Topic: abiLIVE: A Case Study on Common — and Uncommon — Defenses to Preference Action

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Disclaimer: Although this is a sanitized study of a settled case, the bankruptcy case is still active and the Plaintiff is still prosecuting preference cases. Nothing in this presentation is intended to be a commentary on the Plaintiff's ("Plaintiff") or Defendant's/Company XYZ's ("Defendant" or "XYZ") position on any adversary proceeding, whether open or closed. The presenters' commentary is solely their generalized and personal views, and any commentary that is similar to an actual case is strictly coincidental and not indicative of any future argument or position either side may take.

I. Transfers Sought in Case in Chief

During the preference period, the Debtors made transfers totaling approximately $4.6 million (the "Transfers") to XYZ. There was no disagreement between the parties that at least 4 of the 5 the elements of Plaintiff's case in chief had been met; that is, the transfers: 1) were made to or for the benefit of a creditor, 2) on antecedent debt, 3) during the preference period, and 4) while the Debtors were insolvent. The final element, whether XYZ received more than it would have in a chapter 7 liquidation had the transfers not been paid, is subject to some of the more nuanced defenses discussed below.

II. New Value

Definition: The net preference may be reduced by the "subsequent new value" defense. This defense applies when a defendant provided new value to the Debtors: (i) not secured by an otherwise unavoidable security interest; and (ii) on account of which new value the Debtors did not make an otherwise unavoidable transfer to or for the benefit of the Defendant. 11 U.S.C. § 547(c)(4).

XYZ's Position:

a. XYZ's maximum potential exposure after applying all paid and unpaid new value, but not taking into account the disagreement as to whether section 503(b)(9) and critical vendor new value should be counted (discussed herein), is approximately $637,000.

Plaintiff's Position:

b. As will be discussed in further detail below, Plaintiff's position is that not all new value unpaid *as of the petition date* qualifies for the subsequent new value defense. The net of new value amount when pre-petition invoices paid post-petition (section 503(b)(9) and/or critical vendor) are denied new value credit is approximately $2.4 million. Plaintiff agrees that, were all invoices that were unpaid as of the petition date allowed new value, the net of new value would be approximately $637,000.

III. Subjective OCB Defense

Definition: Transfers are also protected from avoidance to the extent they were incurred and made in the ordinary course of business of the debtors and the defendant. Courts examine a variety of factors when determining whether preference period payments are subjectively ordinary between the parties, including:

(1) the length of time the parties were engaged in the transaction at issue;
(2) whether the amount or form of tender differed from past practices;
(3) whether the debtor or creditor engaged in any unusual collection or payment activity; and
(4) the circumstances under which the payment was made.

Compton v. Plains Marketing, LP (In re Tri-Union Dev. Corp.), 349 B.R. 145, 150 (Bankr. S.D. Tex. 2006); *Burtch v. Prudential Relocation, Inc. (In re AE Liquidation, Inc.)*, 2013 WL 3778141 (Bankr. D. Del. July 17, 2013); *Schick v. Herskowitz (In re Schick)*, 234 B.R. 337 (Bankr. S.D.N.Y. 1999).

XYZ's Position:

a. While the analyses presented here are based on Days-to-Pay, as different terms applied during the pre-preference period, a days late or arrears analysis is also appropriate. *See Montgomery Ward, LLC v. OTC Int'l, Ltd. (In re Montgomery Ward, LLC),* 348 B.R. 662, 676 (Bankr. D. Del. 2006); *Official Committee of Unsecured Creditors of Gregg Appliances, Inc. v. D&H Distributing Company (In re HHGregg, Inc., et al.),* Adv. Pro. No. 17-50282 (Bankr. S.D. IN. Jan 13, 2022) [ECF No. 75].

b. XYZ's exposure after applying the subjective ordinary course of business defense (the "Subjective OCB Defense") and subsequent new value defense is $0.00.

    i. The applicable ranges for each of the analyses are as follows: (i) High/Low OCB Range: 7 to 245 Days-to-Pay, (ii) 90% Range: 17 to 50 Days-to-Pay, and (iii) Standard Deviation Range: 11 to 49 Days-to-Pay.

c. XYZ and the Plaintiff disagree as to whether certain invoices issued during the preference period aggregating approximately $1.82 million (the "Disputed New Value Invoices") may be applied to reduce XYZ's preference exposure on the grounds that such invoices were paid in connection with the CV Agreement (defined herein) and/or are also entitled to section 503(b)(9) treatment.

    i. While XYZ maintains that all of the Disputed New Value Invoices should be applied in full, even if just 50% of such Disputed New Value Invoices (aggregating approximately $909,000) are applied for settlement purposes only, XYZ's exposure is still $0.00.

d. XYZ always offered the Debtors a single bifurcated set of payment terms that included a discount component.

    i. XYZ should not be penalized for, and lose the benefit of the Subjective OCB Defense, for accepting: (i) earlier payments based on the parties' agreed upon discount (net 15 days), and (ii) later payments where the discount was not taken (net 45 days), as the Debtors always had the option to choose whether they wanted to pay earlier and take the agreed upon discount, or pay later and not take the agreed upon discount.

    ii. Accordingly, all payments at issue were made according to the parties' bifurcated terms and were an accommodation to the Debtors as XYZ's exposure actually doubled as the Debtors unilaterally shifted from paying early and taking the discount to paying later and not taking the discount. *See In re Montgomery Ward, LLC,* 348 B.R. 662 (Bankr. D. Del. 2006)*; In re HHGregg, Inc., et al.),* Adv. Pro. No. 17-50282 (Bankr. S.D. IN. Jan 13, 2022) [ECF No. 75].

e. Approximately one month prior to the Petition Date, the parties changed terms. 232 invoices aggregating a total of approximately $1.76 million were paid following the change in terms during the preference period.[1]

    1. Of those 232 invoices, 175 invoices aggregating a total approximately $1.373 million were paid on account of, and consistent with the timing of, payments on account of the old terms where the Debtors did not take the discount and the subjective ordinary course defense should apply, whereas just 57 invoices aggregating a total approximately $391,000 (approximately 22% of payments following the terms change) were paid faster, consistent with the changed terms.

[1] There was a change in terms during preference period, approximately one month prior to the Petition Date, but the new terms still included a discount option so the analysis remains the same.

2. Without conceding the inapplicability of the Subjective OCB Defense to these payments, the preference risk on them would be reduced to zero after deducting new value and giving credit to some risk on account of the new value that was paid pursuant to the CV Agreement, the critical vendor defense and XYZ's recoupment and/or setoff rights with respect to the approximate $272,000 credit owing by XYZ to the Debtors.

Plaintiff Position:

a. The Plaintiff argues that the subjective ordinary course of business defense was not available for two reasons.

ii. First, the Plaintiff asserts here that a "truncation" of the historical period is appropriate. Truncation is a method employed by some courts to eliminate a historical time period when the debtor is in distress, so that the payments during periods of financial stress do not "distort" what was ordinary between the parties.

iii. Here, the invoice terms of the parties prior to ~1 month before the petition date were 2%15, net45, which changed to 2%20, net21 approximately 1 month prior to the petition date (during the Preference Period). Additionally, while the parties' payment terms historically were 2%15, Net 45, the Debtors' records show that for the overwhelming majority of the parties' historical relationship (nearly 67% of all historical transactions), the Debtors made payments between 16–20 days. However, as the Debtors neared the Preference Period, specifically starting around 4 months before, and its financial condition began to rapidly deteriorate, the Debtors' payment timing dramatically shifted to 45-52 days. Not only was this payment timing not reflective of the ordinary course between the parties, but furthermore the result of the financial distress experienced by the Debtors. **When the period of 4-6 months prior to the petition date through the start of the Preference Period is excluded from the historical baseline, none of the Preference Period payments are made within the same timing as the historical payments.**

iv. Second, the Plaintiff asserts that collection activity during the Preference Period bars XYZ from asserting this defense. Without getting too into specifics, Plaintiff asserts that there were frequent inquiries into the financial health of the Debtors during the Preference Period that ultimately resulted in the change in terms. These included emails requesting a financial meeting, phone calls regarding c-suite departures, and frequent requests for payment status. These activities started at the beginning of the Preference Period and continued through the end, when XYZ successfully got payments sped back up based on

reduced terms. Based on these activities, Plaintiff asserted there was no subjective OCB credit available to Defendant.

IV. Objective OCB Defense

Definition: The objective OCB defense is concerned with the relationship between similarly situated parties in the industry as a whole. *See, e.g. Gulf City Seafoods, Inc. v. Ludwig Shrimp Co. (In re Gulf City Seafoods)*, 296 F.3d 393, 369 (5th Cir. 2002). "As to what constitutes the relevant industry, Gulf City held that the term ordinarily encompasses 'suppliers to whom [the debtor] might reasonably turn for [similar supplies] and firms with whom [the debtor] competes for customers.' *" In re SGSM Acquisition Co., LLC*, 439 F.3d 233, 239 (5th Cir. 2006) (quoting *Gulf City* at 369).

The parties agreed as to the appropriate NAICS (North American Industry Classification System) code for XYZ. The NAICS code is the standard used by Federal statistical agencies in classifying business establishments for the purpose of collecting, analyzing, and publishing statistical data related to the U.S. business economy. For purposes of the objective OCB defense, using an NAICS code ensures that the parties are properly comparing the debtor and defendant to similarly situated businesses.

XYZ's Position:

a. Invoices were paid between 22 and 112 days-to-pay ("Days-to-Pay") during the preference period.

b. Based on the Risk Management Association ("RMA") report (the "RMA Report") covering 4/1/2019 to 3/31/2020 (the "Complete RMA Period"), which covers 151 reporting companies, XYZ calculated the following ordinary course of business ranges and the below exposures based solely on the objective ordinary course of business defense (the "Objective OCB Defense"):

	Objective OCB Range	Exposure Applying Objective OCB Defense Only
Total Range	0 – 212	$0.00
90% Total Range	19 – 72	$21,333.37
Standard Deviation	20 – 64	$67,847.09

i. XYZ also purchased from RMA all of the underlying company data for the Complete RMA Period (the "Purchased RMA Data") as the publically available RMA data only covers the middle 50% of the transactions of the reporting companies, which, based on relevant case law, is insufficient to analyze and/or

satisfy the Objective OCB Defense. *See In re Waterford Wedgwood, USA, Inc.,* 508 B.R. 821 (Bankr. S.D.N.Y. 2014); *In re Hayes Lemmerz Intern., Inc.,* 339 B.R. 97 (Bankr. D. Del. 2006).

ii. XYZ's own internal data further supports the satisfaction of the Objective OCB Defense, as the percentage of XYZ's customers that paid invoices within the above referenced ranges during the preference period was well above the percentages accepted by the Sixth and Eighth Circuits as indicative of the Objective OCB Defense. *See In re Carled, Inc.,* 91 F.3d 811 (6th Cir. 1996); *In re USA Inns of Eureka Springs Arkansas Inc.,* 9 F. 3d 680 (8th Cir. 1993).

c. Each of these calculated exposures is reduced to zero after applying new value and giving credit to some risk on account of the new value that was paid pursuant to the CV Agreement (defined herein), the critical vendor defense and XYZ's recoupment and/or setoff rights with respect to the approximate $272,000 credit owing by XYZ to the Debtors.

Plaintiff Position:

a. The parties did not disagree on the NAICS code or the use of the RMA data but did disagree on the appropriate RMA range to use for Defendant. Plaintiff was willing to concede a range of 30-47 days from invoice date to payment date. The interquartile days for all sales/asset sizes in the industry is 30-46 days, while the industry range for companies with $25 million+ sales is 30-47 days. As XYZ is likely a larger player in the industry, Plaintiff gives an extra day in this range.

b. Plaintiff understands that it is Defendant's position that a broader range applies, either by performing a standard deviation of the underlying data or providing a certain percentage of the total range based on reviewing that underlying data. Plaintiff rejects these calculations as impermissibly skewing what is ordinary in the industry such that the defense becomes so wide as to be meaningless. Additionally, Plaintiff is dubious that terms in the industry regularly stretched over 47 days, given the renegotiated terms in the preference period and phone calls when payments stretched into that range.

c. After applying the industry OCB defense range of 30-47 days and then applying qualifying new value credit for invoices that were not paid pursuant to the CV Agreement, Plaintiff asserts the minimum net preference amount in this case is approximately $1.69 million.

V. Additional Defenses and Other Relevant Facts

a. **Unpaid Administrative Claim and the Effect on the Preference Case:** XYZ has an allowed, but unpaid, post-petition administrative claim in the amount of approximately $740k.

b. **Rebate owed to Debtors:** An approximate $270,000 rebate (the "Rebate") is available to XYZ for recoupment and/or setoff against any preference liability.

   i. Defendant asserts that, should it have preference liability under sections 547(b) and 550, it is entitled to file a claim for any settlement payment under section 502(h). This section provides that any claim for the recovery of property under section 550 shall be determined as if the claim had arisen before the petition date. On this basis, Defendant asserts that it is not required to return the Rebates, and may instead exercise setoff or recoupment to apply the Rebates against any general unsecured claim filed pursuant to section 502(h).

Plaintiff's Position on effect of the Rebate on the Preference Case:

a. Even if recoupment is available to apply all Rebate amounts against a 502(h) GUC claim, it is not appropriate to do so in a preference situation.

   i. This is because the vast majority of cases discussing setoff or recoupment defenses with preferences find that defendants are not allowed to assert the same. *See Shaw v. Walter E. Heller & Co*., 385 F.2d 353 (5th Cir. 1967) (overturning decision by district court holding that creditor was not liable for preference because it could offset amounts owed to it by debtor against the amount sought to be recovered against it); *Prunty v. Terry, Jr. (In re Paschall)*, Bankr. No. 07-32048, 2011 WL 5553483, *7 (Bankr. E.D. Va. 2011) ("[T]he sole asset of the estate is the value of the avoided transfer. Should the Court allow Prunty to offset any claims that she may have against the value of the avoided transfer, this would continue the effect of the preference by allowing Prunty to receive the full amount of these additional claims at the direct expense of other creditors."); *Raleigh v. Mid American National Bank and Trust Company (In re Stoecker)*, 131 B.R. 979, 984 (Bankr. N.D. Ill. 1991) ("One court has held that setoff is not a proper defense to a preference action because its application would defeat the nature of a preference action to achieve equitable distribution of the bankruptcy estate.

   ii. The reason for this rule is that "allowing the creditor to set off the amounts owed by the debtor against the preferential payments received would merely continue the preference and render the preference statute useless, because the preferences would not become available for pro rata distribution to all creditors." *In re JSL Chemical Corp.*, 424 B.R. 573, 583 (Bankr. S.D. Fla.

