11 USC § 547(c)(2)

Hostmann v. Kaiser Aluminum Corp, Adv No. 93-3436-dds

In re XTI XONIX TECHNOLOGIES, INC., Case No. 391-36468-dds7

DDS 5/3/94 unpublished

The trustee sued a supplier under §§ 547 and 550 to recover transfers made within 90 days of the filing of the bankruptcy petition. Part of the transfer was debt assumed by a company that bought a division of the debtor one week before the chapter 11 was filed. The balance was payments from the debtor to the defendant.

The court granted summary judgment in favor of the trustee. The assumption of debt was not in the ordinary course of business, and constituted an avoidable transfer under In re Food Catering & Housing Inc.. The payments were late, and the history between the debtor and the defendant was not sufficient to establish that late payments met the requirements of the ordinary course of business defense. The transfers were recoverable from Kaiser as the initial transferee or as the entity for whose benefit the transfer was made.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	)	Bankruptcy Case No.
	)	391-36468-dds7
XTI XONIX TECHNOLOGIES	)	
INCORPORATED,	)	Adversary Proceeding No.
	)	93-3436-dds
Debtor,	)	
	)	MEMORANDUM IN SUPPORT
	)	OF JUDGMENT IN FAVOR
EDWARD C. HOSTMANN, Trustee,	)	OF TRUSTEE FOR $54,985.56
	)	
Plaintiff,	)	
	)	
v.	)	
	)	
KAISER ALUMINUM CORPORATION,	)	
a Delaware corporation,	)	
	)	
Defendant.	)	

The trustee filed this preference suit against a company that supplied aluminum extrusion products to the debtor. The first claim is for $31,516.26 which was the amount owed to Kaiser that Jishodukoritsu, Inc ("JI") assumed when it bought the Phoenix Gold Division from the debtor. The sale of Phoenix Gold occurred about one week before the debtor filed

chapter 11[1]. The second claim is for $23,469.30 [2] for payments made by the debtor to Kaiser within the 90 days before the chapter 11 was filed.

The trustee moved for partial summary judgment on the transfers which occurred when JI assumed the debts. Kaiser filed a cross-motion for summary judgment for both claims on the basis of its ordinary course of business defense. The trustee agreed that all the relevant facts were before the court and the matter could be resolved on cross motions based on stipulated facts.

The trustee's motion for summary judgment should be granted and Kaiser's cross-motion denied. My reasons follow.

First claim - assumption of debt

The trustee has strong support for his position in the case of Mordy v. Chemcarb, (In re Food Catering & Housing Inc.), 971 F.2d 396 (9th Cir. 1992). The facts of Food Catering are close to those in this case. When the debtor transferred the Phoenix Gold assets to JI, and JI assumed the remaining debt to Kaiser as part of the purchase price, that was a transfer for the benefit of Kaiser. The transfer was not

[1] Unless otherwise indicated, all Chapter and Section references are to the Bankruptcy Code, 11 U.S.C. §§ 101 et seq.

[2] The complaint is for $32,333.10, but was reduced on pg. 14 of plaintiff's response to $23,469.30 because of a double counting of one of the payments involved.

in the ordinary course of business of the debtor because it was the transfer of an entire operating division to a newly formed corporation.

At argument, Kaiser conceded all elements of the trustee's case in chief except § 547(b)(2). Kaiser argued that the assumed debt was not "antecedent debt" because the invoice was not yet due when JI assumed the obligation. A debt arises when the creditor obtains a claim against the debtor. § 101(12). The term claim is broadly defined in § 101(5) and would include the debt incurred by the debtor when it ordered supplies from Kaiser. The invoices for goods shipped to the debtor referred to antecedent debt for which the debtor was obligated before the transfers to JI. See, In re Cybermech, Inc. 13 F.3d 818 (4th Cir. 1994). According to Food Catering, the transfer of the Phoenix Gold division to JI was, at least in part, a transfer "for or on account of the antecedent debt owed by the debtor" to Kaiser. The trustee established all the elements of § 547(b) with respect to the transfers.

Kaiser also argued that the subsequent payments by JI were within the time frame that was ordinary between the debtor and Kaiser, so they fall within the ordinary course of business exception. However, the transfer at issue concerning the assumed debt is the transfer of the Phoenix Gold Division to JI. JI paid less cash to the debtor than it would have for the

assets because part of the selling price was the assumption of $900,000 of wage and trade debt owed by the Phoenix Gold division on the date of the transfer.

Sections 547(c)(2)(A) & (B) focus on the ordinary course of business of the debtor and the transferee, not "such creditor". The transferee was JI, and it was not a payment in the ordinary course of business for either XTI Xonix or JI to transfer or acquire an entire division of a company. Kaiser was "such creditor" that was benefitted by the transfer. Food Catering 971 F.2d at 398. The preferential transfer to JI is recoverable under § 550(a)(1) from the initial transferee (JI) or the entity for whose benefit the transfer was made (Kaiser).

In addition and alternatively,

First and Second Claim - late payments

The payments to Kaiser were late, and do not fall within the ordinary course of business exception found in § 547(c)(2). The history of payments between Kaiser and Phoenix Gold is contained in a chart, which is attached as Exhibit A. There was one purchase in 1989, then a gap of two years between transactions. The history relied on by Kaiser consisted of six orders the debtor placed with Kaiser within a one month period that occurred within a year of the bankruptcy. The deposition testimony of David Bills says that the debtor's financial condition was very negative during the year before

the sale of Phoenix Gold; that the condition was desperate. David Bills was an employee of the debtor at the time of the sale of Phoenix Gold to JI.

