Washington Law Review

Volume 72
Number 1 *Dedication to John Charles Huston*

1-1-1997

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DESPERATE TIMES AND DESPERATE MEASURES: THE TROUBLED STATE OF THE ORDINARY COURSE OF BUSINESS DEFENSE—AND WHAT TO DO ABOUT IT

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Abstract: The ordinary course of business defense to the bankruptcy trustee's preference avoiding power has been controversial since its enactment in 1978. Burdened with a cryptic legislative history concerning its underlying goals, this preference exception has gone through multiple reinterpretations at the hands of Congress and the U.S. Supreme Court. In recent years, faced with a potentially expansive reading of the ordinary course defense that threatened to eclipse the rule, courts have used the "ordinary business terms" element of the defense to engraft an objective requirement that the party asserting the defense establish conformity of the challenged transfer with prevailing industry standards. Although deeply concerned about the expansive application of section 547(c)(2), the authors are critical of the industry terms requirement, concluding that it is incompatible with the goals of the ordinary course of business defense. Focusing on what they contend is the most defensible justification for an ordinary course defense, namely, to encourage creditors to continue to do business with a financially beleaguered debtor, the authors offer a practical proposal for rewriting section 547(c)(2). By deliberately reorienting the focus to the specific debtor/creditor relationship, and reintroducing a temporal requirement into the analysis, the authors maintain that this proposal cures the weaknesses in the statute as presently applied and harmonizes the scope of the exception with its primary purposive objective and preference policy in general.

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I. INTRODUCTION

Nothing, it seems, is ordinary about section 547(c)(2) of the Bankruptcy Code.[1] While the so-called "ordinary course of business" defense[2] has always engendered controversy,[3] two major events have justified increased attention to this provision in recent years. First, in 1984, Congress eliminated as an element of the defense the requirement

1. The current law of Bankruptcy is found in Title 11 of the U.S. Code. 11 U.S.C. §§ 101–1330 (1994). Its foundation is the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (effective Oct. 1, 1979) [hereinafter Reform Act]. The Reform Act, as amended, is commonly referred to as the "Bankruptcy Code" or the "Code," a convention that is followed in this work, such that references to the "Bankruptcy Code" or the "Code" are to Title 11 of the U.S. Code as amended through October 22, 1994, the effective date of the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106 (1994) (H.R. 5116) [hereinafter 1994 Amendments]. The 1994 Amendments did not modify or otherwise affect the ordinary course of business defense.

2. Section 547(c)(2) provides that the trustee may not avoid a transfer as a preference:

(2) to the extent that such transfer was——

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; and

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

(C) made according to ordinary business terms.

11 U.S.C. § 547(c)(2). Throughout this Article, § 547(c)(2) is referred to interchangeably as "the exception" and "the defense." This use is in accord with prevailing custom, although technically § 547(c)(2), like all of the provisions of § 547(c), is an affirmative defense, and not a mere exception. *See* Marschack v. Orange Commercial Credit (*In re* National Lumber & Supply), 184 B.R. 74, 78 (B.A.P. 9th Cir. 1995).

3. The ordinary course of business exception is by far the most litigated of the § 547(c) preference defenses and has been the source of keen interest to commentators. The following is a comprehensive, although far from exhaustive, list of the many articles devoted in whole or in part to § 547(c)(2). Lissa L. Broome, *Payments on Long-Term Debt as Voidable Preferences: The Impact of the 1984 Bankruptcy Amendments*, 1987 Duke L.J. 78; Barkley Clark, *Scheduled Debt Payments as Preferences: Paradigm of the Plain Meaning Rule*, 1 J. Bankr. L. & Prac. 7 (1991); Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 Vand. L. Rev. 713 (1985); David J. DeSimone, *Section 547(c)(2) of the Bankruptcy Code: The Ordinary Course of Business Exception Without the 45 Day Rule*, 20 Akron L. Rev. 95 (1986); Darrell Dunham & Donald Price, *The End of Preference Liability for Unsecured Creditors: New Section 547(c)(2) of the Bankruptcy Code*, 60 Ind. L.J. 487 (1985); Michael J. Herbert, *The Trustee Versus the Trade Creditor: A Critique of Section 547(c)(1), (2) & (4) of the Bankruptcy Code*, 17 U. Rich. L. Rev. 667, 679–98 (1983); Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 Stan. L. Rev. 725, 757 (1984); Lawrence Ponoroff, *Evil Intentions and an Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 Wis. L. Rev. 1439, 1490–95; Charles Jordan Tabb, *Rethinking Preferences*, 43 S.C. L. Rev. 981 (1992); Thomas M. Ward & Jay A. Shulman, *In Defense of the Bankruptcy Code's Radical Integration of the Preference Rules Affecting Commercial Financing*, 61 Wash. U. L.Q. 1, 83–85 (1983); Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 Stan. L. Rev. 3 (1986).

that the defendant-creditor establish any temporal nexus between the incurring of the debt and the preferential payment.[4] Second, in 1991, the U.S. Supreme Court interpreted revised section 547(c)(2) as applicable to protect payments made on long-term debt.[5] Together, these two events vastly increased the potential reach of the ordinary course of business defense. At the same time, perhaps unexpectedly, and almost certainly inadvertently, they triggered a new appraisal of the exception as courts and litigators rediscovered the third element of the defense, *to wit*, subsection C's requirement that the payment be made according to "ordinary business terms."[6]

A provision previously ignored by the courts, the phrase "ordinary business terms" has now become a major roadblock to many creditors' ability to retain payments received from a bankruptcy debtor in the critical ninety-day preference period.[7] This result is not, in our estimation, itself a problem because we believe that, in general, the preference exceptions ought to be narrowly construed. However, our reading and analysis of the recent case law suggests to us that there is presently little, if any, correlation between the transactions excluded from protection by virtue of the current interpretation of the "ordinary business terms" requirement in section 547(c)(2)(C) and the orthodoxy of contemporary preference law and policy.

When interpreting subsection C in its early stages, courts resolved the issue of "ordinariness" by reference to the similarity or deviance of the preferential transfer to or from prior transactions between the debtor and the preferred creditor, which is to say courts looked only for a subjective showing of normalcy in relation to the debtor and creditor's past dealings.[8] Today, an overwhelming majority of courts have refined their interpretation of the subsection to require an additional *objective* showing of compliance with industry standards before a transfer can

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4. *See* Bankruptcy Amendments & Federal Judgeship Act of 1984, Pub. L. No. 98-353, 98 Stat. 333, § 462(c) [hereinafter 1984 Amendments]. As originally enacted, the ordinary course of business defense could be invoked only if the preferential transfer was made not more than 45 days after the debt was incurred. 11 U.S.C. § 547(c)(2)(B) (1978) (repealed 1984). For a detailed discussion of the repeal, see *infra* part III.

5. Union Bank v. Wolas, 502 U.S. 151, 162 (1991).

6. 11 U.S.C. § 547(c)(2)(C). Subsections A and B require, respectively, that the debt be incurred and that the payment be made in the ordinary course of business or financial affairs of the debtor and the transferee.

7. In the case of insiders, of course, the preference period is extended to one year. 11 U.S.C. § 547(b)(4)(B) (1994).

8. *See infra* part IV.A.

qualify for protection under the ordinary course defense.[9] Within this requirement of industry standards as proof of ordinary business terms, however, the circuit courts of appeals are themselves in disagreement over a number of subsidiary issues including: (1) how to identify the proper industry;[10] (2) once the industry has been identified, how to define the proper standards within the industry;[11] and (3) once the standards have been defined, what type of evidence is required to establish compliance with the relevant standards.[12] This lack of uniformity has produced some confusion and some quite out-of-the-ordinary results even for creditors who deal consistently with a particular debtor. More fundamentally, it has moved the ordinary course of business defense even further away from its original and most defensible justification, namely, to promote transactions that do not disturb normal financial relations and that increase the likelihood that the debtor will be able to navigate through turbulent financial seas without the need for a costly put in of uncertain duration in the port of bankruptcy.[13]

The present discordance in the interpretation and application of the ordinary course of business defense suggests that the timing may be propitious to reconsider, yet again,[14] the proper formulation of this controversial preference defense with a view toward more closely aligning the operation of the exception with its original consequential objectives.[15] At the same time, we believe that such a reformulation

9. *See infra* part IV.B. This requirement is treated as an independent element of the cause, separate and distinct from the requirements in subparagraphs A and B. *See generally* Braunstein v. Rockwell Int'l Corp. (*In re* Broderick Co.), No. 92-11974-CJK, 1996 Bankr. LEXIS 105, at *21 (Bankr. D. Mass. Jan. 4, 1996).

10. *See infra* part IV.B.2.a.

11. *See infra* part IV.B.2.b.

12. *See infra* part IV.B.2.c.

13. *See infra* notes 55–56 and accompanying text.

14. From the time of its enactment as part of the Bankruptcy Reform Act of 1978 until it was finally amended by the 1984 Amendments, § 547(c)(2) was the subject of repeated proposals for amendment. A catalogue of the bills introduced in Congress between 1979 and 1983 proposing changes to the Code, including the preference statute, are contained in Broome, *supra* note 3, at 99–100 n.101.