2010) (citing 4 Collier on Bankruptcy, ¶ 553.09, at 553–49–50 (15th Ed. 1990)). On an equitable basis, it makes no sense that a defendant would be prohibited near-universally from exercising recoupment or setoff during the preference litigation, but would be allowed to keep funds owed the Debtors via recoupment after the preference concluded. This elevates an unsecured creditor to a secured one, and favors Defendant at the expense of other similarly situated unsecured parties.

b. **Critical Vendor Agreement:** Defendant was paid approximately $1.9 million in pre-petition invoices post-petition pursuant to the Critical Vendor/503(b)(9) Order

XYZ's Position on the effect of the CV Agreement on the Preference Case:

a. XYZ is entitled to additional defenses as a critical vendor and related entry into a critical vendor agreement with the Debtors (the "CV Agreement").

   i. Pursuant to the CV Agreement, the Debtors agreed to pay XYZ's pre-petition claim in full in exchange for XYZ's agreement to extend post-petition credit.

   ii. This arrangement, consistent with the facts before the Bankruptcy Court for the District of Delaware in *AFA Investment Inc. v. Trade Source Inc.,* 538 B.R. 237, 243 (Bankr. D. Del. 2015), satisfies the critical vendor preference defense because XYZ was in fact paid in full, and XYZ also, in fact, did extend credit post-petition to the Debtors as evidenced by XYZ's material post-petition administrative claim.

   iii. In addition, like in *AFA,* the *Final Order Authorizing (I) Debtors to Pay Prepetition Critical Vendor Claims and 503(b)(9) Claims in the Ordinary Course of Business, (II) Debtors to Return Goods, and (III) Financial Institutions to Honor and Process Related Checks and Transfers* [ECF No. 121] makes no reference to preference claims or the ability of XYZ to assert its status as a critical vendor as a defense to a future preference claim.

   iv. XYZ believes the total amount the Debtors paid XYZ under the Critical Vendor Agreement, plus the anticipated preference amount, is *de minimis* in comparison to the total amount the Debtors were authorized and paid to critical vendors and 503(b)(9) claimants.

   v. Furthermore, it is clear that the parties intended that XYZ's entire a prepetition claim would be paid in connection with the CV Agreement. Accordingly, XYZ did not receive more than it would in a hypothetical Chapter 7 liquidation. *See In re AFA Investment Inc.,* 538 B.R. 237, 244 (Bankr. D. Del. 2015) (section 547(b)(5) of the Bankruptcy Code is not satisfied where preference payment

was a "mere fraction" of the critical vendor cap and it was unlikely the inclusion of the alleged preference payment would have drawn an objection or result in the Court's refusal to enter the critical vendor order).

1. Significantly, each of the opinions that have considered the critical vendor defense to an alleged preference did not proceed to trial, but were rather decided in connection with both dispositive and non-dispositive motions. *In re Insys Therapeutics, Inc.,* 2021 WL 3083325 (Bankr. D. Del. Jul. 21, 2021) (motion to dismiss); *In re AFA Investment Inc.,* 538 B.R. at 239, 246 (motion for summary judgment); *In re Zenith Industrial Corp.,* 319 B.R. 810 (Bankr. D. Del. 2005) (motion to strike); *HLI Creditor Trust v. Export Corp., (In re Hayes Lemmerz International, Inc.),* 313 B.R. 189 (Bankr. D. Del. 2004) (motion to dismiss).

Plaintiff's Position on the effect of the CV Agreement on the preference case:

a. Plaintiff, not surprisingly, disagrees that these payments bar a preference action.

i. Defendant cites *AFA Inv. Inc.*, 538 B.R. 237, 244 (Bankr. D. Del. 2015) in support for the position that had it not been paid the nearly $4.7 million in Preference Period Transfers, it would have simply been paid them along with the $1.9 million it received post-petition pursuant to the CV Agreement. However, this is impermissible speculation into what could have happened had XYZ been owed money and is insufficient to defeat Plaintiff's case.

ii. AFA is one of the few minority cases finding a critical vendor was shielded by its post-petition payments. The mere fact that a vendor is a critical vendor, without an explicit preference waiver, does not defeat a 547 case. In *In re Hayes Lemmerz International, Inc.*, 313 B.R. 189 (Bankr. D. Del. 2004), the Delaware Bankruptcy Court expressly rejected that recovery of preferential payments is barred by the entry of a critical vendor order. The order in question authorized, but did not require, the payment of prepetition claims, and neither the motion nor the order included a waiver of the right to recover preferential transfers.

iii. The *Hayes* decision is just one of several cases rejecting the argument that an order authorizing (but not requiring) payment of prepetition debts precludes recovery of preferential transfers. *See also In re Maxus Energy Corp., et al.*, 615 B.R. 62, 73 (Bankr. D. Del. 2020) (denied motion to dismiss as genuine fact issue as to whether defendant paid under critical vendor order would have been paid full amount of transfers in a chapter 7 liquidation); *Devices Liquidation Trust v. KMT Wireless, LLC (In re Personal Commc'n Devices, LLC*), 588 B.R. 661 (Bankr. E.D.N.Y. 2018) ("This Court rejects KMT's theory of hindsight extrapolation, of trying to consider and then make findings of fact

on what it might have approved at the initial stages of this case if a request would have been made to waive a nearly $4,000,000 claim in addition to paying nearly $1,000,000 on pre-petition claims."); *Gonzales v. Sun Life Ins. Co. (In re Furr Supermarkets, Inc.*), 485 B.R. 672, 706 (Bankr. Ct. D.N.M. 2012) (finding reasoning in Hays persuasive and adopting the same); *In re Phoenix Rest. Grp., Inc.*, 373 B.R. 541 (M.D. Tenn. 2007) (concluding bankruptcy court did not err in determining the preference action against defendant was not waived on basis of defendant being designated as a critical vendor); *Pelz v. Hartford Life Ins. Co. (In re Bridge Info. Sys., Inc.)*, 321 B.R. 247, 253 (Bankr. E.D. Mo. 2005) (finding benefits order that authorized, but did not mandate, payments did not protect defendant from preference action); *Zenith Indus. Corp. v Longwood Elastomers, Inc. (In re Zenith Indus. Corp.)*, 319 B.R. 810 (Bankr. D. Del. 2005) (PJW) (denying motion to dismiss of critical vendor defendant and distinguishing these vendors from assumed contracts on the basis that critical vendor payments are wholly discretionary).

2014 WL 1569284
United States Bankruptcy Court, S.D. New York.

In re Waterford Wedgwood USA, Inc., et al.
Debtors.
John S. Pereira, as Chapter 7 Trustee for Waterford Wedgwood USA, Inc., Plaintiff,
v.
United Parcel Service of America, Inc. a/k/a UPS, UPS Freight, UPS Supply Chain Solutions (Georgia), UPS–Consolidated and UPS–Philly, Defendant(s).
John S. Pereira, as Chapter 7 Trustee for Royal Doulton USA, Inc., Plaintiff,
v.
United Parcel Service of America, Inc. a/k/a UPS, UPS Freight, UPS Supply Chain Solutions (Georgia), UPS–Consolidated and UPS–Philly, Defendant(s).

Case No. 09–12512 (SHL) (Jointly Administered) | Adv. No. 11–01820 (SHL), Adv. No. 11–02177(SHL) | Signed April 17, 2014

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Opinion

Chapter 7

POST–TRIAL MEMORANDUM OF DECISION

SEAN H. LANE UNITED STATES BANKRUPTCY JUDGE

Before the Court are two adversary proceedings brought by the Chapter 7 Trustee (the "Plaintiff" or the "Trustee") of Waterford Wedgwood USA, Inc. ("Waterford") and Royal Doulton USA, Inc. ("Doulton" and, together with Waterford, the "Debtors") against United Parcel Service of America Inc., UPS Freight, UPS Professional Services, UPS Supply Chain Solutions (Georgia), UPS–Consolidated, and UPS–Philly (collectively, "UPS" or the "Defendants"). Pursuant to Section 547 of the Bankruptcy Code, the Trustee seeks to recover alleged preferential transfers made to UPS in the amount of $897,546.85 by Waterford and $81,828.22 by Daulton within 90 days of the filing of this bankruptcy case. The Trustee also requests prejudgment interest. UPS does not dispute that the transfers were preferences but asserts that they were made in the ordinary course of business and under ordinary business terms as contemplated by Sections 547(c)(2)(A) and 547(c)(2)(B) of the Bankruptcy Code, respectively. Based on the evidence presented at trial,[1] the Court finds that some–but not all– of the transfers were made according to ordinary business terms under Section 547(c)(2)(B). The Court reserves its decision on whether any transfers were made in the ordinary course of business until the parties ascertain whether such a determination is necessary.[2]

BACKGROUND

The parties have stipulated to the relevant facts regarding the Debtors, the bankruptcy case, and the parties' business relationship. Waterford and Doulton were wholly owned indirect subsidiaries of Waterford Wedgwood PLC ("PLC"), an Irish company. *See* Joint Pretrial Orders, Section III, ¶ 1. The Debtors were in the business of importing, distributing and selling china, crystal and other consumer goods that were manufactured by PLC and its affiliates. *See id.* at Section III, ¶ 2. In connection with this business, the Debtors purchased and obtained shipping and related services from UPS. *See id.* at Section III, ¶ 3. Upon providing services to the Debtors, the Defendants would issue an invoice. *See id.* at Section III, ¶ 4. The Debtors would pay UPS by check. *See id.*

On January 5, 2009, PLC was placed in receivership in Ireland and certain of its subsidiaries and affiliates were placed in administration in the United Kingdom. *See* Daulton Joint Pretrial Order at Section III, ¶ 10; Waterford Joint Pretrial Order at Section III, ¶ 7. On February 27, 2009, the receiver and the joint administrators in the foreign proceedings entered into a Share and Business Sale Agreement (the "Global Sale

Agreement") with KPS Capital Partners LLP ("KPS"). *See* Daulton Joint Pretrial Order at Section III, ¶ 11; Waterford Joint Pretrial Order at Section III, ¶ 8. The Global Sale Agreement provided for, among other things, the sale of substantially all of the Debtors' assets to KPS or its designee. *See* Daulton Joint Pretrial Order at Section III, ¶ 12; Waterford Joint Pretrial Order at Section III, ¶ 9. On March 26, 2009, the Debtors sold substantially all of their assets to WWRD LLC (an affiliate of KPS) and ceased doing business. *See* Daulton Joint Pretrial Order at Section III, ¶ 13; Waterford Joint Pretrial Order at Section III, ¶ 10. On April 23, 2009 (the "Petition Date"), the Debtors filed voluntary petitions for relief with this Court pursuant to Chapter 7 of the Bankruptcy Code. *See* Daulton Joint Pretrial Order at Section III, ¶ 14; Waterford Joint Pretrial Order at Section III, ¶ 11.

The Trustee filed the Waterford adversary proceeding on April 20, 2011 and the Daulton adversary proceeding on May 24, 2011. Both seek the return of money paid by the Debtors during the statutory preference period. Transfers from the Debtors to the Defendants on or after January 23, 2009 through the Petition Date are covered by the 90 day time period set forth in Section 547(b)(4)(A) of the Bankruptcy Code (the "Preference Period"). Trial in these cases took place on March 19, 2013. *See* Transcript of Trial (Waterford Adversary ECF No. 30; Daulton Adversary ECF No. 24). The parties completed their post-trial briefing on May 16, 2013.

DISCUSSION

A. *Preferential Transfers and Defenses*

To be avoidable as a preferential transfer, a payment must satisfy each of the requirements of Section 547(b) of the Bankruptcy Code. The Trustee bears the burden of proving the transfers were:

> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such Transfers were made;
>
> (3) made while the debtor was insolvent;
>
> (4) on or within ninety (90) days before the date of filing of the petition; and
>
> (5) enable the benefited creditor to receive more than such creditor would have received had the case been a chapter 7 liquidation and the creditor not received the transfer.

11 U.S.C. § 547(b). UPS does not challenge the Trustee with respect to these elements, and the Court finds that the Trustee has made the necessary *prima facie* case under Section 547(b) that the payments were preferential transfers.[3]

UPS instead contends that the payments fall under the two exceptions contained in Section 547(c)(2) of the Bankruptcy Code. Section 547(c)(2), as amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), provides that:

> (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.

11 U.S.C. § 547(c)(2).

Section 547(c)(2) is meant to protect "recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor's transferee." *Official Comm. Of Unsecured Creditors of Enron Corp. v. Martin (In re Enron Creditors Recovery Corp.),* 376 B.R. 442, 459 (Bankr.S.D.N.Y.2007) (quoting *Sender v. Heggland Family Trust (In re Hedged–Investments Assocs.),* 48 F.3d 470, 475 (10th Cir.1995)). The purpose of the exception is to "leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or [its] creditors during the debtor's slide into bankruptcy." *Lawson v. Ford Motor Co. (In re Roblin Indus., Inc.),* 78 F.3d 30, 41 (2d Cir.1996) (quoting H.R.Rep. No. 95–595 (1978) at 373, reprinted in 1978 U.S.C.C.A.N. 6329).

Prior to 2005, Section 547(c)(2) required a creditor to prove that the transfer was made both in the ordinary course of the debtor's business under Section 547(c)(2)(A) and according to ordinary business terms under Section 547(c)(2)(B). The BAPCPA amendments made the test disjunctive, allowing a defendant to prevail by proving either the so called "subjective" test under Section 547(c)(2)(A), or the so called "objective" test under Section 547(c)(2)(B). *See Jacobs v. Gramercy Jewelry Mfg. Corp. (In re M. Fabrikant & Sons, Inc.),*

2010 WL 4622449, at *2 (Bankr.S.D.N.Y. Nov. 4, 2010). As the wording of the subsections was not changed by BAPCPA in 2005, the case law prior to BAPCPA's enactment as to the requirements of each subsection remains good law. *See id.* at *2 (citations omitted).

A creditor bears the burden of proving the defenses by a preponderance of the evidence. *Id.* at 39 (citations omitted); 11 U.S.C. § 547(g). UPS has invoked both subsections of Section 547(c)(2) by submitting evidence to support its argument that the transfers were "made in the ordinary course of business or financial affairs of the debtor and the transferee" and were "made according to ordinary business terms." *See* 11 U.S.C. § 547(c)(2). While the Court reserves decision today on whether any transfers were made in the ordinary course of business under Subsection (A), it is necessary to discuss both defenses in order to understand and evaluate the arguments made by the parties on the ordinary business terms defense under Subsection (B).

Subsection (A) is a "subjective element that requires an examination of whether a transfer was ordinary between the parties to the transfer." *Daly v. Radulesco (In re Carrozzella & Richardson),* 247 B.R. 595, 603 (B.A.P.2d Cir.2000) (citations omitted); *see also In re Enron Creditors Recovery Corp.,* 376 B.R. at 459 (stating that the subjective test focuses solely on the prior dealings of debtor and creditor). In determining whether a transfer satisfies the requirements of Section 547(c)(2)(A), courts examine several factors including "(i) the prior course of dealing between the parties, (ii) the amount of the payment, (iii) the timing of the payment, (iv) the circumstances of the payment, (v) the presence of unusual debt collection practices, and (vi) changes in the means of payment." *Buchwald Capital Advisors LLC v. MetlSpan I., Ltd. (In re Pameco Corp.),* 356 B.R. 327, 340 (Bankr.S.D.N.Y.2006); *see also Official Comm. of Unsecured Creditors of 360networks (USA) Inc. v. U.S. Relocation Servs. (In re 360networks (USA) Inc.),* 338 B.R. 194, 210 (Bankr.S.D.N.Y.2005); *Hassett v. Goetzmann (In re CIS Corp.),* 195 B.R. 251, 258 (Bankr.S.D.N.Y.1996).

