11 U.S.C. § 547(c)(1)
11 U.S.C. § 547(c)(2)
11 U.S.C. § 547(c)(4)
11 U.S.C. § 547(a)(2)
new value
recoupment

In re Smith's Home Furnishings, Inc., Case No. 395-35704-elp7
Batlan v. Equifax Check Services, Inc., Adv. No. 97-3134

12/30/97 ELP Unpublished

In this preference action, the court determined that payments made 118, 94, and 107 days after invoice were not in the ordinary course of business. Payment terms were 90 days after invoice, and debtor had paid more than 90 days after invoice only once before the preference period.

The court determined that defendant's forbearance from exercising its right to recoup amounts it owed debtor against amounts debtor owed it did not consitute new value for either the contemporaneous exchange or the new value defense. Forbearance does not fit within the statutory definition of new value.

Defendant did give new value by continuing to provide services after the preferential payments were made. Defendant was not entitled to recoup the amounts it owed the trustee for recovery of preferences against the amounts debtor owed it. The debts did not arise from the same transaction, and recoupment is not a valid defense to a preference claim.

UNITED STATES BANKRUPTCY COURT

FOR THE DISTRICT OF OREGON

In Re:	)	Bankruptcy Case No. 395-35704-elp7
SMITH'S HOME FURNISHINGS, INC.,	)	
Debtor,	)	Adversary Proceeding No. 97-3134-elp
MICHAEL B. BATLAN, Trustee,	)	MEMORANDUM OPINION
Plaintiff,	)	
v.	)	
EQUIFAX CHECK SERVICES, INC.,	)	
Defendant.	)	

This matter came before the court for trial on the trustee's action to recover three payments totaling $90,806.95 as preferences under 11 USC § 547(b). Defendant raises affirmative defenses of ordinary course of business and contemporaneous or subsequent new value. It also alleges that the payments are subject to recoupment.

FACTS

Defendant provided check warranty services to debtor. Under the parties' Check Purchase Agreement, when a customer wanted to pay for a purchase by check, debtor would request an approval of the

check from defendant. Defendant would approve or decline the check based on information in its database. If an approved check was later dishonored or otherwise not paid, defendant was obligated to purchase the check from debtor for its face amount up to $5,000, provided the check met certain specified criteria. Debtor would submit claims monthly to defendant for checks defendant had approved but that were not paid. Defendant paid on approved claims within 30 days.

Debtor paid fees for defendant's check authorization and warranty services, which were based on numerous factors including the face value of checks and the number of checks warranted or declined. Defendant billed monthly, and issued invoices on the last day of the month. According to the parties' agreement, debtor was to pay the invoices within 30 days, but in no event more than 90 days after invoice. The agreement allowed defendant to offset amounts it owed debtor for warranty claims against amounts debtor owed it for the check authorization and warranty services. Defendant never exercised its right to offset before debtor filed bankruptcy.

During the 90 days before bankruptcy, debtor paid the February 28, 1995 invoice for $28,662.13 on June 26, 1995, 118 days after invoice; the March 31, 1995 invoice for $33,802.50 on July 3, 1995, 94 days after invoice; and the April 30, 1995 invoice for $28,341.97 on August 15, 1995, 107 days after invoice. Also during that period, sometime after July 3 defendant paid debtor $62,233.43 on claims for warranted checks. Although it had a right to offset

that amount, it did not exercise the right but instead made the warranty claim payment. Defendant continued to provide check authorization and warranty services to debtor through the preference period and after debtor filed bankruptcy.

Debtor filed Chapter 11 on August 22, 1995. The case was converted to Chapter 7 in October 1995.

ISSUES

1. Did debtor prove its prima facie case under section 547(b)?

2. Did defendant prove its defenses under section 547(c)?

A. Were the payments made in the ordinary course of business?

B. Did defendant give new value for the payments?

(i) Was defendant's $62,233.43 payment to debtor new value because defendant had a contractual right to recoup amounts it owed to debtor against amounts debtor owed to defendant?

(ii) Was defendant's continued provision of services new value?