A close look at the "prior relationship" indicates that there really was not much of a prior relationship from which to draw a conclusion. The average calculated from the brief and sporadic relationship portrayed on Exhibit A is not a meaningful statistic on which to base a finding of an "ordinary" course of business.

Kaiser submitted the affidavit of Kirk McVean to show it was "ordinary" for the debtor and other creditors to pay Kaiser 30 - 60 days late. Mr. McVean states that during the period that the payments involved were made, August 1991 through December 1991, approximately 4% to 6% of Kaiser's invoices were within the 30 - 60 day past due range.

Kaiser cited the cases of Jones v. United Savings and Loan Assn. (In re USA Inns of Eureka Springs, Arkansas, Inc.), 9 F.3d 680 (8th Cir. 1993) and In the Matter of Tolona Pizza Products, Corp, 3 F.3d 1029 (7th Cir. 1993). The bankruptcy court in Jones found that there was no evidence to sustain the creditor's burden of proof that the late payment practice between the debtor and the creditor was an industry wide practice. The Eighth Circuit decided that this finding was clearly erroneous.

The Eighth Circuit said that "what constitutes ordinary business terms will vary widely from industry to industry." 9 F.3d at 685. The evidence the Court of Appeals determined was adequate was the testimony of the president, CEO and chairman of the board of the defendant bank. He said "probably 8 - 10% of the bank's accounts were on a similar pay schedule as the debtor, but that working with delinquent customers as long as some type of payment was forthcoming was common industry practice." .... The Court of Appeals found that the terms on which the bank dealt with the debtor were not so idiosyncratic or extraordinary as to fall outside the broad scope of § 547(c)(2)(C). Section 547(c)(2)(C) is the industry practice subsection, or objective test. The bankruptcy court in Jones had determined that the payments were made within the ordinary scope of the relationship between the debtor and the defendant under § 547(c)(2)(B), and that finding was not contested on appeal.

The Ninth Circuit BAP has strictly construed the term ordinary course to eliminate late payments. In one case, the panel noted that payment was overdue by almost a week when the shipment that was set off was ordered by the creditor. The BAP stated that the facts of the case, especially the fact that the payment was one week overdue took the transfer outside the ordinary course of business defense as a matter of law. Matter

of Gold Coast Seed Co, 24 Bankr. 595, 597 (9th Cir BAP 1982). The Court of Appeals has cited the analysis in Gold Coast Seed with approval. Food Catering, 971 F.2d at 398.

Although Gold Coast Seed was decided when there was a 45 day rule included in the ordinary course defense, that was a separate subsection of 547(c)(2), and does not require a change in the analysis of § 547(c)(2)(B). The BAP considered the element of lateness separately from the 45 day subsection. In In re Powerine Oil Co, 126 Bankr. 790 (9th Cir. BAP 1991) the panel stated "while failure to make payments within the time required by the contract creates a rebuttable presumption that the payment is non-ordinary, late payments can be within the ordinary course of business if they are a few days late and follow the prior practice between the parties." 126 Bankr. at 795. This discussion was in a separate part of the opinion than the consideration of the 45 day rule.

There was not much "prior practice" between the debtor and Kaiser. There was not a long history of regular dealing between the parties sufficient to counteract the literal terms of the contract. See, Logan v. Basic Distribution Corp. (In re Fred Hawes Organization, Inc.), 957 F.2d 239, 244 (6th Cir. 1992). All but one transaction between the parties occurred just a few months before the preference period began.

The payments at issue were between 29 and 56 days past

due. The fact that only 4 - 6% of Kaiser's customers pay that late supports a finding that this is not ordinary in Kaiser's business or the industry. Kaiser typically makes collection calls on accounts that are 10 days past due. Although Kaiser's records do not indicate any collection activity against the debtor, if these payments are considered "ordinary" there is almost nothing left to be "extraordinary".

Even if the Jones decision that 8% - 10% was within the range of "ordinary for the industry", not "idiosyncratic or extraordinary", is correct, the 4% - 6% range in this case slices off half of the percentage used in Jones. On a bell curve, 4% - 6% is certainly at the outer limits of the curve, and falls outside of ordinary which Black's Law Dictionary defines as "regular, usual, normal, common, often recurring, according to established order, settled, customary, reasonable, not characterized by peculiar or unusual circumstances, belonging to, exercised by, or characteristic of, the normal or average individual." 4% - 6 % falls outside the "average," which is 50%. It is on the fringe.

Conclusion

The transfers and payments involved were preferential transfers made within 90 days of the bankruptcy filing that allowed Kaiser to receive more than it would have received in a chapter 7. The payments do not fall within the ordinary

course of business exception because the history between Kaiser and the debtor was too limited to create a normal or common practice between them sufficient to override the contract terms. The payments were late, and not within the average payment period in the industry.

The transfers are recoverable from Kaiser as the initial transferee or as the creditor for whose benefit the transfer was made. A separate judgment will be entered.

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DONAL D. SULLIVAN
Bankruptcy Judge

cc: Sanford R. Landress
Bradley O. Baker