The creditor must establish a "baseline of dealings" between the parties in order to "enable the court to compare the payment practices during the preference period with the prior course of dealing." *In re M. Fabrikant & Sons, Inc.,* 2010 WL 4622449, at *3 (citations omitted); *see also Cassirer v. Herskowitz (In re Schick),* 234 B.R. 337, 348 (Bankr.S.D.N.Y. 1999). The creditor must "demonstrate some consistency with other business transactions between the debtor and the creditor." *In re M. Fabrikant & Sons, Inc.,* 2010 WL 4622449, at *3 (citations omitted). "The starting point–and often ending point–involves consideration of the average time of payment after the issuance of the invoice during the pre-preference and post-preference periods, the so-called 'average lateness' computation theory." *Id.* While a late payment is usually nonordinary, the defendant can rebut this presumption if late payments were the standard course of dealing between the parties. *See id.* (quoting 5 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 504.04[2][ii], at 547–55 (16th ed.2010)). "To determine whether a late payment may still be considered ordinary between the parties, a court will normally compare the degree of lateness of each of the alleged preferences with the pattern of payments before the preference period to see if the alleged preferences fall within that pattern." 5 COLLIER ON BANKRUPTCY ¶ 504.04[2][ii], at 547–55. Generally, this involves a comparison of the average number of days between the invoice and payment dates during the pre-preference and preference periods. *See In re M. Fabrikant & Sons, Inc.,* 2010 WL 4622449, at *3; *see also Hassett v. Altai, Inc. (In re CIS Corp.),* 214 B.R. 108, 120 (Bankr.S.D.N.Y.1997).

Subsection (B) is an objective test which "looks not to the specifics of the transaction between the debtor and the particular creditor, but rather focuses on general practices in the industry, in particular the industry of the creditor." *Abovenet, Inc. v. Lucent Technologies, Inc. (In re Metromedia Fiber Network, Inc.),* 2005 WL 3789133, *5 (Bankr.S.D.N.Y. Dec. 20, 2005). It is well established that the creditor's industry is the measure for ordinariness under this subsection. *See, e.g., Matter of Midway Airlines,* 69 F.3d 792, 797 (7th Cir.2004); *Sigmon v. Butner (In re Johnson Bros. Trucker, Inc.),* 2001 WL 520649 *4 (4th Cir. May 15, 2001); *Sass v.* Vector Consulting, Inc. (In re Am. Home Mortgage Holdings, Inc.), 476 B.R. 124, 140–41 (Bankr.D.Del.2012); Hechinger Liquidation Trust v. James Austin Co. (In re Hechinger Inv. Co. of Delaware, Inc.), 320 B.R. 541, 550 (Bankr.D.Del.2004).

In *In re Roblin Indus., Inc.,* the Second Circuit held that " 'ordinary business terms' refers to the general practices of similar industry members and that 'only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection C.' " *Roblin,* 78 F.3d at 39–40 (quoting *In re Tolona Pizza Products Corp.,* 3 F.3d 1029, 1033 (7th Cir.1993). "Under this standard, a creditor must show that the business terms of the transaction in question were 'within the outer limits of normal industry practices....' " *Id.; see also In re Carled,* 91 F.3d 811, 818 (6th Cir.1996) (holding that late payments are made according to

ordinary business terms so long as they are not "aberrational, unusual or idiosyncratic" for creditors in the defendant's industry). The "statutory language should not be construed to place businessmen in a straitjacket." *In re Gulf City Seafoods,* 296 F.3d 363, 368 (5th Cir.2002). "Some latitude exists under the objective prong, as the courts should not impose a single norm for credit transactions within the industry; the inquiry is whether 'a particular arrangement is so out of line with what others do' that it cannot be said to have been made in the ordinary course." *G.G. Leidenheimer Baking Co., Ltd. v. Sharp (Matter of SGSM Acquisition Co.),* 439 F.3d 233, 239 (5th Cir.2006) (citing *In re Gulf City Seafoods,* 296 F.3d at 369).

B. *Ordinary Business Terms (Objective Test)*

1. Evidence Presented by the Defendant

To demonstrate that the payments from the Debtors to UPS were similar to those in the industry, UPS provided evidence of payments and invoice records between itself and the Debtors. *See* Joint Exhibits A, B, C, D, and E and Defendants' Exhibit C. The amount and timing of those payments are not in dispute. The only other evidence presented at trial was the testimony of Thomas Salutric, an employee of UPS. Mr. Salutric is a corporate credit manager at UPS and has worked in billing, credit management, credit approval, and credit risk analysis for more than 25 years. *See* Defendants' Exhibit B. Mr. Salutric is also an active member of the Credit Research Foundation and the National Association of Credit Managers. *See id.*

Mr. Salutric testified, among other things, about the contract between the Debtors and UPS, its terms, and how and when the payments in question were made. *See* Trial Tr. 82:15–83:7. Mr. Salutric's testimony focused on the time customers took to pay UPS compared to other similarly situated shipping companies. He testified that the Defendants followed normal industry practice during the period Defendants provided shipping services to the Debtors. Mr. Salutric noted that UPS is the largest player in the domestic shipping market with approximately half of the domestic market share, and that it is not uncommon in the industry to allow some flexibility in paying invoices. *See id.* at 70:23–25; 71:1–6; 74:6–75:6; 89:16–90:13. While UPS's stated invoice terms are 32 days, Mr. Salutric testified that because of the economic downturn in late 2008, many of UPS's larger customers began to request some latitude in the time to pay invoices. *See id.* at 74:16–25; 75:1–6; 85:7; 86:6–10. Customers of other transportation companies did the same. *See id.* at 75:1–6. On average, during the time the Debtors conducted business with the Defendants, the Debtors paid their invoices later than their stated terms: approximately 51 days[4] during the Preference Period and 56 days during the historical period. *See* Defendants' Exhibits A and C.

Mr. Salutric's analysis of industry practices relied heavily upon data collected from the Credit Risk Monitor database ("CRMZ"), which monitors the average number of days for a company to receive revenue after a sale has been made. *See* Defendants' Exhibit A; Trial Tr. 79:16–25. Mr. Salutric used the information in the CRMZ database to compile a list of forty businesses in the domestic shipping industry, including UPS, FedEx Corporation, and Ryder System, Inc., and to calculate the average number of days that these companies received payment after a sale in 2008 and 2009. *See* Defendants' Exhibit A. He then ranked those businesses according to the average days sales outstanding ("DSO")[5] for the year. *See id.* Mr. Salutric testified that he relied upon 90% of the data, removing the top and bottom five percent in his analysis as outliers and concluded that the normal industry pay range in 2008 was from 14 to 70 days and from 16 to 72 days in 2009. Defendants' Exhibit A; Trial Tr. 99:6–16.

According to the Defendants' CRMZ database chart, UPS received payments from all of its customers in 2009 on average 44 days after sale while industry competitors, FedEx and Ryder, received payments on average in 40 and 45 days respectively. *See* Defendants' Exhibit A. In 2008, UPS received payments on average within 45 days and FedEx and Ryder received payments on average in 41 and 46 days respectively. *See id.* Mr. Salutric concluded that UPS's average days to payment during 2008 and 2009 aligned with industry practice. Mr. Salutric further concluded that during the period UPS and the Debtors conducted business, UPS's pay range was between 16 and 88 days, which he found to be a reasonable deviation from industry norm considering market conditions and the size of the Debtors. *See* Trial Tr. 102:15–104:16.

2. The Trustee's Arguments

The Trustee did not present any witnesses at trial, choosing only to engage in limited cross examination of Mr. Salutric. Trustee's counsel asked limited questions about the use of the CRMZ database and did not identify any alternative source of information about the payment practices in the domestic shipping industry. The Trustee instead focused on the proper scope of the ordinary business terms defense and criticism of Mr. Salutric's methodology. The Trustee's arguments fall generally into four categories, which the Court will address separately.

The Trustee first argues that the relationship between the

Debtors and UPS was not conducted in accordance with ordinary business terms because there were fluctuations in the parties' payment history over time. To illustrate this point, the Trustee divided the history of payments between UPS and the Debtors into three periods: 1) November 24, 2007 to September 30, 2008, which was more than six months before the bankruptcy filing; 2) October 2, 2008 to February 28, 2009, which was over one month into the 90 day Preference Period; and 3) March 1, 2009 to April 7, 2009, which includes some 38 days of the 90 day Preference Period. *See* Plaintiff's Exhibits 1, 2, and 3. The purported purpose of this analysis was to contrast the payment times during the first and third periods with the payment times during the second period.[6] The Trustee contends this disparity is evidence that the Debtors accelerated their payments to UPS as the closing of the Global Sale Agreement approached, and the transfers therefore must fall outside normal industry practice. As payments during the second period were paid significantly later than the first and third periods, the Trustee contends that they were markedly different from the terms upon which UPS routinely collected its invoices and therefore not made according to ordinary business terms.

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

Indeed, "courts do not look at the manner in which one particular creditor interacted with other similarly situated debtors, but rather analyze whether the particular transaction in question comports with the standard conduct of business within the industry." *Logan v. Basic Distribution Corp. (In re Fred Hawes Org., Inc.),* 957 F.2d 239, 245–46 (6th Cir.1992); *see also Abovenet Inc. v. Lucent Technologies, Inc. (In re Metromedia Fiber Network, Inc.),* 2005 Bankr.LEXIS 3168, at * 17 (Bankr.S.D.N.Y. Dec. 20, 2005) (" '[M]ade according to ordinary business terms,' looks not to the specifics of the transaction between the debtor and the particular creditor, but rather focuses on general practices in the industry, in particular the industry of the creditor.") "[T]he question must be resolved by consideration of the practices in the industry – not by the parties' dealings with each other." *In re Gulf City Seafoods,* 296 F.3d at 369.

The Trustee appears to be advocating for a return to the pre-BAPCPA test, when a successful defense under Section 547(c)(2) required a creditor to prove not only that the transfer was made in the ordinary course of business between the debtor and transferee, but also that it was made according to ordinary business terms (i.e., both the subjective and objective elements). But the statutory language of the BAPCPA amendments is clear. Congress made the test disjunctive, allowing a defendant to prevail by proving either the subjective test under Section 547(c)(2)(A), or the objective test under Section 547(c)(2)(B). *See In re M. Fabrikant & Sons, Inc.,* 2010 WL 4622449, at *2; *see, e.g., Appalachian Oil Co. v. Va. State Lottery Dept. (In re Appalachian Oil Co.),* 2012 Bankr.LEXIS 4677 (Bankr.E.D.Tenn. Oct. 4, 2012) (finding transfers were not within the "ordinary course of business," but were made according to "ordinary business terms.")) If Congress intended to add a subjective component to Section 547(c)(2)(B) or to somehow make it more difficult for a creditor to prevail under the subsection, it could easily have done so. Instead, Congress simply changed one word – "and" to "or" – and left the wording of the subparts unchanged.[8]

Indeed, the Trustee's view is contrary to the Second Circuit's clear guidance in *Roblin Industries, Inc. v. Ford Motor Company (In re Roblin Industries, Inc.),* 78 F.3d 30 (2d Cir. 1996), which addressed the relationship between the objective and subjective elements of Section 547(b)(2). In *Roblin,* the Second Circuit adopted the objective test used by *Tolona Pizza,* stating that a payment made according to ordinary business terms must be "ordinary from the perspective of the industry." *Id.* at 40. In reaching its conclusion, the Second Circuit observed that an alternative to the objective approach was to "look to the conduct of the parties themselves to determine if the terms of a preferential transfer are ordinary." *Id.* at 41. But it remarked that "by treating both [Section 547(c)(2)(A) and (B)] as subjective requirements and focusing entirely upon the conduct of the parties in question, the ordinary business terms requirement becomes surplusage. Congress could not have intended that one of the three separate requirements enacted to satisfy [Section] 547(c)(2) was simply redundant." *Id.*[9]

For its second argument, the Trustee urges the Court to focus on the Defendants' stated terms for payment. Rather than compare the actual payment history with the typical payment practices in the industry, the Trustee appears to propose that the Court examine whether there has been a deviation from a creditor's stated payment policy. *See* Plaintiff's Post–Trial Brief at 6. But such an analysis would ensure that any late payment would be a transfer outside of ordinary business terms. As such, the defense would be of little use to a creditor. *See In re Carled,* 91 F.3d 811, 818 (6th Cir.1996) (holding that late payments are made according to ordinary business terms so long as they are not "aberrational, unusual or idiosyncratic" for creditors in the defendant's industry).

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

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

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

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

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

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

> The ordinary course of business exception is consistent with the general thrust of preference law. The exception benefits all creditors by protecting payments received by those creditors who remain committed to a debtor during times of financial distress while at the same time affording a measure of flexibility to creditors in dealing with the debtor, provided that the steps taken are consistent with customary practice among industry participants.

Roblin, 78 F.3d at 41.

In any case, the Court is hard pressed to see how a historical variation in the parties' prior course of dealings constitutes a "term" as described by the Trustee. *See Metromedia Fiber Network,* 2005 Bankr.LEXIS 3168, at *24, *30 (Bankr.S.D.N.Y. Dec. 20, 2005) ("A threshold point of inquiry is whether any of the *enumerated terms* of the Lucent Debt Rescheduling was, in fact, "unique" or 'different' from other [debtors'] restructurings or the terms ordinarily agreed upon in restructurings by telecommunications vendors.") (emphasis added). The relationship between the parties is precisely what is examined in the subjective test of Section 547(c)(2)(A). To impose that requirement in the ordinary business terms analysis of Section 547(c)(2)(B) would render 547(c)(2)(A) surplusage, and would also raise the requirements of the standard in a way that Congress did not do in the plain language of BAPCPA.[11]

Turning to the third category, the Trustee takes issue with the Defendants' method for comparing payments here to UPS with payments made by customers to other domestic shipping companies. As a threshold matter, the Trustee complains that looking "on an invoice-by-invoice basis, at each collection UPS made during the preference period, and declar[ing] each payment ordinary (or not ordinary),

based on whether it fell within the outer bounds of the times other participants in the transportation industry took, on average, to collect their invoices pursuant to their individual business terms [is] ... unprecedented, and inconsistent with the case law ...” Plaintiff’s Post–Trial Brief at 6. But the Court notes that other courts have done a similar analysis. *See, e.g., Schoenmann v. BCCI Constr. Co. (In re Northpoint Communs. Group, Inc.),* 361 B.R. 149, 160 (Bankr.N.D.Cal.2007). Indeed, such an approach is consistent with the plain language of the statute that “the trustee may not avoid under this section a *transfer* ... to the extent that such *transfer* was ... made according to ordinary business terms.” 11 U.S.C. § 547(c)(2)(B) (emphasis added); *see also Roblin Indus.,* 78 F.3d at 40 (quoting *Tolona Pizza,* 3 F.3d at 1033) (“Under this standard, a creditor must show that the business terms *of the transaction* in question were ‘within the outer limits of normal industry practices’ ... Assuming subsections (A) and (B) are satisfied, only *when a payment is ordinary* from the perspective of the industry will the ordinary course of business defense be available for an otherwise voidable preference.”) (emphasis added); *Metromedia Fiber Network,* 2005 Bankr.LEXIS 3168, at *24, *30 (Bankr.S.D.N.Y. Dec. 20, 2005) (“As enacted by Congress, the statute requires the Court to focus on the *transfer* which is being challenged.... [Section 547(c)(2)(B)] asks whether the *transfer* was made in accordance with normal industry practice.”).

The parties fail to cite any case law on the proper method for evaluating the actual transactions between the Debtors and UPS to see if they comport with industry practices. Nor did the Court find a consensus in the case law on the appropriate methodology. The Court, however, believes that it is useful to look to how courts analyze the subjective “ordinary course of business” defense. Under an ordinary course analysis, “ ‘[t]o determine whether a late payment may still be considered ordinary between the parties, a court will normally compare the degree of lateness of each of the alleged preferences with the pattern of payments before the preference period to see if the alleged preferences fall within that pattern.’ ... Generally, this involves a comparison of the average number of days between the invoice and payment dates during the pre-preference and preference periods.” *Davis v. R.A. Brooks Trucking, Co. (In re Quebecor World (USA), Inc.),* 491 B.R. 379, 386 (Bankr.S.D.N.Y.2013) (quoting 5 COLLIER ¶ 504.04[2][ii], at 547–55; citing *In re M. Fabrikant & Sons, Inc.,* 2010 WL 4622449, at *4; *Hassett v. Altai, Inc. (In re CIS Corp.),* 214 B.R. 108, 120 (Bankr.S.D.N.Y.1997)). Though the subjective test compares the course of dealings of the parties, it essentially is a comparison of two sets of data over differing periods of time. It therefore seems reasonable to apply these same principles to an objective analysis by comparing the timing of purported preference payments with the timing of payments in the industry as a whole.