15. Although their solutions are different than the ones we offer in this Article, other commentators also have taken note of the lack of congruence between the goals of the preference law and the objective interpretation of § 547(c)(2)(C). *See* Timothy M. Lupinacci, *Analyzing Industry Standards in Defending Preference Actions: Equitable Purpose in Search of Statutory Clarity*, 5 Bankr. L. & Prac. 129 (1996) (recommending deletion of subsection C). A recent student comment that offers a particularly thoughtful approach can be found in Janet E. Byrne Thabit, Comment, *Ordinary Business Terms: Setting the Standard for 11 U.S.C. § 547(c)(2)(C)*, 26 Loy. U. Chi. L.J. 473 (1995) (urging abandonment of industry-term compliance in most, but not all, cases, with determination tied to policy objectives of preference law).

would enhance the overall coherence of the Code's preference provisions. To that end, this Article begins by outlining briefly the development of bankruptcy preferences and the ordinary course of business exception as originally enacted in the Bankruptcy Reform Act of 1978. It next explores the judicial interpretations of section 547(c)(2) both before and after the 1984 Amendments and the U.S. Supreme Court's 1991 decision in *Union Bank v. Wolas*.[16]

We conclude from this examination that the objective standard in subsection C, as presently construed, is incompatible with the goals of the ordinary course of business defense as properly defined, failing to shield from the trustee's preference power certain kinds of transfers worthy of protection and, at the same time, insulating from liability a range of other wholly undeserving transactions. We then suggest and evaluate several specific legislative and judicial solutions that have been proposed in the literature to alleviate some of the present confusion in the decisional law. Our analysis suggests that certain shortcomings inhere in each of these proposals. Accordingly, in the final part of this Article we eventually settle on a compromise approach. It is our belief that this proposal would cure the most serious deficiencies in the current incarnation of the statute by reorienting the focus in a manner that harmonizes the operation of the exception with its originally intended purpose and with preference policy in general. Equally important, we also believe that, unlike some of the other solutions that have been offered, our proposal stands a realistic chance for enactment because of what we perceive (and hope) would be its broad acceptability among interested constituencies.

II. PREFERENCE LAW AND THE ORDINARY COURSE OF BUSINESS DEFENSE IN THE 1978 BANKRUPTCY CODE

A. *Modern Preference Law Generally*

Succinctly, a preference is a pre-bankruptcy transfer of an insolvent debtor's property to an unsecured creditor that enables that creditor to enjoy an advantage over other general creditors in the distribution of the assets of the debtor's bankruptcy estate.[17] In essence, preference law

16. 502 U.S. 151 (1991); *see infra* part III.

17. H.R. Rep. No. 95-595, at 177 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6138 [hereinafter 1978 House Report]. Essentially, a preference is a transfer that favors one creditor over another. *See* Jackson, *supra* note 3. For a succinct history of Anglo/American preference law, see John C. McCoid, II, *Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 Va. L. Rev. 249,

ensures that the basic bankruptcy objective of equal treatment among similarly situated creditors is not undermined by eve-of-bankruptcy transfers that have the effect of permitting one creditor to receive more than that creditor's ratable share of the debtor's assets.

With the Bankruptcy Reform Act of 1978, Congress significantly changed the contours of the preference law by moving away from notions of intent, duty, and moral blameworthiness "to the principle that 'all creditors ought to be treated equally.'"[18] This revision of the

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259 (1981). Section 541 of the Code defines the property of the estate to include not only "all legal or equitable interests of the debtor in property as of the commencement of the case," but also any interest in property recovered by the trustee under § 550. *Id.* at 250.

18. Weisberg, *supra* note 3, at 120 (quoting Ward & Shulman, *supra* note 3, at 17–18); *see also* McCoid, *supra* note 17, at 259 ("Preference law has thus moved from a notion of debtor fraud [under the 1978 Code] to a standard of absolute liability . . . ."); Jay L. Westbrook, *Two Thoughts About Insider Preferences*, 76 Minn. L. Rev. 73, 91–92 (1991) (discussing "formulization" of preference law).

Under the Code's new preference provision, a trustee (or debtor-in-possession in chapter 11) can establish an avoidable preference by proving that the transfer was made:

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

(5) that enables such creditor to receive more than such creditor would receive if

(A) the case were a case under chapter 7;

(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.

11. U.S.C. § 547(b)(1)–(5) (1994).

In addition to the statutory elements, a number of courts impose an additional implied requirement that the debtor's estate be diminished by the transfer sought to be avoided. Hanson v. McDonald Meat Co. (*In re* Kemp Pac. Fisheries, Inc.), 16 F.3d 313, 316 (9th Cir. 1994) (stating that "diminution of the estate" doctrine has been developed to determine whether property transferred by debtor belongs to debtor for § 547 purposes); Estate of Toyota of Jefferson v. Vallette (*In re* Toyota of Jefferson, Inc.), 14 F.3d 1088, 1092 (5th Cir. 1994) (explaining application of subsequent advance rule in § 547(c)(4) to shield otherwise avoidable transfer from preference recovery on ground that effect of transactions between debtor and creditor occasioned no diminution of estate, and thus did not harm other creditors); Buckley v. Jeld-Wen, Inc. (*In re* Interior Wood Prods. Co.), 986 F.2d 228, 231 (9th Cir. 1993) (holding that although there is no express statutory requirement, most courts have found diminution of estate requirement implicit in language of statute); *In re* Smith, 966 F.2d 1527, 1535 (7th Cir.) ("Courts have . . . long held that to be avoidable, a transfer must result in a depletion or diminution of the debtor estate."), *cert. dismissed sub nom.* Baker & Schultz, Inc. v. Boyer, 506 U.S. 1030 (1992); Coral Petroleum, Inc. v. Banque Paribas-London, 797 F.2d 1351, 1355–56 (5th Cir. 1986) (stating that fundamental inquiry is whether transfer diminished or depleted estate); Bergner v. Bank One, Milwaukee (*In re* Bergner & Co.), 187 B.R. 964, 973 (Bankr. E.D. Wis. 1995) (referring to diminishment principle as "akin to a sixth requirement").

preference law was significant in several critical respects. First, the Code made it easier to prove that a preferential transfer had occurred than was the case under the prior Bankruptcy Act.[19] For example, Congress eliminated the Act's requirement that the trustee in a preference action establish affirmatively that the debtor was insolvent at the time of the challenged transfer,[20] replacing this element with a presumption of the debtor's insolvency during the ninety days prior to filing.[21] Also, the Code eschewed the "reasonable cause to believe" requirement that forced Act trustees to prove that the transferee-creditor knew or had reason to know of the debtor's insolvency as of the time the transfer occurred.[22] By making it easier for the trustee to avoid preferential transfers, all of the debtor's creditors were put on a more equal footing in the distribution of the estate. Thus, preference law shifted "from a policy of avoiding only those preferential transfers that were made to creditors who had reason to know of the debtor's insolvency and may have therefore exerted pressure on the debtor, to a policy of preserving equal distribution, even in the absence of creditor pressure."[23]

With this shift in emphasis, contemporary preference law shrugged off the last of its historical ties to the concept of fraud and fraudulent conveyances.[24] The essence of modern preference law is no longer in the

19. Act of July 1, 1898, ch. 541, 30 Stat. 544, as amended. References herein to the "Bankruptcy Act" or the "Act" are, unless otherwise indicated, to the statutory provisions of the Bankruptcy Act of 1898 as they existed immediately prior to their repeal in 1978.

20. *See* Bankruptcy Act § 60a(1), 11 U.S.C. § 96(a)(1) (1976) (repealed 1978).

21. 11 U.S.C. § 547(f) (1994). The presumption of insolvency exists only for the 90-day period immediately preceding filing and, therefore, does not apply to the extended insider preference period. 11 U.S.C. § 547(b)(4)(B) (1994).

22. Bankruptcy Act § 60b, 11 U.S.C. § 96b (1976) (repealed 1978); *see also* Countryman, *supra* note 3, at 725 (noting that under Act, trustee's burden was to prove something about state of mind of transferee-creditor rather than, under earlier bankruptcy laws, state of mind of debtor).

23. Broome, *supra* note 3, at 96; *see also* Isaac Nutovic, *The Bankruptcy Preference Laws: Interpreting Code Sections 547(c)(2), 550(a)(1), and 546(a)(1)*, 41 Bus. Law. 175, 186 (1985) ("Their purpose is to proscribe those transactions that represent attempts, conscious or unconscious, to rearrange the distribution scheme that falls into place upon the filing of a bankruptcy petition."); Ward & Shulman, *supra* note 3, at 16 ("The cornerstone of the new preference section is the principle of equality of distribution . . . .").

24. *See* Thomas H. Jackson & Anthony T. Kronman, *Voidable Preferences and Protection of the Expectation Interest*, 60 Minn. L. Rev. 971, 977–78 n.20 (1976) (indicating that, historically, law of voidable preferences developed as branch of law of fraudulent conveyances); McCoid, *supra* note 17, at 250. Actually, the last vestige of a subjective component in the preference law was not eliminated until 1984 when § 547(b)(4)(B) was amended to remove the requirement that the trustee establish for insider transfers occurring outside of the standard 90-day preference period that the transferee have had "reasonable cause to believe" the debtor insolvent. 11 U.S.C. § 547 historical note (1994).

preferring, but in the consequence of being preferred.[25] This focus on preferential *effect*, rather than on subjective motive or intent, is a manifestation of the fact that, in defining a voidable preference, the drafters of the Code decided to give primacy to the policy of equality among creditors after insolvency as the central justification for the preference law.[26] What was not entirely clear at the inception of the Code, however, and what remains obscure to the present day, is how that policy choice relates to the preference defenses, and, in particular, to the ordinary course of business defense in section 547(c)(2).[27]

B. The Ordinary Course of Business Exception: Elements and Purpose

Because of the breadth of the Code's preference provisions, and their perceived harshness to creditors in certain contexts, the Bankruptcy Reform Act also included several narrow exceptions to the trustee's avoidance power under section 547(b).[28] By and large, the purpose for these exceptions is to protect transactions that do not result in a diminution of the estate and, therefore, do not interfere with the distribution scheme of the Bankruptcy Code.[29] Section 547(c)(2) is

25. Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. Rev. 235, 301 (1995) (describing preferential effect, not intent, as centerpiece of doctrine).

