under an F.O.B. shipment contract, should not be construed to be a buyer's agent.

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Set-Off Defense

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Fulcrum Direct, Inc. v Associated Footware, Inc. (In re Fulcrum Direct, Inc.),

2003 Bankr. LEXIS 318, 41 Bankr. Ct. Dec. 37 (Bankr. D. Del. Apr. 14, 2003)

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Facts:

- The Debtors Fulcrum Direct, Inc. and Fulcrum West, LLC (collectively, “Fulcrum”) were leading catalogue retailers of apparel, shoes, and accessories for children, teenagers, and young women.
- The Defendant Associated Footwear, Inc. ordered merchandise from Fulcrum for resale to third parties. Footwear also manufactured merchandise for Fulcrum.
- Prepetition, Fulcrum shipped Footwear 14,883 pairs of shoes (worth $10,800), which Footwear did not want.
- Footwear asked Fulcrum for instructions to return them but also agreed to hold them, store them for a fee, and to try to sell them. Fulcrum never provided Footwear with instructions regarding disposal of the shoes.
- In addition, there were unpaid invoices between the parties.

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Facts:

- The Fulcrum Invoices represented goods sold to Footwear by Fulcrum and totaled $262,084.50. After adjustments, the parties agreed that balance owed to Fulcrum was $136,101.15.
- The Footwear Invoices for goods Footwear sold to Fulcrum totaled $175,599.80.
- According to Fulcrum, Footwear established that only $38,036.60 of the $175,599.80 in goods were actually delivered to Fulcrum. Fulcrum therefore agreed that its claim of $136,101.15 should be reduced by the $38,036.60 it owed Footwear, leaving a balance due to Fulcrum of $98,064.55.
- Finally, during the 90-day preference period, Fulcrum made three payments to Footwear totaling $60,000.
- Fulcrum sought to avoid and recover the $10,800, $ 98,064.55, and the $60,000 payments as preferential transfers.

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Defendant’s Arguments:

- Footwear asserted that the $60,000 payment was made in the ordinary course of business and pursuant to ordinary business terms and thus fell under the exception to preference payments in § 547(c)(2).
- Although Fulcrum requested that Footwear put the shoes in storage, Footwear asserted that Fulcrum’s silence and failure to take the shoes back constituted abandonment of the property.
- Finally, Footwear asserted a set-off against the $98,064.55 allegedly owed to it by Fulcrum for goods that Footwear sold but never delivered to Fulcrum.

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Debtor's Arguments:

- Fulcrum asserted entitlement to summary judgment on its claim to avoid preferential payments in the amount of $60,000 because the payments were not made according to ordinary business terms. Of the two catalogue companies, Footwear had Fulcrum on a payment plan throughout the parties two-year history. The other company was not on a payment plan.

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Issues:

- Were the three payments totaling $60,000 made in the ordinary course of business between Fulcrum and Footwear?
- Were the 14,883 pairs of shoes abandoned by Fulcrum and, thus, no longer part of its estate?
- Did Footwear have a set-off defense?

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§ 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;

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§ 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;

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HN2 The phrase "ordinary business terms" refers to "'the range of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage.'" *In re Molded Acoustical Products, Inc., 18 F.3d 217, 224 (3d Cir. 1994)*, quoting *Matter of Tolona Pizza Products Corp., 3 F.3d 1029, 1033 (7th Cir. 1993)*. "Only dealings so [unusual] as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection C." *Molded Acoustical, 18 F.3d at 224*. Where the debtor's industry is different than the creditor's industry, the court in *Sacred Heart* held, after reviewing cases from other circuits, that the focus must be on the creditor's industry. *Sacred Heart, 200 B.R. at 118-19*.