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

When viewed in this light, Mr. Salutric’s analysis is revealed as suspect. Simply put, his range of permissible payments is too broad. As the Trustee points out, Mr. Salutric uses a range of 14 to 70 days in 2008 and 16 to 72 days in 2009 that includes outliers that unreasonably extended the range. More specifically, Mr. Salutric used the CRZM database to rank businesses in the shipping industry according to average DSO per year for both 2008 and 2009. *See* Defendants’ Exhibit A. Mr. Salutric testified that he looked to the payment practices in 90% of the industry, removing only the top and bottom five percent in his analysis as outliers.[12] Defendants’ Exhibit A; Trial Tr. 99:6–16. In determining that he should use the 90% figure as his range, he relied only on his judgment, stating that the data points at the outer limits “would be maybe atypical for the industry.” (Trial Tr. 132:2–11, March 19, 2013).[13]

As an alternative, the Trustee believes that a more accurate depiction of the industry pay range is a single standard deviation from the mean.[14] Similar to the average lateness method, a standard deviation analysis serves to view the payments centered around the mean. In post-trial briefing, Trustee concluded that, on average, the industry collected on their invoices within 42 days with a standard deviation of 12 days.[15] As a result, the Trustee maintained that the proper industry pay range is 30 to 54 days. As support for its alternative single standard deviation analysis, the Trustee cites to an article discussing the methodology for an analysis of whether transfers are made in the ordinary course of business between the

parties under Section 547(c)(2)(A) of the Bankruptcy Code. *See* George Abrams, Joseph Steinfeld Jr. and Joseph Hess, *Prosecuting Preference Actions Post–BAPCPA: Another View Toward a Reliable Statistical Model,* 25–10 ABIJ 54, December 2006–January 2007. The article explains that for purposes of calculating the difference between the baseline average of the historical period and the preference period, it is statistically sound to use a percentage that is at or close to the standard deviation percentage. *See id.* at 107–08. While the article does not touch on computation of an ordinary business terms analysis, the Court believes that the purpose of the two methods is similar enough that the Court can look to this methodology in analyzing the available data.

When compared to this methodology, the naked, unweighted averages used by Mr. Salutric can be seen as not appropriately representative. His mechanical exclusion of two companies from the list of forty does not appropriately account for outliers and skews the industry range too much by condoning all payment practices within 90% of the industry. By contrast, the Trustee notes that a single standard deviation encompasses approximately 68 percent of the data set.[16] The Court therefore adopts the Trustee's use of one standard deviation from the mean.[17] All transfers that fall within the range of 30 to 54 days should be considered as having been made within ordinary business terms.

Fourth and finally, the Trustee argues that the preference payments are not made pursuant to ordinary business terms because the Defendants were paid in full prior to the Debtors' bankruptcy. It appears that the Defendants disagree and, in fact, the Trustee has failed to provide evidence that the Defendants have been paid in full. The Trustee relies on the fact that no proof of claim was filed by the Defendants. In and of itself, however, this is not enough. The Trustee also states that Joint Exhibit A shows that all of the Defendants' invoices were paid by the end of the Preference Period. But this exhibit does not establish that fact; the 77 page exhibit merely lists payments and invoices but does not provide a balance that nets out the two. In any event, payment in full does not necessarily constitute treatment outside of ordinary business terms. *See Tolona,* 3 F.3d at 1031 (ruling that the payments in question had followed ordinary business terms, despite noting that "the checks ... cleared and as a result Tolona's debts to Rose were paid in full.")

In sum, the Court concludes that the Defendants are entitled to the benefit of the ordinary business terms defense, but not to the extent claimed. The Court cannot determine the monetary scope of its ruling on the ordinary business terms defense, nor have the parties quantified the impact of the new value defense. The Court requests that the parties quantify these matters and inform the Court whether it is necessary for the Court to decide whether any of these transfers are covered by the ordinary course of business defense under Section 547(c)(2)(A) of the Bankruptcy Code. The parties should contact Chambers to set a status conference to discuss these remaining issues.

C. *Prejudgment Interest*

Finally, the Court grants the Trustee's request for prejudgment interest for any preferences recoverable, which is a determination within a court's discretion for actions brought under Section 547 of the Bankruptcy Code. *In re Pameco Corporation,* 356 B.R. 327, 342 (Bankr.S.D.N.Y.2006); *In re Cyberrebate.com, Inc.,* 296 B.R. 639, 645 (Bankr.E.D.N.Y.2003). Pursuant to Section 550(a), a plaintiff can recover a preferential transfer or its value. 11 U.S.C. § 550(a). The policy of Section 550 is to restore the estate the full value of the asset transferred to the preferred creditor, thereby compensating the estate for the loss of the time value of the asset. *In re L & T Steel Fabricators, Inc.,* 102 B.R. 511, 521 (Bankr.N.D.La.1989). Value includes pre-judgment interest from the date of the transfer. *Id.* The time value of money is an asset of the estate that should be recovered for the benefit of all creditors under the policy in the Bankruptcy Code, which favors equal treatment for all creditors of a bankruptcy estate. By awarding pre-judgment interest from the date of a preferential transfer, both the estate and the transferee are restored to the economic position each were in prior to the preferential. Prejudgment interest is not a penalty, but rather is viewed as "delayed damages to be awarded as a component of compensation to the prevailing party." *General Motors Corp. v. Devex Corp.,* 461 U.S. 648, 654 n.10 (1983); *see also West Virginia v. United States,* 479 U.S. 305, 310 n.2 (1987).

CONCLUSION

For the reasons stated above and consistent with its Opinion, the Court determines that the Defendants prevail in part on their ordinary business terms defense under Section 547(c)(2)(B) of the Bankruptcy Code. The Court reserves judgment on the ordinary course of business defense under Section 547(c)(2)(A) until it becomes clear that a decision is necessary on that issue. Defendants' should settle an order on three days' notice.

Footnotes

1 The parties have consented to this Court entering a final order or judgment in these adversary proceedings. *See* Joint Pretrial Orders at Section II (Adv. No. 11–01820, ECF No. 19; Adv. No. 11–02177, ECF No. 13).

2 The Defendants assert the defense of new value under Section 547(c)(4) of the Bankruptcy Code. At trial, the Plaintiff conceded that some of the transfers in question represented new value. *See* Trial Tr. 41:13–14 (March 19, 2013). The parties, however, have not quantified the amount of new value upon which they agree. *See id.* at 57:3–11 (Defendants requesting that Court first make determination with respect to defenses under Section 547(c)(2) before Defendants determine and calculate the new value defense); *see id.* at 169:8–10. It is unclear based upon the Court's ruling today and the undisputed new value defense transfers whether there is a need to address the ordinary course of business defense.

3 In fact, the parties stipulated in their pre-trial pleadings that the criteria listed in Section 547(b) were met. *See* Joint Pretrial Orders at Section III.

4 There actually is a slight discrepancy as to this number, with Defendants' Exhibit A listing 51 days and Defendants' Exhibit C stating 52 days. Given that Defendants have the burden of proof on the defense, the Court will use the more conservative of these numbers.

5 Mr. Salutric testified that DSO is credit terminology for the calculation of how long it takes a sale to be paid. It is used by a company to measure its effectiveness in the credit world. *See* Trial Tr. 92:16–22.

6 According to the Trustee, UPS received payments from the Debtors on its invoices on average within 49 days during the first period and 44 days during the third period whereas during the second period, UPS received payments on average within 72 days. *See* Plaintiff's Exhibits 1, 2, and 3. There are questions, however, about the basis for the selection of these three time periods, which the Defendants criticize as a result oriented test. The Trustee has provided no case law to support this methodology, which largely disregards whether payments were made during the Preference Period.

7 The Plaintiff provided no case law to support this interpretation of the statute, instead citing to two cases in which the courts remarked that the parties practices were consistent prior to and during the preference period. *See Tolona Pizza,* 3 F.3d at 1033; *McCord v. Venus Foods, Inc. (In re Lan Yik Foods Corp.),* 185 B.R. 103, 115 (Bankr.E.D.N.Y.1995). But these were simply observations of the facts in those cases; neither case affirmatively stated that an objective analysis must take such factors into account.

8 While not cited by the Trustee, the Court notes that *Hutson v. Branch Banking & Trust Co. (In re National Gas Distributors, L.L.C.),* 346 B.R. 394 (Bankr.E.D.N.C.2006), held that pre-BAPCPA case law discussing the ordinary business terms standard had been affected by the amendment to the statute and was therefore no longer instructive. *See id.* at 402–03. Cases in this jurisdiction, however, have stated that "the words of the subparagraphs have not changed, and the pre–2005 cases interpreting their requirements remain good law." *In re M. Fabrikant & Sons, Inc.,* 2010 Bankr.LEXIS 3941, at *6 (citing 5 Collier on Bankruptcy ¶ 547.04[2], at 547–51). Additionally, the approach adopted in *National Gas* has been rejected by other jurisdictions. *See Simon v. Gerdau MacSteel, Inc. (In re American Camshaft Specialties, Inc.),* 444 B.R. 347 (Bankr.E.D.Mich.2011) (noting that while revisiting the ordinary business terms standard "might be warranted in other circuits where controlling precedent is unclear, the Sixth Circuit Court of Appeals has articulated a clear and consistent standard, from which this Court sees no reason to deviate.").

9 Commentators have debated the policy wisdom of Congress's change to the statute, wondering whether the objective test is too low a hurdle. *See In re National Gas Distributors L.L.C.,* 346 B.R. at 404–05. But as there is no denying the plain language of the statute as amended, this Court leaves such policy choices to Congress.

10 Indeed, Mr. Salutric testified that during the financial crisis, shipping companies were allowing their customers more flexibility in payment timing. *See* Trial Tr. 70:23–25; 71:1–6; 74:6–75:6; 85:7; 86:6–10; 89:16–90:13. Thus, both the deviation from nominal terms and the variation in payment times from year to year were within normal industry practice, as the entire shipping industry was simply responding to the financial crisis.

11 To the extent that the Trustee suggests that a creditor is required to mathematically compare the parties' deviation from nominal payment terms against the deviation from nominal terms of those in the industry, the Court also rejects that notion. It would be impossible for the creditor to meet its evidentiary burden due to a lack of available data. Courts have acknowledged that "information about competitors' trade practices used to establish industry standards may be difficult to obtain.... Thus, courts must allow some flexibility regarding sources of evidence used to establish the range of practices that will be deemed the industry

standard." *Troisio v. E.B. Eddy Forest Prods. (In re Global Tissue L.L.C.),* 2004 U.S.App. LEXIS 14003, at *103 (3d Cir. July 7, 2004). The Trustee himself agrees that "the potential difficulty in obtaining industry data from competitors justifies a flexible evaluating standard in proving what terms are "ordinary" in the industry ... and that such proof may be based on the testimony of an employee who has sufficient first-hand knowledge of industry practices." Plaintiff's Post–Trial Brief at 2.

12 It is unclear whether these outliers had already been removed from the information that the Defendants provided to the Court. Defendant does not conclusively state this to be the case and, if so, Defendants have failed to inform the Court as to how many companies were excluded or provided the Court with any information regarding those companies. For purposes of the Court's analysis, however, the Court assumes that the data provided in Defendants' Exhibit A includes the full industry database, prior to the removal of any outliers. In fact, a review of Defendants' Exhibit A shows that only two companies out of a total of 40 from the CRZM data fall outside of Mr. Salutric's 16 to 72 date range. *See* Defendants' Exhibit A.

13 Mr. Salutric's conclusion is also undercut by a lack of support for his methodology. Mr. Salutric testified that in formulating this analysis, he did not consider any alternative methods for sorting the data. Trial Tr. at 132:12–16. Mr. Salutric was unaware of any case law that adopted his formulation. *Id.* at 132:20–22. He got no input from counsel in conducting his investigation and rendering his opinion, nor did he review any other expert testimony on the process of rendering his report with respect to ordinary business terms or consult any other professionals or peer review on how to go about doing so. *Id.* at 131:6–18; 133:9–19. Mr. Salutric consulted one article which he described as "high-level" and discussed what to expect when testifying as an expert witness. *Id.* at 131:20–132:1. But the article did not discuss the methodology to be used in determining the ordinary course of business. *Id.* at 131:20–25.

14 "A 'standard deviation' is a statistical measure of the amount by which a set of values differs from the arithmetical mean. In plain English, when the standard deviation number is applied to both sides of the mean, the numbers that fall within the resulting range will encompass 67.76 percent of all numbers used to arrive at the mean." George Abrams, Joseph Steinfeld Jr. and Joseph Hess, *Prosecuting Preference Actions Post–BAPCPA: Another View Toward a Reliable Statistical Model,* 25–10 ABIJ 54, December 2006–January 2007, at 108 n.5.

15 The Court notes that the Plaintiff appears to concede what is taking place in the industry and does not challenge the information or credibility of the CRMZ database.

16 Two standard deviations would account for approximately 95 percent of the data set, which would impermissibly expand the range.

17 In its reply brief, UPS states that the Trustee does not explain how the use of a single standard deviation is appropriate, given that the industry data does not reflect a "normal bell curve." UPS, however, provides no analysis as to what the industry data shows with respect to a bell curve and offers no basis to understand such data other than their modified total range analysis based on 90% of the industry.

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Distinguished by In re Insys Therapeutics, Inc., Bankr.D.Del., July 21, 2021

615 B.R. 62
United States Bankruptcy Court, D. Delaware.

IN RE MAXUS ENERGY CORPORATION, ET AL., Debtors.
Joseph J. Farnan, Jr, in his capacity as Liquidating Trustee of the Maxus Liquidating Trust, Plaintiff,
v.
Vista Analytical Laboratory, Inc., Defendant.

Case No. 16-11501 (CSS)
|
Adv. Pro. No.: 18-50521 (CSS)
|
Dated: May 12, 2020

Synopsis
Background: Trustee of liquidating trust established under corporate debtor's confirmed Chapter 11 plan brought adversary proceeding seeking to avoid and recover alleged preferential transfers totaling $217,410. Transferee moved for summary judgment.

[Holding:] The Bankruptcy Court, Christopher S. Sontchi, Chief Judge, held that fact issue remained whether transferee would have been paid the full amount of transfers from debtor in a hypothetical Chapter 7 liquidation had the transfers not been paid.

Motion denied.

Procedural Posture(s): Motion for Summary Judgment.

West Headnotes (18)

[1] Bankruptcy Judgment or Order

Summary Judgment is a mechanism used to ascertain the existence of a genuine factual dispute between the parties that would necessitate a trial. Fed. R. Civ. P. 56.

[2] Bankruptcy Judgment or Order

When seeking summary judgment, the movant bears the initial burden of establishing the absence of a genuine issue of material fact. Fed. R. Civ. P. 56.

1 Cases that cite this headnote

[3] Bankruptcy Judgment or Order

A genuine issue at summary judgment stage is not simply based on opposing opinions or unsupported assertions, but rather on conflicting factual evidence over which reasonable minds could disagree on the result. Fed. R. Civ. P. 56.