26. Actually, the legislative history identifies both "equality" and "deterrence" as the goals of the preference law. 1978 House Report, *supra* note 17, at 177–78 (noting that aims of preference laws are to ensure equality and to deter wasteful scramble to devour debtor's assets). However, because an unstated premise of the deterrence rationale is that the creditor is aware of the debtor's financial peril, the elimination of a state of mind element suggests that the policy of distributive equality has emerged as predominant. *See* Tabb, *supra* note 3, at 986–95.

27. Clearly, certain preference exceptions are explicable precisely in these terms, because they shield transactions that do not have the effect of permitting one creditor to enjoy an advantage over similarly situated creditors. However, the rationale for the exceptions is a more complex affair, implicating other policy objectives. *See infra* notes 64–65.

28. The exceptions according to their popular names include: (1) contemporaneous exchange; (2) ordinary course of business; (3) enabling loan; (4) new value; (5) floating lien in inventory and receivables; (6) statutory lien; (7) alimony maintenance and support payments; and (8) consumer small value. 11 U.S.C § 547(c) (1992 & Supp. IV 1996). Section 547(c)(7) was added by the 1994 Amendments, while § 547(c)(8) (formerly (7)) was added by the 1984 Amendments. For a detailed discussion of the six original exceptions, see Countryman, *supra* note 3, at 738–815.

29. *See* Nutovic, *supra* note 23, at 184–86. Other commentators have stated that the exceptions identify those transactions that are "worthy," *see* Ward & Shulman, *supra* note 3, at 15, but that rationale is highly suspect in light of the decision not to make preference liability turn on the intent or knowledge of the parties. In fact, the preference defenses probably cannot be rationalized under any single explanation. Encouraging creditors to continue to deal with a faltering debtor, sparing transactions that do not threaten distributive equality, promoting competing public policy aims, facilitating administrative convenience, and, at some level, protecting innocent transferees are all considerations that enter into the mix.

different.[30] Under the ordinary course of business exception, a creditor can successfully fend off a trustee's attempt to avoid a preferential transfer if it proves that the transfer was:

> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee; (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and (C) made according to ordinary business terms.[31]

All three elements must be met in order for a creditor to resist disgorgement of an otherwise voidable preference,[32] and it is generally accepted that the defense is to be narrowly construed.[33]

It bears noting that in any case to which section 547(c)(2) applies, there has been an indisputable diminution of the distributable estate attributable to a payment made to one of several creditors. The preferential effect could not be clearer. Therefore, when successfully invoked, the ordinary course of business defense is squarely in conflict with the strong "equality among creditors" principle underlying the preference law.

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30. Unlike other preference exceptions when invoked successfully, the ordinary course of business defense is squarely in conflict with the strong equality-based aims of the preference law. *See generally* Ponoroff, *supra* note 3, at 1490 (describing ordinary course of business exception as "weakest link in the chain"). Parenthetically, the same can be said of the two exceptions added subsequent to enactment of the Code, specifically the exceptions for alimony, maintenance, and support obligations, and the small consumer loan provision in § 547(c)(7) and (8) respectively. At a minimum this conflict renders both of the exceptions suspect in our view, but that is a subject for another time.

31. 11 U.S.C. § 547(c)(2)(A)–(C) (1994). As with all of the preference defenses, the party alleged to have received the preference bears the burden of proof. 11 U.S.C. § 547(g) (1994); Advo Sys., Inc. v. Maxway Corp., 37 F.3d 1044, 1047 (4th Cir. 1994); Clark v. Balcor Real Estate Fin., Inc. (*In re* Meridith Hoffman Partners), 12 F.3d 1549, 1553 (10th Cir. 1993). As originally enacted, the creditor had to prove a fourth element: that the transfer was made not later than 45 days after such debt was incurred. *Id.*; 11 U.S.C. § 547(c)(2)(B) (1978) (amended 1984). For a more detailed discussion, see *infra* text accompanying notes 44–45.

32. *See, e.g.*, Jobin v. Cervanka (*In re* M & L Bus. Mach. Co.), 194 B.R. 496, 503 (D. Colo. 1996) (holding that in order to retain transfer under ordinary course of business exception, all three of stated elements must be proven); Jones Truck Lines, Inc. v. Central States, S.E. & S.W. Areas Pension Fund (*In re* Jones Truck Lines, Inc.), 196 B.R. 483 (Bankr. W.D. Ark. 1995); Bergner v. Bank One (*In re* Bergner & Co.), 187 B.R. 964 (Bankr. E.D. Wis. 1995). Section 550(a) of the Code permits the trustee to recover a voidable transfer or its value from the initial transferee, certain secondary transferees, and any person for whose benefit the transfer was made. 11 U.S.C. § 550(a) (1996).

33. For an example, see Jobin v. McKay (*In re* M & L Bus. Mach. Co.), 84 F.3d 1330, 1339 (10th Cir. 1996), *petition for cert. filed*, 65 U.S.L.W. 3310 (U.S. Oct. 10, 1996) (No. 96-569), and authorities cited therein.

In the face of this apparent antinomy, divergent views exist regarding the original and the continuing goals of the ordinary course of business exception. A complete understanding of the reasons for this disharmony, however, requires at least a basic appreciation for the historical origins of the ordinary course of business defense. Thus, to set the stage, we take a brief excursus to examine that historical development.

In terms of pre-Code antecedents, only the defense in section 547(c)(4) for subsequent advances of new value had a direct statutory analogue under the former Bankruptcy Act.[34] Nevertheless, Act cases developed numerous techniques for limiting the trustee's avoiding powers in particular circumstances.[35] Among them was a doctrine dubbed the "current expense rule."[36] The current expense rule operated more-or-less as an exception to the antecedent debt element of a voidable preference because of the view that these transactions should not be treated as preferences even if they technically so qualified.[37] In certain critical respects, the rule was a logical and necessary reaction to nineteenth-century American bankruptcy law's fixation on intent to prefer or gain an advantage as an essential element of a voidable preference.[38] As already observed, section 60b of the Act required the trustee in a preference action to establish that the transferee-creditor had "reasonable cause to believe" that the debtor was insolvent at the time the challenged transaction occurred.[39] This requirement naturally tended to work to protect regularly recurring payments made in the ordinary

34. *See* Bankruptcy Act § 60c, 11 U.S.C. § 96(c) (1976) (repealed 1978); Countryman, *supra* note 3, at 781 (describing operation of what was frequently, but inaccurately, referred to as Act's "net result rule").

35. *See generally* Ward & Shulman, *supra* note 3, at 16.

36. The origins of the rule can be traced back to the "acts of bankruptcy," proof of which was required in order to initiate an involuntary case. Bankruptcy Act § 3a, 11 U.S.C. § 21a (1976) (repealed 1978). One of these acts was the making of a preferential transfer as defined in § 60 of the Act. However, prior to 1952, the petitioning creditors had to establish not just that the payment was made, but that the debtor *intended* to prefer the transferee. *See* James Angell MacLachlan, *Handbook of the Law of Bankruptcy* 44, 52–53 (1956). The current expense rule operated to preclude the petitioning creditors from establishing the requisite intent where the payment was for a current expense. *See* 1 *Collier on Bankruptcy* § 3.01[3] (James Wm. Moore & Lawrence P. King eds., 14th ed. 1974).

37. Ward & Shulman, *supra* note 3, at 19–20 (describing operation of rule as creating "fiction" that payments were for "current expenses" and not "antecedent debts").

38. *See* Tabb, *supra* note 3, at 1009–11; Ward & Shulman, *supra* note 3, at 20 ("The rationale behind the 'current expense' cases was the need to protect ordinary course transactions between the creditor and the financially troubled debtor, irrespective of the creditor's perception of the debtor's problem.").

39. *See supra* note 22 and accompanying text; *see also* Ponoroff, *supra* note 3, at 1477–78.

course of business, thus obviating the need for the courts to employ the current expense rule except in rare cases. Elimination of that requirement in the drafting of the Code created enormous pressure to incorporate an alternative mechanism for protecting those creditors who, for the most part, were small, local suppliers of routine, open account credit.[40]

Under the Act, the current expense rule had functioned to protect payments for essential expenses necessary to maintaining continued operations even when the creditor had knowledge of the debtor's precarious financial circumstances and in spite the preferential advantages attained by the favored creditor. At the same time, however, the current expense rule also reflected the preference law's strong concern for equality among creditors *inter se*. This latter objective was founded largely on the view because of the contemporaniety of the allegedly preferential payment to the provision of new value to the debtor, the payment of a current account did not diminish the debtor's estate in the same manner as, for example, a payment on a long-term installment obligation.[41] In effect, the courts that applied the rule considered these arrangements to more closely resemble cash, rather than credit, transactions.[42] Therefore, to permit recovery in these circumstances would produce a windfall for unsecured creditors, a result no less contrary to the principle of pro rata distribution than permitting a payment to one of several similarly situated creditors to stand.