C. Is defendant entitled to retain the preferential payments as a recoupment of its payments to debtor?

DISCUSSION

Section 547(b) provides that a trustee may avoid any transfer of an interest of the debtor in property (1) to or for the benefit of a creditor; (2) on account of an antecedent debt; (3) made while the debtor was insolvent; (4) made within 90 days before the filing of the petition; and (5) that enables the creditor to receive more than the creditor would receive in a chapter 7 liquidation if the transfer had not been made. The trustee has the burden to show that

the payments are avoidable, and the creditor has the burden to show the applicability of the defenses set out in section 547(c). 11 USC § 547(g).

The parties stipulate that all of the preference requirements are met except that the payments were transfers of debtor's property, or that the payments resulted in defendant receiving more than it would receive in a Chapter 7 liquidation.

1. Prima facie case

Defendant argues that debtor's payments during the preference period were not transfers of an interest of the debtor in property, because defendant had a contractual right to recoup amounts it owed debtor on warranty claims against amounts debtor owed it for providing the check approval and warranty services. Essentially it argues that the right to recoupment should be treated like a security interest, and therefore defendant's right to the funds debtor used to pay its obligation to defendant was superior to debtor's right to those funds.

Debtor made the payments with checks drawn on its general checking account. Even assuming that defendant had a right to recoup the amount it owed against amounts debtor owed it, debtor's payments from its general account were transfers of property belonging to debtor.

Defendant also argues that the transfers did not allow it to receive more than it would have received under a Chapter 7 liquidation, because it had a right to recoup those payments. That argument is dependent on defendant's success on its recoupment

defense, which I will discuss later in this opinion.

2. Defenses

A. Ordinary course of business

An otherwise preferential transfer is not avoidable if it is made in the ordinary course of business. 11 USC § 547(c)(2). The ordinary course of business exception applies if the transferee proves that (1) the debt was incurred in the ordinary course of business of the debtor and the transferee; (2) payment on the debt is ordinary in relation to past practices between the debtor and the transferee; and (3) the payment is ordinary in relation to prevailing business standards. In re Food Catering & Housing, Inc., 971 F2d 396, 398 (9th Cir 1992). There is no dispute that the charges in this case were made in the ordinary course of business.

(i) Past practices between debtor and creditor

In determining whether the payments are ordinary in relation to past practices between the debtor and the creditor, courts compare the payments at issue to the prior course of dealing between the parties and consider various factors, including the method, form, timing and amount of payment and whether the payment arises out of unusual debt collection or payment practices. See Lovett v. St. Johnsbury Trucking, 931 F2d 494 (8th Cir 1991); In re Powerine Oil Co., 126 BR 790 (9th Cir BAP 1991); In re Morris, 53 BR 190 (Bankr D Or 1985). Delay in payment is particularly relevant. Food Catering & Housing, Inc., 971 F2d at 398. 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. In re Grand

Chevrolet, Inc., 25 F3d 728 (9th Cir 1994); Lovett, 931 F2d at 498; Powerine Oil Co., 126 BR at 795.

According to the stipulated facts, invoices were to be paid within 30 days, but in no event later than 90 days after invoice. The parties' payment history before the preference period shows that payments were made anywhere from 58 to 91 days after invoice. Only one payment was made 91 days after invoice. Most payments were made within 70 days.

The payments at issue here were paid 118, 94, and 107 days after invoice. Because the payment terms were that payment was to be made at the latest 90 days after invoice, and debtor had paid later than that on only one occasion before the preference period, the payments during the preference period were not ordinary in relation to past practices of the parties.

This conclusion is supported by defendant's demand after receipt of the June 26 payment that future payments be made within a time certain, setting dates for payment that were less than 80 days after invoice. Although there is no evidence that defendant took any further action when debtor failed to make the payments as demanded, the demand itself indicates pressure on debtor to make payments more timely and shows that defendant did not consider payment more than 90 days after invoice to be ordinary.

(ii) Ordinary in the industry

In considering whether the payment is ordinary under prevailing business standards, the court applies an objective test to determine whether the transaction is ordinary according to the

practices common to businesses similarly situated to the creditor and debtor. In re Loretto Winery, Ltd., 107 BR 707 (9th Cir BAP 1989).