[4] Bankruptcy Judgment or Order

A fact is "material" for summary judgment purposes if it could alter the outcome of a case. Fed. R. Civ. P. 56.

[5] Bankruptcy Judgment or Order

The movant's goal at summary judgment stage is to establish an absence of evidence to support the nonmoving party's case. Fed. R. Civ. P. 56.

[6] Bankruptcy Judgment or Order

If the movant meets its initial burden of demonstrating the absence of a genuine issue of material fact, the burden shifts to the nonmoving party to defeat summary judgment by producing evidence in the record creating a genuine issue of material fact. Fed. R. Civ. P. 56.

1 Cases that cite this headnote

[7] **Bankruptcy** Judgment or Order

To demonstrate a genuine issue of material fact at summary judgment stage, the nonmoving party must do more than simply show that there is some metaphysical doubt as to the material facts. Fed. R. Civ. P. 56.

[8] **Bankruptcy** Judgment or Order

On motion for summary judgment, the nonmoving party must demonstrate sufficient evidence, not mere allegations, upon which a reasonable trier of fact could return a verdict in favor of a nonmoving party. Fed. R. Civ. P. 56.

[9] **Bankruptcy** Judgment or Order

Nonmovant's evidence at summary judgment cannot be conjectural or problematic; it must have substance in the sense that it limns differing versions of the truth which a factfinder must resolve at an ensuing trial. Fed. R. Civ. P. 56.

[10] **Bankruptcy** Judgment or Order

When considering a motion for summary judgment, the court does not weigh the evidence and determine the truth of the matter; rather, the court determines whether there is a genuine issue for trial. Fed. R. Civ. P. 56.

[11] **Bankruptcy** Judgment or Order

At summary judgment stage, the court must view the facts in the light most favorable to the nonmoving party and draw all inferences in that party's favor. Fed. R. Civ. P. 56.

[12] **Bankruptcy** Judgment or Order

If the opposition evidence is merely colorable or not significantly probative, summary judgment may be granted. Fed. R. Civ. P. 56.

[13] **Bankruptcy** Judgment or Order

Where the record could lead reasonable minds to draw conflicting inferences, summary judgment is improper, and the action must proceed to trial. Fed. R. Civ. P. 56.

1 Cases that cite this headnote

[14] **Bankruptcy** Judgment or Order

Summary Judgment is proper only where one reasonable inference or interpretation of the facts can be drawn in favor of the moving party. Fed. R. Civ. P. 56.

[15] **Bankruptcy**Antecedent debt or contemporaneous consideration

A debt is "antecedent" for preference avoidance purposes if the debtor's incurred the obligation to pay before the challenged payment was made. 11 U.S.C.A. § 547(b).

[16] **Bankruptcy**Effect to give more than under bankruptcy distribution

To satisfy requirements for preference avoidance, 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. 11 U.S.C.A. § 547(b)(5).

[17] **Bankruptcy**Effect to give more than under bankruptcy distribution

When a trustee commences a preference action, the bankruptcy court is to compare what the creditor actually received and what it would have received under the Chapter 7 distribution provisions of the Bankruptcy Code in order to determine whether the creditor received more than its fair share. 11 U.S.C.A. § 547(b)(5).

[18] **Bankruptcy**Judgment or Order

Genuine issue of material fact whether transferee would have been paid the full amount of transfers totaling $217,410 from Chapter 11 corporate debtor made pursuant to critical vendor order in a hypothetical Chapter 7 liquidation had the transfers not been paid precluded summary judgment in preference avoidance action brought by trustee of liquidating trust established under debtor's confirmed plan.

1 Cases that cite this headnote

Attorneys and Law Firms

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OPINION[1]

[1] This Opinion constitutes the Court's findings of fact and conclusions of law under Rule 7052.

Sontchi, C.J.

*64 INTRODUCTION

This is a preference action. Defendant has filed a motion for summary judgment arguing that there is no genuine issue of material fact as to whether it would have been paid the full amount of the purportedly preferential transfers in a hypothetical liquidation under Chapter 7 and, thus, Plaintiff cannot prove its prima facie case under section 547(b)(5) of the Bankruptcy Code. Defendant bases its argument on the assertion that it was a "critical vendor" of the Debtors and had it not received its pre-petition payments it would nonetheless have received

payment in full post-petition under the Court's critical vendor order.

The Court finds that Defendant has failed to meet its burden on summary judgment to show there is no genuine issue of material fact as to whether Defendant would have received payment in full for its preferential transfers in a hypothetical Chapter 7 liquidation due to its status as a critical vendor. Even though there is no question the Debtors considered Defendant to be a critical vendor that is not enough. The Debtors were not required to pay Defendant *in full* for its pre-petition invoices.

Thus, Defendant's motion must be denied.

JURISDICTION & VENUE

The Court has jurisdiction over this matter pursuant to 28 U.S.C. §§ 157 and 1334. Venue is proper in this District pursuant to 28 U.S.C. §§ 1408 and 1409. This is a core proceeding pursuant to 28 U.S.C. § 157(b)(2).

STATEMENT OF FACTS

Vista Analytical Laboratory, Inc. ("Vista" or "Defendant") operates an environmental laboratory and services customers by determining the presence of organic contaminants in bottled samples through the use of an analytical method developed in 1993.[2] Maxus Energy Corporation ("Maxus") is an exploration and production company in the petroleum industry.[3] Tierra Solutions, Inc. ("Tierra") manages certain environmental remediation obligations owed by Maxus to third parties.[4] Pursuant to the Analysis Services Agreement dated November 2, 1992 (the "Services Agreement"), Vista provided Maxus with its aforementioned contaminant determination service.[5] Maxus subsequently assigned the Services Agreement to Tierra.[6]

2 *Declaration of Martha Maier in Support of Defendant Vista Analytical Laboratory Inc.'s Motion for Summary Judgment ("Decl. of M. Maier"),* Adv. Proc. No. 18-50521 [D.I. 36], at ¶ 2–3. *See Decl. of M. Maier,* at Ex. A.

3 *Declaration of Javier Gonzalez in Support of Chapter 11 Petitions and Requests for First Day Relief* (*"Decl. of J. Gonzalez"*), Case No. 16-11501 [D.I. 2], at ¶ 5.

4 *Id.* at ¶ 12.

5 *Decl. of M. Maier*, at ¶ 4.

6 *Id.*

Under the Services Agreement, Vista and Tierra executed multiple work order agreements, including Work Order No. 1610006VAL00300 at the Diamond Alkali Superfund Site on Lister Avenue in Newark, New Jersey (the "Lister Site") dated December 15, 2015 (the "Lister Agreement") and Work Order No. 5313-VISTA-002-0 for the Newark Bay Study Area in Newark, New Jersey (the "Newark Bay ***65** Site") dated September 28, 2014 (the "Newark Bay Agreement").[7]

7 *Id.* at ¶¶ 4–5.

Under the Lister Agreement, Vista sent bottles to Tierra each month, which Tierra used to collect samples from the groundwater treatment plant at the Lister Site.[8] After Tierra filled the bottles, Tierra shipped them back to Vista for analysis.[9] Upon receipt of the filled bottles, Vista performed certain analyses requested in the Lister Agreement and prepared a report stating its findings.[10] Thereafter, Vista submitted the report to Tierra, along with an invoice, and to a third-party validator selected by Tierra to validate Vista's analyses.[11] The third-party validator then requested any additional information needed to validate the data and approve Vista's report.[12] Upon validation, Tierra paid Vista on account of the related invoice.[13]

8 *Id.* at ¶ 5.

9 *Id.*

10 *Id.* at ¶ 6.

11 *Id.*

12 *Id.*

13 *Id.*

Under the Newark Bay Agreement, Vista sent bottles to Tierra to collect samples from the Newark Bay Site.[14] Similarly, Tierra filled and returned the bottles to Vista for analysis and third-party validation, and Vista issued Tierra an invoice.[15] The United States Environmental Protection Agency (the "EPA") also required Vista to conduct certain analyses pertaining to the Newark Bay Site.[16] After the EPA reviewed and approved the reports, Tierra paid Vista on account of the related invoice.[17]

14 *Id.* at ¶ 7.

15 *Id.* at ¶¶ 8–9.

16 *Id.* at ¶ 7.

17 *Id.* at ¶ 9.

On June 17, 2016 (the "Petition Date"), Maxus, Tierra, and certain other entities (collectively, "Debtors") filed for chapter 11 relief under the Bankruptcy Code.[18] The Debtors' chapter 11 cases were jointly administered.[19] Within the 90 days preceding the filing of the Debtors' chapter 11 petitions (the "Preference Period"), Tierra made six transfers to Vista on account of invoices Vista issued Tierra under the Services Agreement in an aggregate amount of approximately $217,410.00 (the "Transfers").[20]

18 Chapter 11 Voluntary Petition, Case No. 16-11501 [D.I. 1].

19 *See Order Directing Joint Administration of Chapter 11 Cases*, Case No. 16-11501 [D.I. 34].

20 *See Complaint for Avoidance and Recovery of Preferential Transfers Pursuant to 11 U.S.C. §§ 547 & 550 and Objection to Claim Pursuant to 11 U.S.C. § 502(d)* ("*Plaintiff's Complaint*"), Case No. 16-11501 [D.I. 2063], at ¶ 16, Ex. A.

On July 11, 2016, Vista's Laboratory Director, Martha Maier, engaged in a conversation via email with Tierra's Paul J. Bluestein and Brian Mikucki regarding notice of the bankruptcy.[21] The emails were sent in the following order:

> **1:16 PM** (from Maier to Bluestein & Mikucki): "Hello Brian and Paul, we just received the notice today that we will not be receiving payment for our work. I assume will [*sic*] not need to analyze the Lister samples we just received, but just wanted to confirm. Martha."
>
> **3:19 PM** (from Bluestein to Maier): "Martha, I'm still waiting to get some ***66** guidance on the Newark Bay Invoices, which I should have tomorrow. In the interim, if we were to pre-pay for the Lister samples currently in hand by weeks end would you be willing to go ahead and start the extraction/analyses tomorrow? Paul J. Bluestein, P.E., PMP[.]"
>
> **6:28 PM** (from Maier to Bluestein): "Paul, Yes, that would be fine. I really appreciate your help on this. Martha."
> **6:42 PM** (from Bluestein to Maier): "Thanks Martha. I'll start making the arrangements for payment. Please go ahead and send me an invoice for those samples. Paul J. Bluestein, P.E., PMP[.]"[22]

21 *Decl. of M. Maier*, at ¶ 11, Ex. B.

22 *Id.*

After the Petition Date, on July 19, 2016, Vista filed a proof of claim against Tierra for an amount of $233,840.00, reflecting at least fourteen unpaid invoices owed to Vista by Tierra.[23] In a document dated August 2, 2016 (the "Critical Vendors Listing"), Debtors calculated that they owed an aggregate of $1,553,488.00 to critical vendors.[24] The Critical Vendors Listing also provided the following summary description of Vista:

> Project operates under an old administrative order that utilizes an old methodology. The technology provided by the vendor would be difficult or impossible to get from another vendor as other vendors will have switched to a new methodology. Changing methodologies would require approval from regulatory agency as it would be a change from the governing administrative order. Change would take time and require significant cost. Works at Newark Bay and Lister.[25,26]

23 *Id.* at ¶¶ 7–9, 12, Ex. C.

24 *Id.*, at Ex. H.

25 *Id.*

26 At footnote 2 of *Plaintiff's Response to Defendant's Motion for Summary Judgment and Memorandum of Law in Support Thereof* (*"Plaintiff's Response"*), Adv. Proc. No. 18-50521 [D.I. 42], Plaintiff states the following regarding the materials found in *Decl. of M. Maier*, at Ex. H:

> During discovery in this litigation, the Trustee turned over certain records given to him by the Debtors, including an internal document, marked 8/2/2016 DRAFT /Highly Confidential For Professional Eyes Only/Not for Distribution /Maxus Energy Corporation et al. Critical Vendors Listing. See *Maier Decl.*, Exhibit H. This draft document was prepared by one of Debtors' professionals, a financial advisor. It is in draft format, and it is neither affixed to the Critical Vendor Motion, the Critical Vendor Order, nor incorporated by reference into any documents filed with this Court. See *Kirchner Decl.* Para. 12. As such, it is irrelevant as evidence.
>
> Nevertheless, the Court considers the Critical Vendors Listing as relevant evidence. The fact that "it is neither affixed to the Critical Vendor Motion, the Critical Vendor Order, nor incorporated by reference into any documents filed with this Court" may go to the weight of the evidence but not its admissibility.

On August 17, 2016, Debtors moved for entry of an order authorizing, but not directing, Debtors to pay pre-petition claims of certain critical vendors up to a $2 million cap (the "Critical Vendor Motion").[27] The Critical Vendor Motion included the following language at paragraph 18:

> ***67** In another instance, one of the Projects operates under an old administrative order that requires use of an older and now obsolete methodology to analyze samples of soil, sediment, water, crabs, clams, and fish. The environmental laboratory that tests samples under this specific administrative order provides technology that would be difficult if not impossible to replace because vendors have switched to a newer methodology. In addition, the Debtors would need to apply to and obtain approval from regulatory authorities to modify the terms of the administrative order if the Debtors were forced to find a new vendor that only utilizes the newer methodology. This process would be time consuming and very costly to the Debtors.[28]

27 *Debtors' Motion for Entry of an Order Authorizing, But Not Directing, the Debtors to Pay Pre-petition Claims of Certain Critical Vendors* ("*Critical Vendor Motion*"), Case No. 16-11501 [D.I. 252], at ¶ 9 ("Following this analysis, the Debtors identified the Critical Vendors, which represent approximately 5% of the Debtors' vendors. As of the Petition Date, the Debtors estimate that they owe the Critical Vendors no more than $2.0 million, which has or will become payable in the ordinary course of the Debtors' business.").

28 *Id.* at ¶ 18.

On September 2, 2016, the Court entered an order granting the Critical Vendor Motion and set the cap at $2 million (the "Critical Vendor Order").[29] The Critical

Vendor Order includes the following language at paragraph 5:

> The Debtors are authorized, but not directed, to condition the payment of Critical Vendor Claims upon such Critical Vendor's agreement to continue supplying goods or services on Customary Trade Terms or Negotiated Trade Terms for the duration of these chapter 11 cases by executing trade agreements (each a "Trade Agreement"). Such Trade Agreements, once agreed to and accepted by a Critical Vendor, shall be legally binding contractual arrangements between the parties governing the commercial trade relationship as provided therein.[30]

At no time did Debtors enter into a Trade Agreement with Vista.[31]

29 *Order Authorizing, But Not Directing, the Debtors to Pay Pre-petition Claims of Certain Critical Vendors* ("*Critical Vendor Order*"), Case No. 16-11501 [D.I. 321].

30 *Id.* at ¶ 5.

31 *Declaration of Aine Kirchner in Support of Plaintiff's Response to Defendant's Motion for Summary Judgment and Memorandum of Law in Support Thereof* (*"Decl. of A. Kirchner"*), Adv. Proc. No. 18-50521 [D.I. 43], at ¶ 11.

On September 16, 2016, after entry of the Critical Vendor Order, Tierra paid thirteen of the fourteen outstanding invoices in the total amount of approximately $225,030.00.[32] On October 10, 2016, Tierra paid the final outstanding invoice (hereinafter, the September 16 and October 10, 2016 payments will be referred to collectively as the "Invoice Payments").[33] As of November 25, 2016, Debtors paid approximately $1.4 million in total on account of pre-petition claims of critical vendors.[34]

32 *Decl. of M. Maier*, at ¶ 14.