Several commentators regard section 547(c)(2) as a codification of the current expense rule,[43] roughly consistent with the diminution of the estate principle underlying the preference law and simultaneously operating as a brake on the trustee's vastly expanded preference avoiding power under the Code in circumstances where competing policy aims are implicated. In *Union Bank v. Wolas*, however, the U.S. Supreme Court concluded that the connection between the current expense rule and the ordinary course of business defense was too attenuated to alone justify limiting application of the defense to trade and other recurring, short-term debt obligations once the express forty-five day limitation in old

40. *See* Countryman, *supra* note 3, at 768–70 (relating legislative history of § 547(c)(2)).

41. *See* Union Bank v. Wolas, 502 U.S. 151, 157 (1991); Tabb, *supra* note 3, at 1017. The diminution of the estate doctrine has long roots in preference jurisprudence, tracing at least as far back as the U.S. Supreme Court's decision in National Bank v. National Herkhimer Co. Bank, 225 U.S. 178 (1912); *see also supra* note 18.

42. *See* Ward & Shulman, *supra* note 3, at 20.

43. *See* Broome, *supra* note 3, at 97; Countryman, *supra* note 3, at 767–78; Herbert, *supra* note 3, at 679; Tabb, *supra* note 3, at 1011. Obviously, § 547(c)(1) can also find some ancestral roots in the rule.

section 547(c)(2)(B) was congressionally abrogated by the 1984 Amendments.[44]

As with most questions of policy, some perspective here is essential. According to the legislative history of the 1978 Code, which it will be recalled eliminated any state of mind component from the definition of a voidable preference,[45] the goal of section 547(c)(2) is to "leave undisturbed normal financial relations because it does not distract 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."[46] Lamentably, this statement provides minimal practical guidance as to which transactions should be protected under the ordinary course of business provision. As one court observed, "[t]he sparse legislative history to § 547(c)(2) . . . bestows us with precious little assistance."[47] A few courts, therefore, have articulated a more useful explanation for the exception: "to be a means of encouraging normal credit transactions and the continuation of short-term credit dealings with troubled debtors so as to stall rather than hasten bankruptcy."[48] The Third Circuit echoed that expression of purpose in *Fiber Lite Corp. v. Molded Acoustical Products, Inc. (In re Molded Acoustical Products, Inc.)*,[49]

44. Union Bank v. Wolas 502 U.S. 151, 159 (1991) (noting absence of any textual support for argument).

45. For an excellent account of the evolutionary process culminating in the eventual elimination of any mens rea standard in the preference law, see Weisberg, *supra* note 3, at 13–112. Actually, as originally enacted, § 547 continued to make the defendant-creditor's state of mind relevant in the limited circumstance where the trustee challenged a transfer made to an insider more than 90 days prior to filing, but within the extended one-year period for insiders. Specifically, the Code retained from the Act the requirement that the insider be shown to have "reasonable cause to believe the debtor was insolvent" at the time of the transfer. 11 U.S.C. § 547(b)(4)(B) (1982). However, this last remnant of a state of mind component was itself eliminated by the 1984 Amendments.

46. 1978 House Report, *supra* note 17, at 373; S. Rep. No. 95-989, at 88 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5874 [hereinafter 1978 Senate Report]; *see also* Moran v. Hong Kong & Shanghai Banking Corp. (*In re* Deltacorp.), 179 B.R. 773, 781 (Bankr. S.D.N.Y. 1995).

47. Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods., Inc.), 18 F.3d 217, 223 (3d Cir. 1994); McCord v. Venus Foods, Inc. (*In re* Lan Yik Foods Corp.), 185 B.R. 103–10 (Bankr. E.D.N.Y. 1995) (observing that there is "no precise legal test which may be applied to determine whether the requirements of section 547(c)(2) have been met").

48. Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org.), 957 F.2d 239, 243 (6th Cir. 1992); *accord* Waldschmidt v. Ranier (*In re* Fulghum Constr. Corp.), 872 F.2d 739, 743 (6th Cir. 1989); Fitzpatrick v. Rockwood Water, Wastewater & Natural Gas Sys. (*In re* Tennessee Valley Steel Corp.), 201 B.R. 927, 934 (Bankr. E.D. Tenn. 1996); *In re* Magic Circle Energy Corp., 64 B.R. 269, 272 (Bankr. W.D. Okla. 1986). One problem with this stated purpose is its association with short-term credit, which is more difficult to justify since the U.S. Supreme Court ruled that the exception applied to long-term credit as well. *See generally Wolas*, 502 U.S. 151. For a critical assessment of the holding in *Wolas*, see *infra* text accompanying note 166.

49. 18 F.3d 217 (3d Cir. 1994).

when it stated: "Bankruptcy policy, as evidenced by the very existence of § 547(c)(2), is to promote . . . continuing relationships on level terms, relationships which if encouraged will often help businesses fend off an unwelcome voyage into the labyrinths of a bankruptcy."[50]

It is clear that the object of section 547(c)(2) as originally adopted was to protect recurring, customary credit transactions that would have taken place in the ordinary course of the debtor's and creditor's businesses regardless of whether the prospect of a bankruptcy filing was looming or not.[51] That negative articulation leaves unanswered, however, the fundamental question of why it was perceived as important to leave transactions of this type undisturbed. One possibility is that "ordinary course" is a talisman of innocence or benign motive, in the sense of lack of intent to prefer.[52] Under this account, the ordinary course of business

50. *Id.* at 224 (citing O'Neill v. Nestle Libbys P.R., Inc., 729 F.2d 35, 37 (lst Cir. 1984) (noting that exception encourages creditors to continue conducting business with struggling debtors)); *see also supra* note 28.

51. *See, e.g.*, Intercontinental Publications, Inc. v. Perry (*In re* Intercontinental Publications, Inc.), 131 B.R. 544, 550 (Bankr. D. Conn. 1993); Aguillard v. Bank of Lafayette (*In re* Bourgeois), 58 B.R. 657, 659 (Bankr. W.D. La. 1986). Commentators have expressed an even greater diversity of views on the subject than the courts. *See, e.g.*, Countryman, *supra* note 3, at 761–69 (explaining that it is clear Congress intended only to codify older current expense rule); DeSimone, *supra* note 3, at 100 ("If preference law applied to pre-bankruptcy ordinary course of business transactions, few creditors would extend credit to troubled debtors; and without credit, few troubled debtors could continue in business."); Herbert, *supra* note 3, at 669 (observing that § 547(c)(2) was enacted with problem in mind of encouraging extensions of credit, particularly from trade creditors, to faltering debtors); Weisberg, *supra* note 3, at 124–26, argues that:

> [T]he exception captures the "norm of protecting the innocuous, like-cash, ordinary course payments to garden-variety trade creditors. . . . The creditor should be protected for his nonculpable mental state, even if the reasonable cause standard has been eliminated, where the situation suggests he engaged in no true creditor grabbing at all, but has received payment simply resulting from an automatic schedule.

Id.

52. *See supra* note 38. This tension is also reflected in the split of opinion between the Ninth and Tenth Circuits over whether payments made by a business engaged in an illegal "Ponzi" scheme can ever qualify for protection under § 547(c)(2). *Compare* Sender v. Nancy Elizabeth R. Heggland Family Trust (*In re* Hedged-Investments Assocs.), 48 F.3d 470 (10th Cir. 1995) (ruling that purposes of exception are served by permitting application of exception to payments made to noninvestor-creditors) *with* Danning v. Buzek (*In re* Bullion Reserve of N. Am.), 836 F.2d 1214, 1219 (9th Cir. 1988) (holding that defense cannot be applied to payments made in course of a Ponzi scheme). *See also* Jobin v. McKay (*In re* M & L Bus. Mach. Co.), 84 F.3d 1330, 1340 (10th Cir. 1995) (following *Heggland*), *petition for cert. filed*, 65 U.S.L.W. 3310 (U.S. Oct. 10, 1996) (No. 96-569); Jobin v. Ripley (*In re* M & L Bus. Mach. Co.), 198 B.R. 800, 806 (D. Colo. 1996) (holding that ordinary course of business defense is unavailable to investors as distinguished from arms-length creditors); Jobin v. Cervanka (*In re* M & L Bus. Mach. Co.), 194 B.R. 496, 504 (D. Colo. 1996) (same); Jobin v. Matthews (*In re* M & L Bus. Mach. Co.), 184 B.R. 136, 140 (D. Colo. 1995) (recognizing importance of protecting noninvestor creditors in bankruptcy proceedings involving Ponzi scheme).

defense serves as a surrogate for the former "reasonable cause to believe" requirement,[53] mitigating the overinclusiveness of the expansive definition of a voidable preference in section 547(b). Of course, that position is forcefully at odds with the primary goal of the preference law to achieve equality among similarly positioned creditors, and, in turn, that is the goal that emerged as preeminent in the drafting of the Code and accounted for the Code's formulation of a voidable preference in strict liability terms.[54]

An alternative explanation, then, is that such transactions advance a rival policy aim that has to be reconciled with the equality policy that animates the Code's concept of a voidable preference. That competing principle is the policy of maximizing debtors' opportunity to steer clear of bankruptcy entirely by sending the signal to lenders that bankruptcy is not always the fellow traveler of economic hard times. Putting aside momentarily the question of which conceptualization is in fact accurate, we are convinced that it has been the uncertainty and disagreement over this fundamental question of purpose that has largely accounted for the serpentine path that the ordinary course of business defense has followed since 1978. Thus, we wish to leave no measure of doubt that, in our judgment, the lack of improper ulterior motive in inducing or accepting payment from a debtor is no longer a sufficient basis for allowing one creditor to achieve a better result than its similarly placed counterparts. On the other hand, even though the ordinary course exception impinges on equality policy to some extent,[55] we think it can be defended, as originally conceived, when applied to short-term, and particularly routine, credit obligations extended to the debtor *after* the debtor's slide into bankruptcy has begun.[56]

53. *See supra* note 22.