Defendant's evidence does not show that payment more than 90 days after invoice is ordinary in the industry. Defendant is one of two companies that dominate the check approval and guaranty industry. According to the testimony, normal payment terms are 30 days after invoice. For larger customers, payment terms are negotiated, and can provide for payment between 45 and 60 days after invoice. No customers other than debtor had 90 days within which to pay.

The provision allowing debtor 90 days after invoice to pay is not ordinary in the industry. Therefore, the payments were not in the ordinary course of business.

B. New value

Defendant argues that it gave new value, either contemporaneously or subsequently to debtor's payment, by paying debtor $62,233.43 on warranty claims and by continuing to provide services to debtor after the three preference period payments were made.

> A preferential transfer is not avoidable
>
> "to the extent that such transfer was --
>
> "(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> "(B) in fact a substantially contemporaneous exchange[.]"

11 USC § 547(c)(1). A transfer is also not preferential if, after the debtor makes the transfer, the creditor gives

> "new value to or for the benefit of the debtor --
>
> "(A) not secured by an otherwise avoidable security interest; and
>
> "(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor."

11 USC § 547(c)(4). This latter exception contains two key elements: (1) the creditor must give unsecured new value; and (2) the new value must be given after the preferential transfer. In re IRFM, Inc., 52 F3d 228, 231 (9th Cir 1995).

(i) $62,233.43 payment by defendant to debtor

Defendant asserts that its July 3 payment to debtor of $62,223.43 on its warranty claims constituted new value, either contemporaneous with the debtor's July 3 invoice payment or subsequent to the first two payments made during the preference period. Because the dispositive issue with relation to this payment for both new value defenses is whether new value was given, I will discuss the two defenses together.

New value is

> "money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, . . . but does not include an obligation substituted for an existing obligation."

11 USC § 547(a)(2). The trustee argues that the warranty claim payment was not new value, because it was like an insurance

payment, which is simply a benefit of the insurance coverage. Defendant argues that it was new value because defendant had a contractual right to recoup amounts it owed to debtor against amounts debtor owed to defendant, so that its payment was like the release of a security interest.

Payments by a debtor in exchange for a fully secured creditor's release of its security interest constitutes new value. In re E.R. Fegert, Inc., 887 F2d 955, 959 (9th Cir 1989); Grassmueck v. Food Industries Credit Union, 127 BR 869, 873 (Bankr D Or 1991). Those cases reason that the release of the lien replenishes the estate to the benefit of all the creditors. 887 F2d at 959. Further, release of a lien on debtor's property falls specifically within the definition of "new value" as the release of property previously transferred. 127 BR at 873.

On the other hand, the majority of cases have held that forbearance from exercising a previously existing right is not new value within the meaning of section 547(a)(2). See, e.g., Drabkin v. A. I. Credit Corp., 800 F2d 1153, 1157-58 (DC Cir 1986); In re Cimmaron Oil Company, Inc., 71 BR 1005 (ND Tex 1987); In re Riggs, 129 BR 494, 496 (Bankr SD Ohio 1991); In re Control Electric, Inc., 66 BR 624 (Bankr ND Ga 1986). The reasoning of these cases varies. In some cases, the court points out that forbearance does not replenish the estate to the benefit of other creditors. In re Riggs, 129 BR at 497-98. In other cases, the forbearance arguably does benefit the estate economically. In Drabkin, the creditor, an undersecured insurance premium financier, effectively lost the

right to receive premium refunds by forbearing from canceling the debtor's insurance policy. The court concluded that allowing an undersecured creditor to treat forbearance from foreclosing on its security interest as new value would be contrary to the bankruptcy principle of equality of distribution, because it would give the creditor too much leverage to demand payments, to the detriment of other creditors. 800 F2d at 1159. In Control Electric and Cimmaron Oil, as a result of the debtor's payment, the creditor was deprived of an arguably valuable inchoate statutory lien. The courts held that the failure to assert a statutory lien, which is effectively forbearance, simply did not fit within the statutory definition of new value. 66 BR at 627; 71 BR at 1009.