33 *Id.*

34 *Amended Disclosure Statement for the Amended Chapter 11 Plan of Liquidation Proposed by Maxus Energy Corporation, et al. and the Official Committee of Unsecured Creditors* ("*Disclosure Statement*"), Case No. 16-11501 [D.I. 1232], at Art. IV.B.9.

On April 19, 2017, Debtors filed their Disclosure Statement and liquidation plan (the "Plan").[35] The Disclosure Statement included a Hypothetical Liquidation Analysis,[36] and the Plan included the creation of the Liquidating Trust (the "Trust"), under which the Liquidating Trustee (as appointed by the Liquidating Trust Oversight Board), would have the authority to administer the Trust through certain means, including ***68** the ability to prosecute Causes of Action.[37] On April 19, 2017, the Court approved the Disclosure Statement[38] and on May 22, 2017, the Court entered an order confirming the Plan.[39] On July 14, 2017, the Plan became effective.[40]

35 *Amended Chapter 11 Plan of Liquidation Proposed by Maxus Energy Corporation,* et al. *and the Official Committee of Unsecured Creditors*, Case No. 16-11501 [D.I. 1231].

36 *Disclosure Statement*, at Ex. D.

37 *Id.* at Art. I.A.16 (defining "Causes of Action"); *Id.* at I.A.117 (defining "Liquidating Trustee"); *Id.* at Art. I.A.118 (defining "Liquidating Trust Oversight Committee"); *Id.* at Art. VI.A (creating the "Liquidating Trust"); *Id.* at Art. VI.C. (transferring certain Causes of Action to the Trust); and *Id.* at Art. VI.G (vesting the Liquidating Trustee with the authority to prosecute certain Causes of Action).

38 *Order (A) Approving Disclosure Statement; (B) Establishing Voting Record Date, Voting Deadline, and Other Dates; (C) Approving Procedures for Soliciting, Receiving, and Tabulating Votes on Plan and for Filing*

Objections to Plan; (D) Approving Manner and Forms of Notice and Other Related Documents; and (E) Granting Related Relief, Case No. 16-11501 [D.I. 1237].

39 *Order Confirming Amended Chapter 11 Plan of Liquidation Proposed by Maxus Energy Corporation,* et al. *and the Official Committee of Unsecured Creditors Pursuant to Chapter 11 of the Bankruptcy Code*, Case No. 16-11501 [D.I. 1460].

40 *See Notice of (I) Entry of Order Confirming Amended Chapter 11 Plan of Liquidation, (II) Occurrence of Effective Date, and (III) Related Bar Dates*, Case No. 16-11501 [D.I. 1701], at ¶ 2.

On June 14, 2018, Joseph J. Farnan Jr. ("Plaintiff"), in his capacity as the Liquidating Trustee of the Trust, filed a complaint against Vista.[41] Plaintiff's Complaint seeks to avoid and to recover $217,410.00 paid in the Transfers as preferential.[42]

41 *See Plaintiff's Complaint*.

42 *Plaintiff's Complaint*, at ¶ 16, Ex. A.

On February 8, 2019, Vista responded to each claim in Plaintiff's Complaint and raised twelve affirmative defenses.[43] On July 1, 2019, Plaintiff and Vista attempted to reach a settlement in mediation, but no settlement was reached.[44] Thereafter, on November 27, 2019, Vista moved for summary judgment on Plaintiff's Complaint, arguing that Plaintiff cannot sustain the burden of demonstrating that he is entitled to the relief sought under his Complaint.[45][46]

43 *Answer of Vista Analytical Laboratory Inc. to Complaint for Avoidance and Recovery of Preferential Transfers Pursuant to 11 U.S.C. §§ 547 & 550 and Objection to Claim Pursuant to 11 U.S.C. § 502(d)* ("*Vista's Answer*"), Adv. Proc. No. 18-50521 [D.I. 11].

44 *Mediator's Certificate of Completion*, Adv. Proc. No. 18-50521 [D.I. 26].

45 *Defendant Vista Analytical Laboratory Inc.'s Motion for Summary Judgment*, Adv. Proc. No. 18-50521 [D.I. 34].

46 Vista's Motion for Summary Judgment does not seek summary judgment with respect Vista's other affirmative defenses. *Brief in Support of Defendant Vista Analytical Laboratory Inc.'s Motion for Summary Judgment* (*"Brief in Support of the Motion for Summary Judgment"*), Adv. Proc. No. 18-50521 [D.I. 35], at fn.2.

LEGAL DISCUSSION

A. Standard of Review

[1]Summary Judgment is a mechanism used to ascertain the existence of a genuine factual dispute between the parties that would necessitate a trial. Summary judgment is appropriate "if the pleadings, the discovery and disclosure materials on file, and any affidavits show that there is no genuine issue as to any material fact and that the movant is entitled to judgment as a matter of law."[47]

47 *Celotex Corp. v. Catrett*, 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986).

[2] [3] [4] [5]When seeking summary judgment, the movant bears the initial burden ***69** of "establishing the absence of a genuine issue of material fact."[48] A genuine issue is not simply based on opposing opinions or unsupported assertions but rather on conflicting factual evidence over which "reasonable minds could disagree on the result."[49] Furthermore, a fact is material if it could "alter the outcome of a case."[50] In other words, the movant's goal is "to establish an absence of evidence to support the nonmoving party's case."[51]

48 *J. Aron & Co. v. SemCrude, L.P. (In re SemCrude, L.P.)*, 504 B.R. 39, 51 (Bankr. D. Del.

2013) (*citing* *Celotex*, 477 U.S. at 322, 106 S.Ct. 2548).

49 *Liquidation Tr. v. Huffman (In re U.S. Wireless Corp.)*, 386 B.R. 556, 560 (Bankr. D. Del. 2008) (citations omitted).

50 *Id.*

51 *Id.* (*quoting* *Celotex*, 477 U.S. at 325, 106 S.Ct. 2548).

[6] [7]If the movant meets this initial burden, the burden shifts to the nonmoving party to defeat summary judgment by producing "evidence in the record creating a genuine issue of material fact."[52] To demonstrate a genuine issue of material fact, the nonmoving party "must do more than simply show that there is some metaphysical doubt as to the material facts."[53]

52 *In re W.R. Grace & Co.*, 403 B.R. 317, 319 (Bankr. D. Del. 2009).

53 *Matsushita Elec. Indus. Co., v. Zenith Radio Corp.*, 475 U.S. 574, 586, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986).

[8] [9]The nonmoving party must demonstrate "sufficient evidence (not mere allegations) upon which a reasonable trier of fact could return a verdict in favor of a nonmoving party."[54] This evidence "cannot be conjectural or problematic; it must have substance in the sense that it limns differing versions of the truth which a factfinder must resolve at an ensuing trial."[55]

54 *Giuliano v. World Fuel Servs., Inc. (In re Evergreen Int'l. Aviation)*, 2018 WL 4042662, at *2 (Bankr. D. Del. Aug. 22, 2018) (citations omitted).

55 *In re U.S. Wireless Corp.*, 386 B.R. at 560 (*quoting* *Mack v. Great Atl. & Pac. Tea Co.*, 871 F.2d 179, 181 (1st Cir. 1989)).

[10] [11] [12] [13] [14]When considering a motion for summary judgment, "the court does not weigh the evidence and determine the truth of the matter; rather, the court determines whether there is a genuine issue for trial."[56] The Court must "view the facts in the light most favorable to the nonmoving party and draw all inferences in that party's favor."[57] "If the opposition evidence is merely colorable or not significantly probative, summary judgment may be granted."[58] However, where the record could lead reasonable minds to draw "conflicting inferences, summary judgment is improper, and the action must proceed to trial."[59] Summary Judgment is proper only where one reasonable inference or interpretation of the facts can be drawn in favor of the moving party.[60]

56 *Argus Mgmt. Grp. V. GAB Robins, Inc. (In re CVEO Corp.)*, 327 B.R. 210, 214 (Bankr. D. Del. 2005) (*quoting* *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986) (citations omitted)).

57 *Saldana v. Kmart*, 260 F.3d 228, 231–32 (3d Cir. 2001).

58 *Whitlock v. Pepsi Ams.*, No. C 08-24742 SI, 2009 WL 3415783, at *7 (N.D. Cal Oct. 21, 2009) (citations omitted).

59 *O'Connor v. Boeing N. Am., Inc.*, 311 F.3d 1139, 1150 (9th Cir. 2002) (*quoting* *Munger v. City of Glasgow Police Dep't*, 227 F.3d 1082, 1087 (9th Cir. 2000)).

60 *Id.*

B. Analysis

Section 547(b) of the Bankruptcy Code provides:

> ***70** (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; ... 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.

[15]The undisputed facts indicate Plaintiff has established that sections 547(b)(1) –(4) are satisfied and Vista does not dispute that Plaintiff can carry his burden as it pertains to these subsections. To summarize briefly, (i) section 547(b)(1) is met because Tierra paid the Transfers for the benefit of Vista; (ii) section 547(b)(2) is met because the Transfers were paid by Tierra on account of invoices Vista issued to Tierra under the Services Agreement, which are "antecedent debts;"[61] and (iii) sections 547(b)(3) and (4) are met as there is no dispute as to Debtors' insolvency during the Preference Period nor that payment of the Transfers occurred during the Preference Period. As such, the Court is left only to consider the import of section 547(b)(5).

[61] A debt is "antecedent" for the purposes of section 547(b) if the debtor's incurred the obligation to pay before the challenged payment was made. *AFA Inv. Inc. v. Trade Source, Inc. (In re AFA Inv. Inc.)*, 538 B.R. 237, 241 (Bankr. D. Del. 2015) (hereinafter, "*AFA*") (*citing In re Vaso Active Pharm., Inc.*, 500 B.R. 384, 393 (Bankr. D. Del. 2013)).

[16] [17]The Third Circuit has stated that "[t]o 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."[62] 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 [Bankruptcy] Code' in order to determine whether the creditor received more than its fair share."[63] The Transfers Tierra paid Vista were in the amount of $217,410.00. Therefore, for summary judgment to be granted in favor of Defendant, Defendant must show that there is no genuine issue of material fact as to whether Vista would have recovered the full amount of the Transfers, i.e., $217,410.00, in a hypothetical chapter 7 liquidation. If Defendant meets this initial burden, the burden will shift to Plaintiff to defeat summary judgment by producing evidence in the record creating a genuine issue of material fact.

[62] *Kimmelman v. The Port Auth. Of N.Y. & N.J. (In re Kiwi Int'l Air Lines, Inc.)*, 344 F.3d 311, 317 (3d Cir. 2003) (hereinafter, "*Kiwi*").

[63] *Id.* (*quoting* 2 Collier on Bankruptcy ¶ 547.03[7][a] (15th rev. ed. 2003)).

Defendant Vista argues that there is no genuine issue of material fact and Plaintiff cannot sustain his burden under section 547(b)(5) because (1) Tierra paid Vista the Invoice Payments pursuant to the Critical Vendor Order, (2) the cost of the Invoice Payments exceeded that of the Transfers, (3) had the Transfers not been made, ***71** Debtors had authority to pay the $217,410.00 without adjusting the critical vendor cap, and (4) had the Transfers not been made, Debtors still had not reached the $2 million cap.[64] In response, Plaintiff responds that (1) there is a genuine issue of material fact as to whether Vista's pre-petition general unsecured claim would have been paid in full under a hypothetical chapter 7 liquidation,[65] and (2) the "[Bankruptcy] Code does not contain a critical vendor defense to preference liability," but "[t]o the extent such a defense exists, it applies only in the narrowest of circumstances – none of which are present in this case."[66]

[64] *Brief in Support of the Motion for Summary Judgment*, at ¶ 5.

65 *Plaintiff's Response*, at 2.

66 *Id.* at 6.

In *AFA Inv. Inc. v. Trade Source, Inc. (In re AFA Inv. Inc.)*, the court entered a Essential Suppliers Order,[67] which permitted the AFA Debtors to pay certain essential suppliers up to a cap of $6 million.[68] Pursuant to the Essential Suppliers Order, the AFA Debtors and creditor Trade Source executed a letter agreement, which provided that "Trade Source was to receive payment of its pre-petition claim and, in exchange, would continue to provide its services post-petition."[69] In the weeks following confirmation of the AFA Debtors' reorganization plan, the AFA Debtors filed a complaint "seeking to avoid and recover a $24,999.99 payment made ... to Trade Source by check dated [within the 90 day preference period]."[70] Trade Source filed an answer to the AFA Debtors' preference complaint and the AFA Debtors moved for summary judgment.[71] The AFA Debtors argued that their Motion for Summary Judgment should be granted because Trade Source was an unsecured creditor and, under a hypothetical chapter 7 liquidation, "unsecured creditors [would] receive less than a 100% distribution under the debtors' confirmation plan of liquidation."[72] Trade Source asserted that "even in a chapter 7 liquidation[,] it would have received 100% payment of its claim pursuant to the AFA court's Essential Suppliers Order and the parties' related agreement."[73] The *AFA* court found in favor of Trade Source because, pursuant to the Essential Suppliers Order, Trade Source and the AFA Debtors executed a letter agreement under which "Trade Source agreed to continue providing services to the Debtors in exchange for payment of its pre-petition claim within nine months," and therefore Trade Source would recover 100% in a hypothetical chapter 7 liquidation.[74]

67 *AFA*, 538 B.R. at 239.

68 *Id.* at 244.

69 *Id.* at 239.

70 *Id.* at 240.

71 *Id.*

72 *Id.* at 243.

73 *Id.*

74 *AFA*, 538 B.R. at 243.

In reaching its decision, the *AFA* court considered the Third Circuit's decision in *Kiwi*.[75] In *Kiwi*, the Third Circuit determined that "an unsecured creditor whose claim is paid in full post-petition pursuant to a court order, or court-approved stipulation, cannot then be compelled in a preference action to turn over amounts related to pre-petition payments."[76] Notably, the Third Circuit so decided because it found ***72** payments made to critical vendors pursuant to a court order to be analogous to payments made to contract parties upon assumption of executory contracts under section 365 of the Bankruptcy Code, which require any defaults to be cured.[77]

75 *Id.* (citing *Kiwi*).

76 *Kiwi*, 344 F.3d at 321.

77 *Id.* at 318.

In *HLI Creditor Trust v. Export Corp. (In re Hayes Lemmerz Intern., Inc.)*, the court entered an order, which permitted, but did not mandate, the Hayes Lemmerz Debtors to pay certain critical vendors up to a cap of $1.6

million (the "HLI Order").[78] After confirmation of the Hayes Lemmerz Debtors' reorganization plan, one of the Hayes Lemmerz Debtors filed a complaint against creditor Export "seeking to recover certain alleged preferential transfers ... totaling $286,385.66."[79] Export filed a motion to dismiss the complaint, arguing that "the pre-petition transfers at issue are greater than what Export would have received under a chapter 7 liquidation."[80] The Hayes Lemmerz Debtors responded that the motion to dismiss should be denied because they did not pay Export under the HLI Order, and, even if they did, the HLI Order was "permissive—rather than mandatory."[81] The *Hayes Lemmerz* court decided in favor of the Hayes Lemmerz Debtors because it found (1) the payments were made before filing the critical vendor motion and before entry of the HLI Order, (2) there was a factual dispute between the parties as to whether the Debtors considered Export a critical vendor, and (3) even if Export received "some payments" under the HLI Order, because it was permissive and not mandatory, "it does not follow that [Export] was entitled to receive payment of all pre-petition claims."[82] The *Hayes Lemmerz* court further concluded that the permissive nature of the HLI Order distinguished it from contracts assumed under section 365 of the Bankruptcy Code because section 365 "mandates that all pre-petition obligations be paid before a contract is assumed."[83]

78 *HLI Creditor Trust v. Export Corp. (In re Hayes Lemmerz Intern., Inc.)*, 313 B.R. 189, 191–93 (Bankr. D. Del. 2004) (hereinafter, "*Hayes Lemmerz*").