54. *See supra* text accompanying notes 23–26.

55. Unlike other preference exceptions, which are based on the infusion of new value and thus do not involve any diminution of the estate, the ordinary course of business exception does result in a smaller pool of assets available to satisfy the claims of other general creditors. *See* Tabb, *supra* note 3, at 1017–18 (exposing fallacy in argument that exception is simply codification of judicially-created "current expense" rule that had been invoked frequently under Bankruptcy Act).

56. *See* Robert L. Jordan & William D. Warren, *Bankruptcy* 441–42 (4th ed. 1995) (suggesting that policy of equality for all creditors must be balanced against cost imposed upon and interference with ordinary commercial transactions). Of course, this rationale for protecting employees and other suppliers of short-term unsecured credit offers little support for the extension of the exception to cover installment payments made on long-term debt.

C. *Compatibility of the Ordinary Course Exception with the Preference Law*

Some commentators contend that to the extent the "purpose" of section 547(c)(2) is to encourage creditors to do business with troubled debtors, it is contrary to the "entire concept of preference."[57] In 1985, for example, no less keen an observer of the bankruptcy law than Professor Vern Countryman argued with some force that the only apparent justification for the exception is to allow a debtor to "selectively meet debts currently coming due in order to continue functioning outside of bankruptcy," but that this purpose runs against the main flow of the Code's preference scheme.[58] As stated earlier, preferences are avoidable because avoidance implements the goal of treating similarly positioned creditors with substantial equality; if the preferred creditor is not permitted to get more than the other creditors, then no one creditor is favored at the expense of the others. Under Countryman's logic, if a debtor is allowed to select which creditors it pays in the ordinary course of business, then the debtor is favoring one creditor over others and preference policy demands that the transfer be avoided without exception.

Although the logic is sound as far as it goes, we think that the flaw in this analysis is that every ordinary course payment—whether on the eve of bankruptcy or not—is in a sense favoring one creditor over another.[59] Debtors who momentarily cannot meet all of their debts inevitably select which creditors need regular payment in order for the debtor to stay in business. It could even be argued that paying a creditor within normal business terms should never be considered an avoidable transaction since such payments advance the objective of staving off bankruptcy at all costs.[60] Professor Countryman argues, however, the exception should be

57. Countryman, *supra* note 3, at 775–76 (declaring exception as "completely at war" with concept of preference); *accord* David A. Ontko, Note, *Ordinary Business Terms Must Not Be Ignored: The Forgotten but Critical Role of § 547(c)(2)(C) in the Ordinary Course of Business Exception to the Preference Rules*, 6 Bankr. Dev. J. 429, 438 (1989).

58. Countryman, *supra* note 3, at 775. A few years later, Professor Charles Tabb also made a case for repeal of the ordinary course of business defense in its entirety based on its tendency to undermine the equality-based aims of the preference law which he believes, as do we, predominate over deterrence policy. *See* Tabb, *supra* note 3, at 1029–35.

59. It also ignores the diminution rationale for the current expense rule from which the ordinary course of business defense derived. *See supra* note 41.

60. *See* Raymond T. Nimmer, *Security Interests in Bankruptcy: An Overview of Section 547 of the Code*, 17 Hous. L. Rev. 289, 302 (1980) (arguing on policy grounds that exception should support exemption for any "normal" transaction). The problem with this argument is that it focuses on the wrong policy, namely, lack of moral culpability, as the primary justification for the exception, rather

repealed because it is contrary to the general preference rule.[61] Of course, the preference law only comes into play if an actual bankruptcy ensues. Therefore, neither argument is entirely correct. They both fail to take cognizance of the need to balance and accommodate policies that occasionally pull in opposite directions.

At this juncture, it becomes important to remember what in general the preference exceptions represent: those transactions that are deemed to be *outside* the realm of what is recoverable under the preference law.[62] Many courts and commentators have fallen into the syllogistic trap of requiring the exception to follow the rule.[63] In some instances exception and rule advance a common purpose,[64] but this result is not always logically possible. The fact that section 547(c)(2) does not fit perfectly within the preference scheme is irrelevant so long as the terms of the exception are narrowly tailored to fit its intended purpose and the scope of the exception is contained accordingly. Nevertheless, as a result of this faulty logic, no less perhaps than as a byproduct of the imprudent expansion of the reach of section 547(c)(2), to which the logic is a reaction, this unruly provision of preference law continues to be applied in a manner that undermines the exception's most legitimate purpose,

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than staving off bankruptcy. In essence, it is the extension of credit to a floundering debtor, not the payment on the debt, that is the desirable act. Protecting the payment is simply the way in which to induce the act. A payment made with respect to a long-term extension of credit is unlikely to implicate this policy. Therefore, it provides an insufficient basis to warrant deviation from the basic norm of creditor equality.

61. Countryman, *supra* note 3, at 776.

62. The word "exception" has been defined as "a case to which a rule does not apply," *Webster's Ninth New Collegiate Dictionary* 432 (1984), and a "person, thing, or case specified as distinct or not included," *Black's Law Dictionary* 559 (6th ed. 1990).

63. *See, e.g.*, Jones Truck Lines, Inc. v. Central States, S.E. & S.W. Areas Pension Fund (*In re* Jones Truck Lines, Inc.), 196 B.R. 483 (Bankr. W.D. Ark. 1995) ("The exception of section 547(c)(2) must be considered in the context of the principal goal of the preference section . . . .").

64. For example, the defenses in § 547(c)(1) and (4) for contemporaneous exchanges and subsequent advances, respectively, are both consistent with the view that what makes a preference a preference is a post-insolvency reduction in the net distributable estate that redounds to the benefit of a single general creditor. *See, e.g.*, Reigle v. Mahajan (*In re* Kumar Bavishi & Assocs.), 906 F.2d 942, 950 (3d Cir. 1990) (holding that in determining whether "new value" requirement has been satisfied, focus should be on whether there was augmentation of or material benefit to estate); Anderson-Smith Assocs. v. Xyplex, Inc. (*In re* Anderson-Smith & Assocs.), 188 B.R. 679, 688 (Bankr. N.D. Ala. 1995) (observing that purpose of new value exception to preference avoidance is to protect transactions that do not result in diminution of estate). Of course, the subsequent advance rule also has as an equally important part of its rationale the notion of encouraging creditors to continue to do business with troubled debtors. *See infra* note 251.

that of allowing debtors to continue doing business as usual in order (with a little good fortune) to stay out of bankruptcy altogether.[65]

III. THE 1984 AMENDMENTS AND THE U.S. SUPREME COURT: EXPANDING THE REACH OF THE ORDINARY COURSE OF BUSINESS DEFENSE

In the early stages of section 547(c)(2)'s application (prior to 1984), litigation over the ordinary course requirement focused primarily on timing.[66] Because eligibility for protection under the ordinary course of business defense as originally enacted required proof by the transferee-creditor that the preferential transfer did not occur longer than forty-five days[67] after the debt was incurred,[68] early cases struggled with trying to pinpoint the particular moments in time when the operative events took place so that the relevant measurement could be made.[69] In addition, this limitation proved problematic for corporate issuers of commercial paper, certain trade creditors, and consumer lenders, because their transactions did not always fit within this time period.[70] For those reasons alone, and

65. *See, e.g.*, Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1050 (4th Cir. 1994); Redmond v. Ellis Co. Abstract & Title Co. (*In re* Liberty Livestock Co.), 198 B.R. 365, 373 (Bankr. D. Kan. 1996) ("The purpose of the ordinary course of business defense is to encourage creditors to continue to do business with financially strapped debtors."); *see also* Terry M. Anderson. *In re* Iowa Premium Service Co.: *When is a Debt Incurred Under Section 547(c)(2) of the Bankruptcy Code*, 17 Creighton L. Rev. 1075, 1093–94 (1984) (suggesting that one of original purposes for § 547(c)(2) was to encourage extensions of short-term credit to marginal debtors and, thus, help keep struggling debtors out of bankruptcy whenever possible). *But see* Sacred Heart Hosp. v. E.B. O'Reilly Servicing Corp. (*In re* Sacred Heart Hosp.), 200 B.R. 114, 117 n.2 (Bankr. E.D. Pa. 1996) (concluding that this particular public policy is not recognized in § 547(c)(2)).

66. *See* DeSimone, *supra* note 3, at 108.