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Court's ruling:

- The Court noted that Footwear normally dealt with the retail shoe industry, not the catalogue industry. In fact, of Footwear's 200 customers, only two, one of which was Fulcrum, were catalogue companies; the rest were retail stores.
- The Court found that the relevant industry standard was the retail shoe trade, not the catalogue industry.
- The Court acknowledged that, even according to Footwear, the payment plan between Fulcrum and it was unusual in the retail shoe industry.
- Thus, because Footwear and Fulcrum's relationship was longstanding (2 years) and the record established that there was no material variation in their relationship pre- and post-filing, the Court concluded that the allegedly preferential payments were according to ordinary business terms and qualify under § 547(c)(2).
- Therefore, Fulcrum's motion for summary judgment was denied with respect to the $60,000.

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Court's ruling:

- As to the abandonment issue, the Court noted that Footwear agreed to store the goods for Fulcrum for a storage fee and that it agree to try to sell the goods on behalf of Fulcrum.
- Additionally, Footwear charged Fulcrum storage fees which the Court found to evidence that Footwear did not consider the goods abandoned by Fulcrum.
- Lastly, Footwear failed to file a motion seeking to have the goods abandoned as required by § 554.
- Therefore, the Court found that there was insufficient evidence to establish that the goods were abandoned and ordered Footwear to pay the value of the shoes back into the estate.
- Footwear was directed to remit $10,800 less storage charges of $ 1,532.00 to the bankruptcy estate, for a total of $9,268.00.

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SET-OFF

	Value of Goods Sold	Goods Sold but not delivered	Goods with no documentation	Balance owed After Adjustement between parties	Claim after Set-off	
Fulcrum invoices (Goods sold to Associated Footwear by Fulcrum)	$262084.5	-	-	$ 136,101.15	$ 98,064.55.	Fulcrum's Claim of $ 136,101.15 gets reduced by the $ 38,036.60 it owes Associated Footwear, leaving a balance due to Fulcrum of $ 98,064.55.
Footwear Invoices (Goods Associated Footwear sold to Fulcrum)	$175,599.80	$ 118,609.20	$18,954.00	$38,036.60		
Fulcrum seeks summary judgment for $ 98,064.55.						
Footwear also wants to set off against the $ 98,064.55 certain amounts allegedly owed to it by Fulcrum for goods that Footwear sold but never delivered to Fulcrum. Footwear argued that since it continued to hold these undelivered goods, Fulcrum breached the contract.						
The Court held that - Whether the creditor was entitled to offset any of that amount against its alleged damages for the Debtor's alleged breach of contract required further evidence. Therefore, entry of a judgment on that issue was deferred.						

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Associated Footwear also wants to set off against the $ 98,064.55 certain amounts allegedly owed to it by Fulcrum for goods that Associated Footwear sold but never delivered to Fulcrum. Associated Footwear continues to hold these undelivered goods and contends that Fulcrum breached the contract. As I ruled on the record on May 17, 2001, if **[20]** I were to permit a setoff against what Associated Footwear owes to Fulcrum ($ 98,064.55) with an invoice ($ 136,101.15) issued to Fulcrum for goods that were not delivered, I may be permitting Associated Footwear to "double-dip." That is, it would have the goods worth $ 136,101.15 and receive a credit for $ 98,064.55 against the non-payment of those same goods. However, Associated has not yet proven its damages, if any, and I cannot rule. Inasmuch as Associated Footwear filed a proof of claim for $ 39,498.65 and Debtor has not objected, that amount may be its allowed unsecured claim. However, I am not able to calculate the claim based on the evidence of record. Thus, I will set a status conference to discuss the issue.

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Conclusion:

- Where the debtor's industry is different than the creditor's industry, the focus is usually on the creditor's industry.
- If there is a longstanding relationship between the debtor and creditor, the objective test in the context of 11 U.S.C. § 547(c) may be one where the relationship departs so grossly from what has been established as the pertinent industry's norms that they cannot be seriously considered usual and equitable with respect to other creditors.
- Silence is insufficient to demonstrate abandonment of property.

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