ALERTS

Tenth Circuit Insulates First-Time Transaction from Preference Attack

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A "first-time transaction can qualify" for the ordinary course of business exception to the preference recovery provision of the Bankruptcy Code ("Code"), held the U.S. Court of Appeals for the Tenth Circuit on Aug. 10, 2015. *In re C.W. Mining Co.*, 2015 WL 4717709 (10th Cir. Aug. 10, 2015). Affirming the lower courts, the Tenth Circuit explained that Code Section 547(c)(2)(A) "refers to the 'ordinary course of business … *of* the debtor and the transferee,' not *between* the debtor and the transferee." *Id.* at *3 (emphasis in original). Agreeing with the Seventh Circuit, the court reasoned that preventing a potential creditor from relying on the ordinary course of business defense "would discourage [it] from extending credit to a new customer in questionable financial circumstances." *Id.*, quoting *Kleven v. Household Bank F.S.B.*, 334 F.3d 638, 643 (7th Cir. 2003).

Relevance

Code Section 547(c)(2) insulates otherwise voidable preference payments to the extent they: (1) satisfied a *debt* incurred by the debtor in the ordinary course of business of the debtor and creditor; and (2) were made: (a) in the ordinary course of business of the debtor and creditor; *or* (b) according to ordinary business terms. A creditor can thus shield a routine payment received within 90 days of the debtor's bankruptcy if it can prove either that the payment was made in the ordinary course of business of the debtor and creditor *or* that it was made according to ordinary business terms. As the Bankruptcy Appellate Panel explained here, "the statute … has two prongs: whether the *debt* was incurred in the ordinary course of business of the debtor and creditor, and whether the

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debt *payment* was made in the ordinary course of business of the debtor and a creditor. The first prong is focused on the original transaction between [the debtor and creditor] when the debt was created." 500 B.R. 635, 642 (B.A.P. 10th Cir. 2013) (emphasis added). *Accord*, *In re Affiliated Foods Southwest Inc.*, 750 F.3d 714, 718 (8th Cir. 2014) (same). The second prong is focused on the actual payment made to the creditor.

This defense to preference claims, because it uses phrases like "ordinary course of business" and "ordinary business terms," has provided ample opportunity for litigation. The *C.W. Mining* case is the latest example. In accepting a first-time transaction between the parties as "ordinary course," the court rejected the holdings of many lower courts that the incurrence of debt and payment to the creditor must be in the ordinary course of business *between* the debtor and the transferee. *See, e.g.*, *In re Brown Transp. Truckload, Inc.*, 152 B.R. 690, 692 (Bankr. N.D. Ga. 1992) ("if there is no prior course of dealings between the parties, the transferee cannot satisfy [Code Section 547(c)(2)(A)]").

Facts

The debtor had "entered into its first contract with" the creditor several months prior to bankruptcy. That contract obligated the debtor to buy equipment from the creditor that would increase "coal production by converting [the debtor's] mining method from continuous mining to a long wall system." *C.W. Mining*, 2015 WL 4717709, at *1. The debtor made one payment of $200,000 under the contract within 90 days of its bankruptcy, and the debtor's bankruptcy trustee ("Trustee") sought to recover that payment from the creditor. In rejecting the Trustee's preference claim, the Bankruptcy Appellate panel affirmed the bankruptcy court's grant of summary judgment to the creditor "on the ground that the *debt* was incurred and the *payment* made in the ordinary course of business." *Id.*

Debt Incurred in the Ordinary Course of Business

The equipment and services here were "within the normal scope of products and services" provided by the creditor. The debtor intended to change its mining method to "increase its mining capacity ... ." *Id.* at *6. But the Trustee had argued that the debtor's obligation of more than $800,000 to the creditor was not in the ordinary course of business

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because the creditor failed to prove that "it was ordinary for [the debtor] to incur large obligations for [this kind of] equipment." *Id.* According to the Tenth Circuit, however, the creditor "satisfied its burden of producing evidence that the debt was incurred in the ordinary course of [the debtor's] business. The purchase was an arm's-length transaction, and the undisputed purpose of the purchase was to assist in [the debtor's ongoing] mining operations." *Id.* The Trustee stressed that the debtor "had never done business with" the creditor before and that, essentially, "this was a first-time transaction." *Id.* In the court's view, "that is not enough. Although there is evidence that could support an assertion that [the debtor] was gambling with creditors' money, the Trustee neither alerted the court to that evidence nor argued that such gambling was a possibility that [the creditor] had the burden to disprove. The court was given no good reason to think that the debt was not incurred in the ordinary course of business." *Id. Accord*, *In re Ahaza Sys. Inc.* 482 F.3d 1118, 1125 (9th Cir 2002) (" … Congress aimed not to protect well-established financial relations, but rather to leave undisturbed *normal* financial relations, because [the exception] does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy").

Payment Made in Ordinary Course of Business

The only other issue on appeal was "whether the payment was in the ordinary course of [the debtor's] business … ." *Id.* The creditor's contract provided for progress payments as the creditor produced the bargained-for equipment and issued invoices. In response to a Sept. 18, 2007 invoice for equipment and services totaling more than $800,000, the debtor paid the creditor $200,000 "two days before the due date." *Id.* at *7. There was also "no evidence of collection activity by" the creditor. *Id.*

The court considered the amount of the payment, its timing, any prior dealings between the parties, and other circumstances under which the payment was made. *Id.* at *5, citing *In re Healthco Int'l Inc.*, 132 F.3d 104, 109 (1st Cir. 1997) ("amount transferred, the timing of the payment, the historic course of dealings between the debtor and the transferee, and the circumstances under which the transfer was effected"). "For first-time transactions, however, 'the court may refer solely to the written terms of the transaction to define the ordinary course of business between the parties.'" *Id.*, quoting 5 Collier, *Bankruptcy* ¶ 547-04[2][9][ii][B] (16th ed.

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2014). Because there were no peculiar circumstances here, the court found that “a payment made shortly before or at the due date [would] satisfy the statutory requirement.” *Id.* at *5.

Comment

C. W. Mining, despite contrary bankruptcy court rulings, is consistent with the holdings of other federal courts of appeals that have addressed the first-time transaction issue. *SeeIn re Finn*, 909 F.2d 903, 908 (6th Cir. 1990) (“Obviously every borrower who does something in the ordinary course of her affairs must, at some point, have done it for the first time.”); *In re Ahaza Sys.*, 482 F.3d at 1125 (9th Cir. 2008) (“... first-time transactions may satisfy the requirements of [the exception]”); *Kleven*, 334 F.3d at 642 (7th Cir. 2003) (same).

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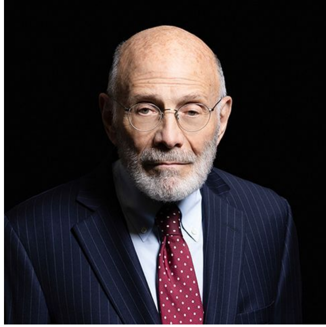

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