67. Apparently, Congress chose a 45-day period because the legislators believed that this was the length of the normal trade credit billing cycle. *See* Richard B. Levin, *An Introduction to the Trustee's Avoiding Powers*, 53 Am. Bank. L.J. 173, 186 (1986); *see also* Broome, *supra* note 3, at 97–99 (reviewing relevant legislative history, which demonstrates that concern of exception, at least originally, was with short-term transactions of routine nature).

68. 11 U.S.C. § 547(c)(2)(B) (1978) (amended 1984).

69. *See* Chaim J. Fortang & Lawrence P. King, *The 1978 Bankruptcy Code: Some Wrong Policy Decisions*, 56 N.Y.U. L. Rev. 1148, 1167 (1981) (criticizing 45-day requirement as suffering from vagueness); *see also* Broome, *supra* note 3, at 102 nn.112–14; *infra* note 260.

70. *See* Union Bank v. Wolas, 502 U.S. 151, 157–58 nn.10–12 (1991); *see also* 130 Cong. Rec. 20013, 20091 (1984) (recording discussion between Sens. Dole and DeConcini concerning reasons for eliminating 45-day requirement). For an extensive discussion of the legislative history leading up to the amendment of § 547(c)(2) in 1984, see Broome, *supra* note 3, at 101–04, and Countryman, *supra* note 3, at 770–72.

not apparently for the purpose of protecting payments on long-term debt,[71] Congress eliminated the forty-five day requirement.[72]

Despite the explicit reasons for the elimination of section 547(c)(2)'s time requirement, courts confronted a new controversy after the amendment's enactment—whether payments on long-term debts could be excepted from the reach of the trustee's avoidance power under section 547(b).[73] As already observed, roughly seven years later, the U.S. Supreme Court settled this issue in *Union Bank v. Wolas*.[74] In *Wolas*, the debtor made two interest payments and paid a loan commitment fee to the creditor who had loaned the debtor seven million dollars six months before bankruptcy.[75] If the purpose for the exception is framed in terms of encouraging creditors to continue to do business with a financially beleaguered debtor by offering to shield payments made, as an example, on recurring monthly accruals such as rent and routine trade debt, then there is good reason to distinguish between that type of creditor[76] and a supplier as in *Wolas*, of conventional kinds of long-term financing to be repaid on an installment basis. Nonetheless, applying the "plain meaning"[77] approach to statutory construction that has come to

71. *See* Broome, *supra* note 3, at 100–01 (noting that virtually all complaints about 45-day requirement came from trade creditors, commercial paper issuers, and consumer lenders).

72. *See supra* note 4. At the same time, Congress adopted § 547(c)(7) (now (c)(8)) to provide a defense for small transfers by a consumer debtor. That provision was a direct response to the complaints voiced by consumer credit industry players that the 45-day rule in § 547(c)(2) operated to deprive them of protection for regular installment payments received on long-term consumer loans. *See infra* note 269. Thus, the consumer creditors ended up getting *both* the elimination of the 45-day rule and their own exception. *See generally* Countryman, *supra* note 3, at 813–16 (expressing some antipathy toward exception).

73. The Ninth Circuit, for example, held that it did not foster congressional policy to allow long-term creditors to make use of the exception, whereas both the Sixth and the Tenth Circuits ruled that, after the 1984 amendment, long-term debt was as amenable to the exception as trade debt. Gosch v. Burns (*In re* Finn), 909 F.2d 903, 907 (6th Cir. 1990); CHG Int'l, Inc. v. Barclays Bank (*In re* CHG Int'l, Inc.), 897 F.2d 1479, 1482 (9th Cir. 1990); Fidelity Sav. & Inv. Co. v. New Hope Baptist, 880 F.2d 1172, 1177 (10th Cir. 1989).

74. 502 U.S. 151 (1991).

75. *See id.* at 152–53.

76. *See, e.g.*, Waldschmidt v. Ranier (*In re* Fulghum Constr. Corp.), 872 F.2d 739, 744 n.6 (6th Cir. 1989); Redmand v. Ellis County Abstract & Title Co. (*In re* Liberty Livestock Co.), 198 B.R. 365, 373 (Bankr. D. Kan. 1996); *supra* note 65.

77. *Wolas*, 502 U.S. at 151. For a general discussion of the U.S. Supreme Court's approach in recent years to deciding bankruptcy cases, see Carlos J. Cuevas, *The Rehnquist Court, Strict Statutory Construction and the Bankruptcy Code*, 42 Clev. St. L. Rev. 435 (1994); Thomas G. Kelch, *An Apology for Plain-Meaning Interpretation of the Bankruptcy Code*, 10 Bankr. Dev. J. 289 (1994); Robert K. Rasmussen, *A Study of the Costs and Benefits of Textualism: The Supreme Court's Bankruptcy Cases*, 71 Wash. U. L.Q. 535 (1993); Charles J. Tabb & Robert M. Lawless, *Of*

characterize the U.S. Supreme Court's bankruptcy jurisprudence, the Court reasoned that the "text of 547(c)(2) as enacted reflects the deliberate choice of Congress," despite the unforeseen consequences of including long-term debt within the exception.[78] Thus, the Court permitted the lender to retain the payments under section 547(c)(2).[79]

As a result of *Wolas*, trustees have less opportunity to avoid preferential transfers than when ordinary course transactions were limited to payments on trade and other short-term debt to fund continuing operations. Consequently, the debtors' distributable estates in many cases will be smaller, and unsecured creditors as a class will be treated with less equality, than had theretofore been the case. On the other hand, the individual creditors that took their chances by providing money, goods, or services to a debtor in the regular course of business will be protected should they receive repayment during the statutory preference period. In theory, this result should encourage creditors to continue conducting business as usual with their regular customers in spite of an unexpected downturn in the economic well-being of a debtor firm. The rub, of course, is that it is highly unlikely that a creditor that first makes the decision to extend credit or loan money perhaps years prior to the challenged payment has rendered emergency aid to a high-risk debtor. That situation stands in stark contrast to the case of a creditor that extends current value immediately prior to, if not actually after, the time the debtor became insolvent. In both situations, protecting the payments made may involve leaving normal financial relations undisturbed, but it is in the nature of the preference law to disturb normal financial relations, some more than others. Accordingly, this justification for the exception to preference recovery is only sufficient in the latter case where the creditor has supplied the kind of routine, short-term credit that is necessary for the continuation of the debtor's daily operations.[80] Moreover, as discussed more fully in the materials to follow,[81] to the extent that the 1984 amendment of section 547(c)(2) and *Wolas* might have been defended as providing an added incentive for creditors to continue to transact business with a debtor experiencing financial woes,

Commas, Gerunds, and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court, 42 Syracuse L. Rev. 823 (1991).

78. *Wolas*, 502 U.S. at 160.

79. *See id.* at 162.

80. *See* Broome, *supra* note 3, at 118–19 (similarly suggesting that goal of encouraging creditors to deal with financially struggling debtor is sensible way to interpret "ordinary course" for purposes of applying exception in § 547(c)(2)).

81. *See infra* notes 234–241 and accompanying text.

the contemporaneous trend toward an objective interpretation of subsection C has acted as a discouraging counterweight more than offsetting any such benefit.[82]

After *Wolas*, or in anticipation of the interpretation adopted by the Court in that case, many commentators urged amendment of the exception.[83] One scholar claimed that by including long-term debt in the ordinary course exception, the goal of preference law shifted from that of "preserving equality of distribution of the debtor's assets among its creditors to that of avoiding preferential transfers received by creditors under unusual circumstances."[84] A logical response to that argument might be that if the goal of the ordinary course of business exception is to leave undisturbed normal financial relations, then this so-called "shift in preference law" has arguably aligned the exception's use with its intended purpose by permitting the debtor to decide which creditors are most vital to its survival. In other words, *Wolas* has not affected preference rules, but affected merely an exception to the rule.[85] The only problem with that rejoinder is that it is hollow unless one also presumes that the preferred creditor was prepared to, or did in fact, offer a valuable quid pro quo for the favored treatment, and there is no basis for indulging a presumption of that sort in the vast bulk of cases. Conversely, if the purpose of the exception is framed in terms of encouraging creditors to continue to do business with a financially beleaguered debtor by offering to shield payments made, as an example, on recurring monthly accruals such as rent and routine trade debt, then there is good reason to distinguish between that type of creditor, who the exception was originally intended to protect,[86] and the suppliers of

82. *See infra* text accompanying notes 252–253.

83. *See generally* Ponoroff, *supra* note 3, at 1494–95.

84. Broome, *supra* note 3, at 81.

85. In 1985, Professor Countryman suggested that the ordinary course exception is justified if it takes into account payments on both long-term and short-term obligations. Countryman illustrates: A banker's long-term note and a retailer's long overdue accounts may present the same obstacle to keeping the debtor out of bankruptcy. *See* Countryman, *supra* note 3, at 775–76. His logic suggests that as long as both of these kinds of payments are excepted from the preference section, then the goal of the exception-preserving "normal financial relations" is met. *See id.* Yet, few courts or commentators see the effect of *Wolas* this way. In additon, this analysis ignores the question of why it is important to preseve "normal financial relations." *See supra* notes 51–53 and accompanying text. Ultimately, we recognize that payments on some long-term debt might properly be shielded under an ordinary course exception, but we recommend different, stricter standards in those cases. *See infra* notes 256–273 and accompanying text.