79 *Id.* at 191.

80 *Id.* at 192.

81 *Id.* at 193.

82 *Id.*

83 *Id.* at 194 (citing 11 U.S.C. § 365(b)(1)(A)).

In *Zenith Indus. Corp. v. Longwood Elastomers, Inc. (In re Zenith Indus. Corp.)*, the court entered an Essential Vendor Order on March 14, 2002, which granted the Zenith Debtors "the right, not the obligation, to pay certain discrete pre-petition claims at Zenith's own discretion" up to a cap of $1 million.[84] Prior to the entry of the Essential Vendor Order, the Zenith Debtors commenced an adversary proceeding against creditor Longwood "seeking to recover $1,317,587 of alleged § 547 preference transfers that were made during the ninety days prior to the petition date."[85] The $1,317,587 figure "comprises twelve separate transfers, including a $506,035 wire transfer made on the eve of the petition date."[86] Longwood argued in its twenty-first affirmative defense the so-called "critical vendor defense" to section 547(b)(5).[87] Longwood's argued that even if ***73** the pre-petition transfers had not been made, Longwood would have still received payments from the Zenith Debtors under the Essential Vendor Order because the Zenith Debtors considered Longwood an essential vendor; and because the transfers *would have* been made pursuant to the Essential Vendor Order, the pre-petition transfers cannot be recovered as preferences.[88] The *Zenith* court rejected Longwood's use of the critical vendor defense.[89] Specifically, the *Zenith* court held that even if Longwood established through discovery that the Zenith Debtors understood it to be an essential vendor, the defense must fail because the $506,035 figure would have drawn objections due to its size relative to the $1 million cap under the Essential Vendor Order.[90] Furthermore, the *Zenith* court agreed with the holding in *Hayes Lemmerz*, which "rejected the analogy to a situation where a debtor assumes a contract pursuant to § 365."[91]

84 *Zenith Indus. Corp. v. Longwood Elastomers, Inc. (In re Zenith Indus. Corp.)*, 319 B.R. 810, 812, 815 (Bankr. D. Del. 2005) (hereinafter, "*Zenith*").

85 *Id.* at 812.

86 *Id.*

87 *Id.*

88 *Id.* at 814–16 (*citing* *Kiwi*; *also citing* *Official Committee of Unsecured Creditors v. Medical Mutual of Ohio (In re Primary Health Systems, Inc.)*, 275 B.R. 709 (Bankr. D. Del. 2002)).

89 *Id.* at 819 ("[T]he twenty-first affirmative defense was properly struck.")

90 *Id.* at 817–18.

91 *Id.* at 817.

Importantly, the *AFA* court noted the disparity between the alleged preferential transfer and the court-ordered cap for critical vendor/essential supplier payments.[92] In *Zenith*, the transfer was $506,035 and the Essential Vendor Order cap was $1 million (over 50% of the cap);[93] whereas in *AFA*, the transfer was $24,999.99 and the Essential Suppliers Order cap was $6 million (less than one-half of 1% of the cap).[94] Thus, the *AFA* court concluded that "unlike *Zenith*, the inclusion of the alleged preference payment in the motion would not have been likely to draw an objection or result in the Court's refusal to enter the [Essential Suppliers] Order."[95]

92 *AFA*, 538 B.R. at 244.

93 *Zenith*, 319 B.R. at 812.

94 *AFA*, 538 B.R. at 244.

95 *Id.*

Regarding, *Hayes Lemmerz*, the *AFA* court distinguished its decision based on whether the creditor-at-issue was identified as a critical vendor/essential supplier pursuant to court order.[96] In *Hayes Lemmerz*, Export was not identified in the HLI Order and that order was permissive not mandatory.[97] In *AFA*, however, Trade Source had been identified as a critical vendor and the AFA Debtors "executed a separate agreement obligating themselves to pay Trade Source its pre-petition claim as long as Trade Source continued to provide post-petition services on pre-petition terms."[98]

96 *Id.*

97 *Id.*

98 *Id.*

[18]The Court determines that there is a genuine issue of material fact as to whether Vista would have been paid the full amount of the Transfers, i.e., $217,410.00, in a hypothetical chapter 7 liquidation. First, the very nature of chapter 7 liquidations often results in general unsecured creditors being paid less than 100% if they are paid anything at all. Indeed, the Debtors in this case already considered the scenario of a hypothetical liquidation in their Disclosure Statement.[99] ***74** Therein, Debtors provided that "the recovery for General Unsecured Claims is between 2.7-11.5%" based on recovery related to certain litigation.[100] Although Vista argues that in a hypothetical chapter 7 liquidation it would have been paid the same $217,410.00 under the Critical Vendor Order, had the Transfers not been paid, the Disclosure Statement dictates that were that not true Vista would have recovered less.

99 *Disclosure Statement*, at Art. VII.D and Ex. D.

100 *Id.* at Ex. D.

Second, unlike in *AFA* where the AFA Debtors and

Trade Source executed a trade agreement pursuant to the Essential Suppliers Order, Vista and Tierra never entered into a separate Trade Agreement pursuant to paragraph 5 of the Critical Vendor Order.[101] The emails between Vista and Tierra, which were sent on July 11, 2016, approximately two months prior to the Court's entry of the Critical Vendor Order, do not satisfy the creation of a Trade Agreement under the Critical Vendor Order.[102]

101 *Critical Vendor Order*, at ¶ 5.

102 *Supra* notes 21–22.

Third, unlike *AFA* but like *Zenith*, had the Transfers not been made, a transfer to Vista in the full amount of the Transfers would have plausibly drawn objections. The Transfers to Vista were in the amount of $217,410.00, which is approximately 11% of the $2 million cap under the Critical Vendor Order. The *Zenith* court's emphasis on the size of the $506,035 transfer in that case in relation to the relief granted by the Essential Vendor Order does not fall of deaf ears.[103] At the very least there is a genuine issue of material fact that, had the Transfers not been paid, a transfer valued at approximately 11% of the relief requested in the Critical Vendor Order would draw no objections. In other words, a transfer to Vista of $217,410.00 made pursuant to the Critical Vendor Order is more similar to the transfer contemplated in *Zenith* (valued at over 50% of the Essential Vendor Order cap) than to the transfer contemplated in *AFA* (valued at less than one-half of 1% of the Essential Suppliers Order cap).

103 *See* *Zenith*, 319 B.R. at 818.

Fourth, and most importantly, the authority granted the Debtors under the Critical Vendor Order was discretionary. While it is true that all of Vista's unpaid pre-petition invoices were paid under the Critical Vendor Order, the Debtors were not required to do so and it is plausible that an additional $217,410.00 would not have been paid.

As such, the Court will deny Vista's motion for summary judgment because there is a genuine issue of material fact as to whether Vista would have recovered $217,410.00 in a hypothetical chapter 7 liquidation.

This conclusion holds even though there is no genuine issue of material fact as to whether the Debtors considered Vista to be a critical vendor – they did. Defendant argues that the Debtors considered Vista to be a critical vendor because of the stark similarities between the language pertaining to Vista in the Critical Vendors Listing and the language found in paragraph 18 of the Critical Vendor Motion. In support of this argument, Vista highlights Debtors' choice of words in the Critical Vendor Motion.[104] Plaintiff argues that Debtors did not consider Vista to be a critical vendor ***75** because (1) Debtors did not explicitly refer to Vista by name in the Critical Vendor Motion, and (2) Debtors at no time entered into a separate Trade Agreement with Vista.[105]

104 *See Brief in Support of the Motion for Summary Judgment*, at ¶¶ 18–20.

105 *Plaintiff's Response*, at 2–3.

The Critical Vendors Listing and paragraph 18 of the Critical Vendor Motion share similar language pertaining to Vista. In the Critical Vendors Listing, a description of Vista begins by calling it a project that "operates under an old administrative order that **utilizes an old methodology**."[106] The Critical Vendor Motion also begins by describing a project that "operates under an old administrative order that **requires use of an older and now obsolete methodology**."[107] Vista services customers through use of an analytical method dated from January 1993.[108] Moreover, the Critical Vendors Listing's description of Vista reads, "The technology provided by vendor would be **difficult or impossible** to get from another vendor as other vendors will have switched to a new methodology."[109] Likewise, the Critical Vendor Motion offers, "**The environmental laboratory that tests samples under this specific administrative order** provides technology that would be **difficult if not impossible** to replace because vendors have switched to a newer methodology."[110]

106 *Decl. of M. Maier*, at Ex. H (emphasis added).

107 *Critical Vendor Motion*, at ¶ 18 (emphasis added).

108 *Decl. of M. Maier*, at ¶ 3.

109 *Id.* at Ex. H (emphasis added).

110 *Critical Vendor Motion*, at ¶ 18 (emphasis added).

The Debtors were not hiding the ball when they described the "environmental laboratory" that tests samples using an "older and now obsolete methodology" rather than outright naming Vista.[111] Although Debtors could have named Vista in the Critical Vendor Motion for the avoidance of doubt, Debtors' substantially similar descriptions of Vista in the Critical Vendors Listing and the "environmental laboratory" in paragraph 18 of the Critical Vendor Motion more than suffices. As such, the Debtors considered Vista to be a critical vendor. Nonetheless, the fact that the Debtors considered Vista to be a critical vendor, in and of itself, does not mean Defendant has carried its burden on summary judgment. As discussed at length above, the case law is more nuanced. Nothing in the Critical Vendor Order required Debtors to pay Vista *in full* for its pre-petition invoices. Therefore, Vista's argument on summary judgment that if the Transfers were not paid pre-petition it would have been paid pursuant to the Critical Vendor Order must fail.

111 *See Id.*

CONCLUSION

For the reasons set forth above, the Court finds that there is a genuine issue of material fact as to whether Vista would have recovered the full amount of the Transfers in a hypothetical Chapter 7 liquidation. Thus, Defendant's motion for summary judgment must be denied.

An order will be issued.

All Citations

615 B.R. 62, 68 Bankr.Ct.Dec. 196

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538 B.R. 237
United States Bankruptcy Court, D. Delaware.
IN RE: AFA INVESTMENT INC., et al.,[1] Debtors.
AFA Investment Inc., et al., Plaintiff,
v.
Trade Source, Inc., Defendant.

1 The Debtors are: AFA Investment Inc.; American Food Service Corporation; American Fresh Foods, Inc.; American Fresh Foods, L.P.; AFA Foods, Inc.; American Fresh Foods, LLC; Fairbanks Reconstruction Corporation; American Foodservice Investment Company, LLC; and United Food Group LLC.

Case No. 12–11127 Jointly Administered
|
Adv. No. 14–50185(MFW)
|
Signed September 14, 2015

Synopsis
Background: Chapter 11 debtors, which were once one of the largest ground beef processing operations in the United States, filed adversary complaint against transferee that, pursuant to prepetition sales-brokerage agreement, had agreed to sell debtors' food products in exchange for commissions, seeking to avoid and recover allegedly preferential $24,999.99 payment. Debtors moved for summary judgment.

Holdings: The Bankruptcy Court, Mary F. Walrath, J., held that:

[1] genuine issues of material fact existed with respect to whether the allegedly preferential transfer was made on account of an antecedent debt, and

[2] debtors failed to establish a prima facie case that their payment enabled transferee to receive more on account of the transfer than it would have in a hypothetical Chapter 7 liquidation, as required for the payment to constitute an avoidable preference.

Motion denied.

Procedural Posture(s): Motion for Summary Judgment.

West Headnotes (5)

[1] Bankruptcy Recovery of preferences or fraudulent conveyances

Bankruptcy court has core jurisdiction over a preference action against a creditor whose prepetition claim is paid pursuant to a "critical vendor" order, as such action is integral to the restructuring of the debtor-creditor relationship. 28 U.S.C.A. §§ 157(b)(2)(F), 1334.

2 Cases that cite this headnote

[2] Bankruptcy Antecedent debt or contemporaneous consideration

For a payment to be recoverable as an avoidable preference, it must have been made for or on account of an "antecedent" debt, that is, the debtor's obligation to pay the debt must have arisen before the challenged payment was made. 11 U.S.C.A. § 547(b)(2).

1 Cases that cite this headnote

[3] Bankruptcy Judgment or Order

Genuine issues of material fact existed with respect to whether Chapter 11 debtors' allegedly preferential transfer of $24,999.99 to entity that had agreed, pursuant to prepetition sales-brokerage agreement, to sell debtors' food products in exchange for commissions, was made on account of an antecedent debt, precluding summary judgment in debtors' preference action. 11 U.S.C.A. § 547(b)(2);

Fed. R. Bankr. P. 7056; Fed. R. Civ. P. 56(a).

[4] **Bankruptcy**Effect to give more than under bankruptcy distribution

In order for Chapter 11 debtors' challenged payment to transferee to constitute an avoidable preference, debtors had to show that transferee received more on account of the transfer than it would have in a hypothetical Chapter 7 liquidation. 11 U.S.C.A. § 547(b)(5).

2 Cases that cite this headnote

[5] **Bankruptcy**Effect to give more than under bankruptcy distribution

Chapter 11 debtors failed to establish a prima facie case that their prepetition payment to transferee, an entity that had agreed, pursuant to sales-brokerage agreement, to sell debtors' food products in exchange for commissions, enabled transferee to receive more on account of the transfer than it would have in a hypothetical Chapter 7 liquidation, as required for the challenged payment to constitute an avoidable preference; fact that transferee was an unsecured creditor did not presumptively satisfy this element of debtors' preference claim, and even in a Chapter 7 liquidation transferee would have received 100% payment of its claim pursuant to bankruptcy court's postpetition "essential suppliers order" and the parties' related continued services agreement, whereby transferee agreed to provide services to debtors in exchange for payment of its prepetition claim within nine months. 11 U.S.C.A. § 547(b)(5).

2 Cases that cite this headnote

Attorneys and Law Firms

***239** Peter J. Keane, Pachulski Stang Young & Jones LLP, Julia B. Klein, Scott J. Leonhardt, The Rosner Law Group LLC, Wilmington, DE, Joseph L. Steinfeld, Jr., ASK LLP, St. Paul, MN, for Plaintiff.

Ronald L. Daugherty, Salmon, Ricchezza, Singer & Turchi, LLP, Wilmington, DE, for Defendant.

MEMORANDUM OPINION[2]

[2] This Memorandum Opinion constitutes the findings of fact and conclusions of law of the Court pursuant to Rule 7052 of the Federal Rules of Bankruptcy Procedure.

Mary F. Walrath, United States Bankruptcy Judge

This Memorandum Opinion addresses the Motion of AFA Investment Inc., et al. (the "Debtors") for Summary Judgment on a preference complaint filed against Trade Source, Inc. ("Trade Source"). Because the Court finds that there are issues of material fact with respect to whether or not the challenged transfer was made on account of an antecedent debt, the Motion for Summary Judgment will be denied.