Some courts treat forbearance from asserting an inchoate lien as new value if the estate is not diminished economically by the debtor's payment. In re Johnson, 25 BR 889, 897 (Bankr ED Tenn 1982)(construction lien). One bankruptcy court extended this reasoning to a creditor that was deprived of a right to setoff as a result of the debtor's payment. In re Mason and Dixon Lines, Inc., 65 BR 973 (Bankr MDNC 1986). The court reasoned that the relinquishment of the setoff right constituted new value because it was involuntary:

> "It appears [the debtor] believes that it could cut off defendant's right of setoff prepetition by payment and then recover that payment as preferential and extinguish the creditor's right to setoff which would have arisen absent payment. This appears to be convoluted reasoning. If followed, this tactic would deny a creditor a right to offset which section 553 of the Code says the bankruptcy law does not affect. This Court finds it hard to believe that defendants would have 'voluntarily' paid [the debtor]

> if [the debtor] had not paid defendants' bills. No factors were presented to the Court to suggest why [the creditor] would have relinquished a right to offset had [the debtor] not paid [the creditor]. The [common carrier] regulations, common trade practice, and logic suggest that the payments were reciprocal in nature and that absent payments from [the debtor] the creditor would have taken an offset and not 'voluntarily' relinquished this right."

65 BR at 977-78. Unlike the creditor in Mason and Dixon, defendant voluntarily relinquished its right of recoupment. Consequently, the rationale of the Mason and Dixon decision regarding why loss of the right of setoff is new value simply does not apply to the facts of this adversary proceeding.

The differences in the cases can best be explained by the fact that some focus on the statutory definition of new value and others focus on the economic impact the transfer has on the estate. I agree with the courts that have focused on the statutory definition and have held that the definition of new value contained in section 547(a)(2) is exclusive. In re Energy Cooperative, Inc., 832 F2d 997 (7th Cir 1987); Cimmaron Oil Company, Inc., 71 BR at 1005. As the court explained in Cimmaron Oil,

> "to reason that the list of what constitutes 'new value' is not exclusive is to ignore the wording of the bankruptcy statute. Congress apparently meant a precise definition when it listed what constitutes new value. Congress could have allowed courts to expand upon the doctrine of new value by legislating that new value includes certain transactions. Instead, Congress stated what new value means, which should retard case law expansion."

71 BR at 1009. This approach is most consistent with the "plain meaning" rule of statutory construction. In re Perroton, 958 F2d

889, 893 (9th Cir 1992).

A creditor's forbearance from exercising a right of recoupment simply does not fit within the definition of new value. A release of security is new value when the release is "by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law . . . ." 11 USC § 547(a)(2). When a creditor forbears from exercising an existing right, either to foreclose a lien, to file a lien to which the creditor has a right, or to exercise a right of recoupment, the creditor does not release any property that was previously transferred to the creditor.

Because defendant's forbearance from exercising its right of recoupment does not fit within the definition of new value, it does not provide a defense to the trustee's preference action.

(ii) Continued provision of services

Defendant also argues that it continued to provide check authorization and warranty services to debtor after debtor made the three invoice payments, and that those services constituted new value. The trustee does not dispute that. The evidence at trial established the following payments from debtor to defendant and the value of services provided to debtor after those payments were made:

DATE	DEBTOR'S PAYMENT	VALUE OF SERVICES PROVIDED
6/26/95	$28,662.13	
6/26 to 6/30		$ 4,231.32
7/1 to 7/3		3,698.51
7/3/95	33,802.50	
7/4 to 7/31		32,792.17
8/1 to 8/14		11,449.29
8/15/95	28,341.97	
8/15 to 8/22		6,759.76

In calculating the new value offset, subsequent advances of new value may be used to offset prior preferences. A creditor is permitted to carry forward preferences until they are exhausted by subsequent advances of new value. In re IRFM, Inc., 52 F3d at 232.

Using that method of calculation, all of the new value given by defendant offsets the payments debtor made during the preference period. That leaves recoverable preferential transfers of $31,875.55.

C. Recoupment

Finally, defendant argues that it is entitled to retain the remainder of the preferential payments as a recoupment of its overpayments to debtor. As I understand the argument, defendant asserts that, by providing services to debtor through the preference period and after bankruptcy, it overpaid debtor and is entitled to recoup that overpayment by retaining the payments

debtor made for past-due services.