86. *See, e.g.*, Miller v. Kibler (*In re* Winters), 182 B.R. 26, 29 (Bankr. E.D. Ky. 1995) ("It is clear that § 547(c)(2) applies if the debtor and the transferee have an ongoing, 'recurring' business relationship."); Aguillard v. Bank of Lafayette (*In re* Bourgeois), 58 B.R. 657, 659 (Bankr. W.D. La.

conventional kinds of long-term financing repaid on an installment basis. *Wolas*, however, has foreclosed drawing any such distinction, and in fact, hopelessly blurred the two together.

Although the focus in section 547(c)(2) cases changed dramatically after *Wolas*, that decision did not end the controversy over the ordinary course of business exception. Rather, perhaps in reaction to the decision, or perhaps just in futility,[87] beginning in 1992, courts turned to a new interpretation of section 547(c)(2) by zeroing in on the theretofore neglected provision in subsection C. This new interpretation has shifted the ordinary course of business defense as applied even further away from the goal of maximizing the prospects of avoiding bankruptcy entirely to a new and perverse sort of equality policy, one that advocates leaving all creditors that can demonstrate, by implication, a lack of moral blameworthiness free from the trustee's preference power. In this connection, the "ordinary" nature of the payment supplies the inferential proof of lack of intent to gain an advantage over other creditors. As mentioned earlier,[88] however, lack of preferential intent is no longer relevant to preference analysis, nor, arguably was it ever a particularly sensible rationale since it is only natural for a creditor that becomes aware of a debtor's financial peril to push for payment. Thus, the new interpretation, although welcome because it offers a limitation to counterbalance the dangerously expanded reach of the exception after *Wolas*, has completely misaligned the use and purpose of the exception in a manner that has seriously undermined the integrity of the Code's preference law scheme. It is the story of that new interpretation that we turn to next.

IV. ORDINARY COURSE LITIGATION AFTER *WOLAS*: USING THE DEFENSE TO ALTER THE GOAL OF PREFERENCE LAW

Ever since Congress removed the time limitation from section 547(c)(2) and the U.S. Supreme Court confirmed the far-reaching implications of that congressional action, courts have focused on the

1986) (noting that ordinary course exception is intended to except payments for short-term obligations to cash creditors whose debts come due on monthly basis); *see also* Countryman, *supra* note 3, at 769 (noting that clearly Congress intended to limit exception to payment of current expenses).

87. *See infra* text accompanying note 241.

88. *See supra* notes 23–25 and accompanying text.

final prong of the ordinary course of business exception.[89] Specifically, debate has centered around the meaning of the phrase "ordinary business terms" in subsection C. Does that language require a separate, objective showing of ordinary course outside of the historical course of dealing between the parties, or is a subjective showing of the parties' prior practices acceptable?

The meaning of "ordinary business terms" is anything but plain. It is not defined in the Bankruptcy Code, and the legislative history provides little additional insight.[90] As the Third Circuit recognized: "Neither a perfunctory survey of the bare language of section 547(c)(2), nor a careful, resolute stare, would lead the average reader to an appreciable understanding of what subsection (C) adds to subsections (A) and (B)."[91] Consequently, courts are left with the difficult task of making subsection C fit within the broader framework and purpose of the ordinary course exception. Lamentably, their performance in this capacity has left something to be desired.

A. *The Original Interpretation—A Subjective Look at Ordinary Terms Between Debtor and Creditor*

1. *The Purposes Underlying the Subjective Approach*

Before 1991, the majority of the circuit courts of appeals required only a showing that the transaction at issue was similar to the past practices between the debtor and a specific creditor in order to satisfy subsection C's ordinary business terms.[92] The standard thus coincided with the

89. DeSimone, *supra* note 3, at 108. Before the 1984 Amendments, the 45-day limitation tended to be the most frequently litigated element of the ordinary course of business defense. *Id.* at 108. After that element of the defense was removed, the emphasis shifted from timing considerations to the proper definition of "ordinariness." *See* David A. Ontko, Note, *Ordinary Business Terms Must Not Be Ignored: The Forgotten But Critical Role of § 547(c)(2)(C) in the Ordinary Course of Business Exception to the Preference Rules*, 6 Bank. Dev. J. 429, 436 (1989); *see also* Nutovic, *supra* note 23, at 177 n.11 ("It can be argued that the elimination of the 45-day rule will not decrease the volume of litigation over § 547(c)(2) but will merely shift the litigation focus to the remaining requirements of that subsection.").

90. *See supra* notes 46–47 and accompanying text.

91. Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods, Inc.), 18 F.3d 217, 223 (3d Cir. 1994).

92. The U.S. Courts of Appeals for the Third, Fourth, Sixth, Seventh, Eighth, and Eleventh Circuits originally (pre-*Wolas*) required only a subjective showing of ordinariness. *See, e.g.*, Lovett v. St. Johnsbury Trucking, 931 F.2d 494, 499 (8th Cir. 1991) (recognizing that subsection may require proof of industry standards but not relying on those standards); Morrison v. Champion Credit Corp. (*In re* Barefoot), 952 F.2d 795, 801 (4th Cir. 1991); *In re* J.P. Fyfe, Inc. v. Bradco Supply Corp., 891 F.2d 66, 71 (3d Cir. 1989); Waldschmidt v. Ranier (*In re* Fulghum Constr. Corp.), 872

standard of "ordinary course of business" under subsection B so that, as a practical matter, it added very little additional burden to the transferee-creditor's case. There were numerous reasons for this approach, derived from, among other sources, statutory interpretation, legislative history, and judicial creativity. In *Ewald Bros. v. Kraft, Inc. (In re Ewald Bros)*,[93] for example, the bankruptcy court declared the subjective approach to be

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F.2d 739, 743 (6th Cir. 1989); Courtney v. Octopi, Inc. (*In re* Colonial Discount Corp.), 807 F.2d 594, 600 (7th Cir. 1986); Marathon Oil Co. v. Flatau (*In re* Craig Oil Co.), 785 F.2d 1563, 1565 (11th Cir. 1986).

Lower courts in the Fifth and Tenth Circuits required an objective test prior to *Wolas*. *See, e.g.*, Estate of SPW Corp. v. A.P.V. Equip., Inc. (*In re* SPW Corp.), 96 B.R. 683, 689 (Bankr. N.D. Tex. 1989) (5th Circuit); *In re* Magic Circle Energy Corp., 64 B.R. 269, 272 (Bankr. W.D. Okla. 1986) (10th Circuit); *see also* Iannacone v. Klement Sausage Co. (*In re* Hancock-Nelson Mercantile Co.), 122 B.R. 1006 (Bankr. D. Minn. 1991); Richardson v. Philadelphia Hous. Auth. (*In re* Richardson), 94 B.R. 56 (Bankr. E.D. Pa. 1988). The Bankruptcy Appellate Panel for the Ninth Circuit was a little more equivocal on the issue, although generally supportive of an objective standard. *See* Bell Flavors & Fragrances, Inc. v. Andrew (*In re* Loretto Winery, Ltd.), 107 B.R. 707, 709 (B.A.P. 9th Cir. 1989) (suggesting that § 547(c)(2)(C) embodies purely objective standard); Gold Coast Seed Co. v. Beachner Seed Co. (*In re* Gold Coast Seed Co.), 24 B.R. 595, 597 (B.A.P. 9th Cir. 1982) (applying subjective standard).

The Second Circuit did not address the meaning of "ordinary business terms" prior to *Wolas*. However, after *Wolas* several lower courts in the Second Circuit have applied the objective standard. *See, e.g.*, McCord v. Venus Foods, Inc. (*In re* Lan Yik Foods Corp.), 185 B.R. 103, 110 (Bankr. E.D.N.Y. 1995); Wallach v. Vulcan Steam Forging Co. (*In re* D.J. Management Group, Inc.), 164 B.R. 831, 835 (Bankr. W.D.N.Y. 1994); Sapir v. Green Forest Lumber Ltd. (*In re* Ajayem Lumber Corp.), 145 B.R. 813, 818 (Bankr. S.D.N.Y. 1992). Eventually, the Second Circuit spoke to the issue and concluded that under § 547(c)(2)(C) the conduct of the debtor and creditor must be considered objectively in light of industry practice. Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 78 F.3d 30, 40 (2d Cir. 1996). In *Roblin*, the trustee challenged a $53,320.78 payment on an open account debt made by the debtor within 90 days of the filing of the debtor's chapter 11 petition. The bankruptcy court found that the transfer was preferential and that the payment was not protected under § 547(c)(2) because it was not made in accordance with the terms of the debtor's account with the creditor. *See* Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 127 B.R. 722, 725 (Bankr. W.D.N.Y. 1991), *aff'd*, 78 F.3d 30 (2d. Cir. 1996). The Second Circuit rejected the rule that a payment made pursuant to a debt restructuring could never be deemed made according to ordinary business terms, but nevertheless upheld the ruling based on the district court's finding that Ford had failed to offer any evidence whatsoever of the ordinary practices of similarly situated firms. *Roblin*, 78 F.3d at 41.

Although the U.S. Court of Appeals for the First Circuit has been cited for using the objective standard pre-*Wolas*, *see infra* note 129 and accompanying text, the court of appeals for that circuit has never explicitly so held. *See, e.g.*, WJM, Inc. v. Massachusetts Dept. of Pub. Welfare, 840 F.2d 996, 1011 (lst Cir. 1988). Post-*Wolas*, lower courts within the First Circuit apply the objective standard. *See, e.g.*, Gray v. Huntsman Chem. Corp. (*In re* Dooley Plastics Co.), 185 B.R. 389, 392 (Bankr. D. Mass. 1995); Miller v. Perini Corp. (*In re* A.J. Lane & Co.), 164 B.R. 409, 416 (Bankr. D. Mass. 1994).