I. *BACKGROUND*

The Debtors were once one of the largest ground beef processing operations in the United States. (Adv. D.I. 1, at ¶ 14.) The Debtors produced more than 500 million pounds of ground beef products annually, primarily for distribution to restaurants and retail grocery stores across the United States. (*Id.*)

On August 1, 2011, one of the Debtors, AFA Foods, Inc., executed a sales-brokerage agreement with Trade Source (the "Brokerage Agreement"). (Adv.D.I.25, Ex. B.) Under the Brokerage Agreement, Trade Source agreed to sell the Debtors' food products in exchange for commissions. (*Id.*) The Brokerage Agreement also provided for Trade Source to receive monthly "retainers" in the amount of $8,333.33. (*Id.*)

On April 2, 2012, the Debtors filed petitions for relief under chapter 11 of the Bankruptcy Code. (D.I.1.) On April 3, 2012, the Court entered an Order Authorizing the Debtors to Pay Pre–Petition Claims of Certain Essential Suppliers (the "Essential Suppliers Order"). (D.I.32.) Thereafter, the Debtors and Trade Source executed a letter agreement, pursuant to which Trade Source was to receive payment of its pre-petition claim and, in exchange, would continue to provide its services post-petition. (See Adv. D.I. 25, Ex. B.)

***240** The Debtors' joint plan of reorganization was confirmed on March 7, 2014. (D.I.1499.)

On March 28, 2014, the Debtors filed a preference complaint seeking to avoid and recover a $24,999.99 payment made by AFA Foods to Trade Source by check dated February 23, 2012. (Adv.D.I.1.) Trade Source filed an answer to the complaint on May 9, 2014. (Adv.D.I.5.) The parties attended mediation on January 23, 2015, but did not reach a settlement. (Adv.D.I.7.) On April 17, 2015, the Debtors filed a Motion for Summary Judgment. (Adv.D.I.24.) A notice of completion of briefing on that motion was filed on June 18, 2015, and the matter is now ripe for decision. (Adv.D.I.41.)

II. *JURISDICTION*

[1]The Court has core jurisdiction over this adversary proceeding. 28 U.S.C. §§ 1334 & 157(b)(2)(F). *See Stern v. Marshall,* —— U.S. ——, 131 S.Ct. 2594, 2617, 180 L.Ed.2d 475 (2011) ("[a] preferential transfer claim can be heard in bankruptcy when the allegedly favored creditor has filed a claim, because then 'the ensuing preference action by the trustee become[s] integral to the restructuring of the debtor-creditor relationship.' ") (citations omitted). The Court finds that a preference action against a creditor whose pre-petition claim is paid pursuant to a "critical vendor" order is similarly integral to the restructuring of the debtor-creditor relationship.

III. *DISCUSSION*

The Debtors argue that their Motion for Summary Judgment should be granted because there are no disputed issues of material fact as to the prima facie elements of the preference action and they are entitled to judgment as a matter of law on all of Trade Source's asserted defenses.

Trade Source argues that the Motion should be denied because the Debtors have not established that the allegedly preferential transfer was made on account of an antecedent debt, have not met their burden of proof with respect to insolvency, and have not shown that Trade Source received more than it would otherwise have obtained in a hypothetical chapter 7 liquidation. In addition, Trade Source asserts that the new value and ordinary course of business defenses apply to the allegedly preferential transfer.

A. *Standard of Review*

Summary judgment is proper if there is no genuine dispute over any material fact and if, viewing the facts in the light most favorable to the non-moving party, the moving party is entitled to judgment as a matter of law. Fed.R.Civ.P. 56(a); Fed. R. Bankr.P. 7056. *See also Celotex Corp. v. Catrett,* 477 U.S. 317, 322, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986).

The movant bears the burden of establishing that no genuine dispute as to any material fact exists. *See Matsushita Elec.Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 585 n.10, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986). A fact is material when it could "affect the outcome of the suit." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 252, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986). Once the moving party establishes a prima facie case in its favor, the opposing party must go beyond the pleadings and identify specific facts showing more than a scintilla of evidence that a genuine dispute of material fact exists. *See, e.g., Anderson*, 477 U.S. at 252, 106 S.Ct. 2505; *Matsushita*, 475 U.S. at 585–86, 106 S.Ct. 1348; *Michaels v. New Jersey*, 222 F.3d 118, 121 (3d Cir.2000).

***241** B. *Elements of an Avoidable Preference*

For a payment to be recoverable as a preferential transfer, it must meet the requirements of section 547(b) of the Bankruptcy Code. Under section 547(b), the Debtors can avoid as a preference a transfer:

> (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 ... on or within ninety (90) days before the date of the filing of the petition ...; 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.

See 11 U.S.C. § 547(b).

The Debtors argue that they have established a prima facie case with respect to each of these five elements, while Trade Source contends that there are issues of material fact with respect to elements two, three and five.

1. *Antecedent Debt*

[2]For a payment to be recoverable as an avoidable preference, it must have been made for or on account of an antecedent debt. 11 U.S.C. § 547(b)(2). For a debt to be antecedent, the debtor's obligation to pay must have arisen before the challenged payment was made. *In re Vaso Active Pharm., Inc.,* 500 B.R. 384, 393 (Bankr.D.Del.2013) ("A debt is antecedent for the purposes of Section 547(b) if it was incurred before the debtor made the allegedly preferential transfer.").

[3]The Debtors argue that the challenged transfer was made in satisfaction of pre-existing obligations to Trade Source. In support, the Debtors offer the declaration of their Chief Restructuring Officer ("CRO"), David J. Beckman, which states that the $24,999.99 payment satisfied three, sixty-one (61) day-old invoices, each in the amount of $8,333.33. Attached to the declaration are a copy of the Brokerage Agreement, a copy of the $24,999.99 check, a historical payment record for Trade Source's account, and a "paid invoices list" purportedly showing all payments made by the Debtors to Trade Source within the 90–day preference period.

Trade Source argues that the challenged payment was not made in satisfaction of a pre-existing obligation, but was instead a retainer for future services. In support, Trade Source offers the declaration of its President, Keith Jahnke, stating that the challenged transfer was a voluntary pre-payment, to which Trade Source only became entitled through subsequent performance under the Brokerage Agreement. Trade Source further maintains that it earned commissions in excess of $24,999.99 after receiving the transfer.

The Debtors reply that it is unlikely that the $24,999.99 payment was a pre-payment under the Brokerage Agreement. They contend that $8,333.33 was due to Trade Source each month as a base payment, independent of earned commissions, and further note that $24,999.99 is equivalent to three such monthly payments.

The Debtors assert that the challenged payment was made in March 2012, while the last prior payment was made in December 2011. Thus, they argue that at the time the payment was made, at least ***242** $16,666.66 was past-due for the months of January and February 2012 and $8,333.33 was currently due for March. The Debtors also argue that such a large voluntary advance would not have made sense given their financial distress. Lastly, the Debtors claim that if Trade Source had, in fact, earned commissions in excess of $25,000 during the month of April, additional payments would have come due. The Debtors claim that none were billed.

The Court finds that there are issues of material fact with respect to whether or not the allegedly preferential transfer was made on account of an antecedent debt.

First, there is conflicting evidence as to whether the monthly "retainers" were a base payment or voluntary pre-payments for future services. (*Compare* Declaration of David Beckman, Adv. D.I. 25, ¶ 10–11, 15 *with* Declaration of Keith Jahnke, Adv. D.I. 27–1, ¶ 4–5.)

The Court cannot determine from the Brokerage Agreement alone whether the monthly retainers were, or were not, prepayments for future services. The Brokerage Agreement uses the term "retainer," which may mean a pre-payment for future services, but can also mean a present payment. *See In re Insilco Technologies Inc.,* 291 B.R. 628, 632 (Bankr.D.Del.2003) (discussing different types of "retainers".) Additionally, the Brokerage Agreement states that the retainer would be paid in accordance with AFA Foods "Policy Statement of Payment Terms to Brokers," which has not been provided to the Court. (Adv. D.I. 25, Ex. B at 8.)

On a motion for summary judgment, the Court must view the facts in the light most favorable to the non-moving party and, therefore, assumes that under the Brokerage Agreement "retainer" means a pre-payment for future services.

However, the Debtors contend that even if the retainers were originally intended as pre-payments, the $24,999.99 transfer covered retainers that were unpaid from prior months. In support, the Debtors rely on the testimony of their CRO and supporting documentation in the form of "paid invoice statements." However, the invoice statements are records of the Debtors and at least one, sub-titled "All Paid Invoices Within the Preference Period," was created post-petition. The other, an "historical payment record," may have also been prepared post-petition and says nothing about the nature of the disputed payment. Thus, these statements carry little evidentiary weight.

In addition, the statements are inconsistent with other documentation submitted by the Debtors. The summary attached to the Debtors' complaint lists the "invoice numbers" associated with the disputed transfer as "10/1/2011," "11/1/2011," and "12/1/2011," while the invoice statement attached to the Debtors' brief lists them as "40817," "40848," and "40878." Further, while the Debtors argue that the payments could have also been attributed to amounts due for January and February 2012, there is no evidence there were any invoices for those periods. Moreover, there are no copies of any actual invoices attached to the Debtors' submissions.

Therefore, the Court finds that the evidence on this issue is contradictory. On a motion for summary judgment, when a factual dispute arises that cannot be resolved without a credibility determination, the Court must deny summary judgment. *See Adams v. Selhorst,* 779 F.Supp.2d 378, 385 n.6 (D.Del.2011).

Thus, the Court finds that the Debtors have not met their burden of showing that no genuine issue of material fact exists with respect to whether or not the allegedly ***243** preferential transfer was made on account of an antecedent debt.[3]

[3] Trade Source also contends that the Debtors have failed to establish insolvency. The Debtors rely on the presumption of insolvency in section 547(g). However, Trade Source contends that the Debtors cannot rely on the presumption because they failed to produce documents related to insolvency in discovery. Because the Court finds that there are issues of material fact with respect to whether the allegedly preferential transfer was made on account of an antecedent debt, it does not need to reach the issue of the Debtors' solvency. Further, any discovery issue should be addressed by proper motion.

2. *Hypothetical Liquidation*

[4]In order for the challenged payment to constitute an avoidable preference the Debtors must also show that Trade Source received more on account of the transfer than it would have in a hypothetical chapter 7 liquidation. 11 U.S.C. § 547(b)(5).

[5]The Debtors claim that this element is presumptively satisfied because Trade Source was an unsecured creditor, and unsecured creditors will receive less than a 100% distribution under the Debtors' confirmed plan of liquidation. *See In re Total Tech. Serv., Inc.,* 150 B.R. 893 (Bankr.D.Del.1993).

Trade Source argues that the element is not satisfied because even in a chapter 7 liquidation it would have received 100% payment of its claim pursuant to the Court's Essential Suppliers Order and the parties' related agreement.

The Court agrees with Trade Source. The Third Circuit has held that an unsecured creditor whose claim is paid in full post-petition pursuant to a court order, or a court-approved stipulation, cannot then be compelled in a preference action to turn over amounts related to pre-petition payments. *In re Kiwi Int'l Air Lines, Inc.,* 344 F.3d 311, 321 (3d Cir.2003).

In *Kiwi,* the trustee sought to recover payments made within the preference period to creditors whose contracts had been assumed by the debtor, obligating it to cure all pre-petition claims. *Id.* at 315. As the Debtors argue here, the trustee in *Kiwi* claimed that the Court had to consider a hypothetical liquidation on the petition date, at which time the creditors were in the same position as other general unsecured creditors whose contracts were never assumed. Because those creditors had received payment within the preference period and other unsecured creditors would receive less than a 100% distribution under the debtor's confirmed plan, the trustee argued that section 547(b)(5) was satisfied. *Id.*

However, the Third Circuit disagreed with the trustee's analysis in *Kiwi* because it ignored the special rights those creditors had under section 365. *Id.* at 321. Had the challenged payments not been made pre-petition, the Third Circuit reasoned, the creditors would have been entitled to receive those payments post-petition under section 365. *Id.*

The Third Circuit reached the same conclusion with respect to a creditor who had been paid its pre-petition claim pursuant to section 1110 of the Bankruptcy Code. *Kiwi,* 344 F.3d at 321 (*citing* *Seidle v. GATX Leasing,* 778 F.2d 659 (11th Cir.1985)).

The Court finds the *Kiwi* and *Seidle* holdings persuasive in this case. Post-petition, the Court entered the Essential Suppliers Order. (D.I.32.) Pursuant to that Order, the Debtors and Trade Source executed a continued services agreement, by which Trade Source agreed to continue providing services to the Debtors in exchange for payment of its pre-petition claim within nine months. (*See* Declaration of Keith Jahnke, Adv. D.I. 27–1, at ***244** ¶¶ 11–12; Adv. D.I. 27, Ex. B.) Thus, as was the case in both *Kiwi* and *Seidle,* had the alleged preferential payment not been made pre-petition, Trade Source would have received that payment post-petition, as part of the continued services agreement it had with the Debtors.

The Debtors argue that creditors cannot rely on a critical vendor order to defend against a preference claim in the District of Delaware. *See* *Zenith Indus. Corp. v. Longwood Elastomers, Inc. (In re Zenith Indus. Corp.),* 319 B.R. 810, 814 (D. Del. 2005) (holding that it was pure speculation that if the preference payment had not been made, the vendor would have been included as a critical vendor and the court would have approved it); *HLI Creditor Trust v. Export Corp. (In re Hayes Lemmerz Int'l, Inc.),* 313 B.R. 189, 193 (D.Del.2004) (holding that the critical vendor order was not a defense because it permitted, rather than mandated, payment of pre-petition claims of critical vendors). However, the Court finds that *Hayes Lemmerz* and *Zenith* are distinguishable.

In *Hayes Lemmerz* the Court based its holding, in part, on the fact that the creditor had not been identified in the Critical Vendor Order and that the Order was permissive not mandatory. *Hayes Lemmerz,* 313 B.R. at 193. Here, the Debtors identified Trade Source as a critical vendor and executed a separate agreement obligating themselves to pay Trade Source its pre-petition claim as long as Trade Source continued to provide post-petition services on pre-petition terms. (Adv.D.I.27, Ex. B.) The critical vendor motion was in fact approved in this case and the Debtor executed and complied with the agreement to pay Trade Source's pre-petition claims. (*See* Declaration of Keith Jahnke, Adv. D.I. 27–1, at ¶¶ 11–12.)

Zenith is also distinguishable. In *Zenith* the Court noted that the alleged preference was large (over $500,000) in relation to the approved cap in the Critical Vendor Order ($1,000,000). It concluded that it was, therefore, unlikely that there would be no objection and that the Court would have approved the creditor as a critical vendor. *Zenith,* 319 B.R. at 818–19. In this case, the alleged preference is a mere fraction of the critical vendor cap ($24,999 versus $6,000,000). (D.I.32.) Thus, the Court finds that unlike in *Zenith,* the inclusion of the alleged preference payment in the motion would not have been likely to draw an objection or result in the Court's refusal to enter the Order.

Therefore, the Court finds that the Debtors cannot establish a prima facie case with respect to this element of their preference claim, and their Motion for Summary Judgment must, therefore, be denied.[4]

[4] While Trade Source also argues that it has affirmative defenses to the Complaint, the Court finds it unnecessary to address them at this time because it has already determined that the Debtors' Motion for Summary Judgment must be denied. Nor can the Court enter judgment in favor of Trade Source because Trade Source did not itself file a Motion for Summary Judgment.

IV. *CONCLUSION*

For the foregoing reasons, the Debtors' Motion for Summary Judgment will be denied.

An appropriate order is attached.

All Citations

538 B.R. 237, 61 Bankr.Ct.Dec. 148

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Faculty: A Case Study on Common — and Uncommon — Defenses to Preference Actions

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