Recoupment involves a netting out of debt arising from a single transaction. In re Harmon, 188 BR 421, 425 (9th Cir BAP 1995). It is the setting up of an obligation arising from the same transaction as the plaintiff's claim as a means of reducing or eliminating the claim. In re Photo Mechanical Services, Inc., 179 BR 604, 612 (Bankr D Minn 1995). Recoupment has been applied in bankruptcy proceedings. Newbery Corp. v. Fireman's Fund Ins. Co., 95 F3d 1392, 1399 (9th Cir 1996).

Defendant is not entitled to recoupment for two reasons. First, recoupment requires that the debts owed by each party to the other arise out of the same transaction. In deciding whether the claims arose from the same transaction, I consider whether there is any logical relationship between the claims. Id. at 1402.

In this case, defendant's debt is its obligation to return the payments that debtor made during the preference period. That is a statutory obligation that arose pursuant to the Bankruptcy Code. The obligation against which defendant seeks to set off that obligation arose out of the parties' check warranty agreement, in which debtor agreed to pay defendant for its warranty services. As in In re Stoecker, 131 BR 979, 983 (Bankr ND Ill 1991),

> "[t]he Trustee is not asserting any contractual right or tort claim against [defendant]. The Trustee's separate statutory preference action against [defendant] and [defendant's] claim against [debtor] do not arise from a single transaction or contract."

There is no logical relationship between defendant's statutory obligation to return the preference payment and debtor's contractual obligation to pay for services provided.

More fundamentally, recoupment is not a valid defense to a preference action. Congress has specifically enumerated the defenses to a preference action in section 547(c). When Congress specifically enumerates exceptions to a general prohibition, the court should not infer additional exceptions absent evidence of contrary legislative intent. Stoecker, 131 BR at 984; In re Candor Diamond Corp., 26 BR 850, 851 (Bankr SDNY 1983); In re Sterling Die Casting Co., Inc., 118 BR 205, 207 (Bankr EDNY 1990).

Defendant cites Visiting Nurse Ass'n of Tampa Bay, Inc., 121 BR 114, 121 n4 (Bankr MD Fla 1990) and Electronic Metal Products, Inc. v. Honeywell, Inc., 95 BR 768 (D Colo 1989) for the proposition that recoupment is an appropriate defense to a preference action, and attacks Stoecker as having "mechanically concluded, without analysis," that recoupment is not a defense to a preference action.

Defendant's arguments are not persuasive. Neither Visiting Nurse Ass'n nor Electronic Metal Products addressed the issue of the enumerated defenses set out in section 547(c). Visiting Nurse Ass'n involved a creditor who was attempting postpetition to recoup money owed to it by debtor. The court determined that such an action would not constitute a preference. In Electronic Metal Products, the court determined that the debts did not arise out of the same transaction, and therefore recoupment was not allowed.

Therefore, any comment the court made about the applicability of recoupment in a preference action was dicta.

As to defendant's criticism of Stoecker, the court in fact did analyze the issue before it reached its conclusion. It cited and agreed with cases that had held that the substantive exceptions to preference actions enumerated in section 547(c) are exclusive, and additionally reasoned that, under the rules of statutory construction, where Congress has enumerated exceptions, additional exceptions are not to be implied. I find this reasoning persuasive.

Finally, as with setoff under section 553, a creditor cannot recoup its liability for the return of the preferential payments against the amount of the debtor's unsecured claim.

> "The reasoning for this rule is that allowing the creditor to offset the amount of the transfer would merely continue the preference, thereby rendering the preference statute useless because the preference would not become available for pro rata distribution to all creditors."

5 Collier on Bankruptcy ¶ 553.03[3][e] (15th ed rev 1996) (footnotes omitted). The same reasoning applies to recoupment.

Because defendant is not entitled to recoupment, its argument that receipt of the payments did not result in its receiving more than it would have received under a Chapter 7 liquidation fails.

CONCLUSION

The trustee is entitled to recover preferential transfers

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in the amount of $31,875.55. Mr. Migchelbrink should submit the order.

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ELIZABETH L. PERRIS
Bankruptcy Judge

cc: Paul D. Migchelbrink
Robert J. Vanden Bos
Donald A. Workman