93. 45 B.R. 52 (Bankr. D. Minn. 1984).

a "common sense interpretation of the statute."[94] The court recognized that while many commentators had debated the proper standard, courts were consistently defining the term "ordinary" as "that which is ordinary as between the respective parties."[95] Only in the absence of a specific past history with the particular creditor that received the preference would the courts resolve the issue with reference to the creditor's prior transactions with other debtors.[96]

Some courts relied on legislative history to justify this interpretation of the exception.[97] For example, in *Marathon Oil Co. v. Flatau (In re Craig Oil Co.)*,[98] the Eleventh Circuit looked to Congress's statement that the purpose of the exception is to "leave undisturbed normal financial relations."[99] As a result, the court stated:

> It seems clear from this statement that § 547(c)(2) should protect those payments which do not result from "unusual" debt collection or payment practices. To the extent an otherwise "normal" payment occurs in response to such practices, it is without the scope of § 547(c)(2). Thus, whenever the bankruptcy court receives evidence of unusual collection efforts, it must consider whether the debtor's payment was in fact a response to those efforts.[100]

Similarly, the Seventh Circuit opined that the unordinary transactions about which Congress was concerned were those that were related to pre-bankruptcy planning, that is, those transactions that were obviously not commercially normal.[101] Clearly, these sentiments reflected a continued preoccupation with pre-Code concepts of state of mind and moral innocence as critical ingredients of a preferential transfer. As

94. *Id.* at 57 ("I am unwilling to deviate from such a common sense interpretation of the statute. Consequently, it will be necessary to view each transfer in the context of the parties' past course of dealing.").

95. *Id.*

96. *See, e.g.*, Howison v. Adkin Plumbing & Heating Supply Co. (*In re* Websco, Inc.), 92 B.R. 1, 3 (Bankr. D. Me. 1988); Campbell v. Cannington (*In re* Economy Milling Co.), 37 B.R. 914, 922 (D.S.C. 1983).

97. *See, e.g.*, Morrison v. Champion Credit Corp. (*In re* Barefoot), 952 F.2d 795, 801 (4th Cir. 1991).

98. 785 F.2d 1563 (11th Cir. 1986).

99. *See* 1978 House Report, *supra* note 17, at 373–74; *see also supra* note 46 and accompanying text.

100. *Craig Oil*, 785 F.2d at 1566. The Eleventh Circuit's view rested on its belief that the exception is directed toward trade credit. *See id.* at 1567.

101. *See* Courtney v. Octopi, Inc. (*In re* Colonial Discount Corp.), 807 F.2d 594, 600 (7th Cir. 1986).

discussed,[102] however, the drafters of the Code deliberately eliminated any mens rea test from the definition of a voidable preference, thereby rendering suspect the credibility of explanations predicated on those concepts. In marked contrast to the Eleventh and Seventh Circuits, the Sixth Circuit adopted the subjective interpretation of "ordinary course" and "ordinary business terms" on the ground that it was consonant with the exception's goal of allowing creditors to deal with troubled debtors in order to help them forestall bankruptcy or avoid filing altogether.[103] In the final analysis, then, because no real consensus on the purposive object of the ordinary course of business defense ever emerged, the threat always existed for application of the exception on an inconsistent, if not ad hoc, basis. The lack of a shared understanding also left the door open to inventive reinterpretation, a threat that subsequently proved to be a much more serious one.

2. *The Practical Effect of the Subjective Approach*

As noted, the subjective approach concerned itself with the way in which a transferee-creditor dealt with one particular debtor. Courts required only a showing that the challenged transaction conformed with the past relationship between the debtor and the creditor in order to satisfy section 547(c)(2)(C).[104] To aid in this inquiry, one bankruptcy court[105] suggested that courts "consider factors such as the prior course of dealing between the parties, the amount of the payment, the timing of the payment, and the circumstances surrounding the payment."[106] These

102. *See supra* notes 20–25 and accompanying text; *see also* Weisberg, *supra* note 3, at 116–18 (explaining evolution of preference law in these terms).

103. *See* Waldschmidt v. Ranier (*In re* Fulghum Constr. Corp.), 872 F.2d 744, 744 (6th Cir. 1989). The *Fulghum* court stated: "The primary purpose of that section was to encourage 'short term credit dealing[s] with troubled debtors in order to forestall bankruptcy.'" *Id.* (quoting *In re* First Software Corp., 81 B.R. 211, 213 (Bankr. D. Mass. 1988)). Further, the court cited O'Neill v. Nestle Libbys P.R., Inc., 729 F.2d 35 (1st Cir. 1984), for the proposition that the "exception is designed to encourage creditors to conduct business with a struggling enterprise so that debtors can rehabilitate themselves." *Id.* at 37.

104. *See, e.g.*, *Fulghum Constr.*, 872 F.2d at 743 ("The focus of this court's inquiry must be directed to an analysis of the business practices which were unique to the particular parties under consideration and not to the practices which generally prevailed in the industry of the parties."); *accord* Michigan Consol. Gas Co. v. Solomon (*In re* Industrial Metal Fabricators), No. 89-1814, 1990 WL 57232, at *3 (6th Cir. May 2, 1990); *In re* J.P. Fyfe Inc., 891 F.2d 66, 71 (3d Cir. 1989).

105. Newton v. Ed's Supply Co. (*In re* White), 58 B.R. 266 (Bankr. E.D. Tenn. 1986).

106. *Id.* at 269; *see also* Warren v. Huntington Nat'l Bank (*In re* Ullman), 80 B.R. 101, 103 (Bankr. S.D. Ohio 1987) (suggesting that court must consider prior dealings of parties, amount, timing, and circumstances surrounding particular payments).

factors, when followed among the courts adopting the subjective approach, allowed even irregular transactions to be excepted if they were consistent with the parties' course of dealing.[107] The types of transactions that were held to fall within the exception under the subjective test included first-time loan payments,[108] late or irregular payments,[109] short-term cash advances,[110] and regular trade payments.[111]

Today, the Eleventh Circuit remains the only court of appeals that still applies the subjective test. Although that court has not addressed the issue since its 1986 *Craig Oil* decision, several of the district courts in the Eleventh Circuit still follow *Craig Oil*, ignoring industry standards altogether. As one district court made clear: "The analysis of this exception to the trustee's avoidance powers is based upon the circumstances of the business transactions between the parties, *not the standard in the industry*."[112]

However, the strength of the Eleventh Circuit view is waning. Within the past two years, bankruptcy courts in Georgia have strayed from the subjective approach and adopted the objective interpretation of subsection C, which is now followed by the vast majority of courts in other circuits.[113] If or when the Eleventh Circuit falls to the objective

107. *See, e.g.*, Yurika Foods Corp. v. United Parcel Serv. (*In re* Yurika Foods Corp.), 888 F.2d 42, 45 (6th Cir. 1989) (finding late payments within exception); *Fulghum Constr.*, 872 F.2d at 743–45 (finding prompt repayments on advances to cover overdrafts within exception).

108. *See, e.g.*, Gosch v. Burns (*In re* Finn), 909 F.2d 903, 908 (6th Cir. 1990).

109. *See, e.g.*, *Yurika Foods*, 888 F.2d at 45; Carson v. Metzger Bus. Forms (*In re* Decor Noel Corp.), 65 B.R. 707, 709 (Bankr. W.D. Tenn. 1985); *White*, 58 B.R. at 270; Carmack v. Zell (*In re* Mindy's, Inc.), 17 B.R. 177, 179–80 (Bankr. S.D. Ohio 1982).

110. *See, e.g.*, *Fulghum Constr.*, 872 F.2d at 743–45; Courtney v. Octopi, Inc. (*In re* Colonial Discount Corp.), 807 F.2d 594, 600 (7th Cir. 1986).

111. *See, e.g.*, Tolz v. Sunspa/Skinflicks (*In re* Sunup/Sundown, Inc.), 66 B.R. 1021, 1022–23 (Bankr. S.D. Fla. 1986).

112. Braniff, Inc. v. Sundstrand Data Control (*In re* Braniff, Inc.), 154 B.R. 773, 780 (M.D. Fla. 1993) (emphasis added); *see also* Grant v. Suntrust Bank (*In re* L. Bee Furniture Co.), No. 96-1017-BKC-3P7, 1996 Bankr. LEXIS 1629, at *10–*11 (M.D. Fla. Dec. 11, 1996); Miller v. Florida Mining & Materials (*In re* A.W. & Assocs.), 196 B.R. 900 (Bankr. N.D. Fla. 1996) (applying *Craig Oil*); Graphic Prods. Corp. v. WWF Paper Corp. (*In re* Graphic Prods. Corp.), 176 B.R. 65 (Bankr. S.D. Fla. 1994) (refusing to apply industry standards test in determination of whether transfer was made in ordinary course). A more equivocal view is expressed in Grant v. Estate of Beverly S. Thurman (*In re* Thurman Constr. Inc.), 189 B.R. 1004, 1011–13 (Bankr. M.D. Fla. 1995), wherein the court cited *Braniff*, but stopped short of expressly adopting it. Subsequent decisions have characterized *Thurman* as in accord with *Braniff*. *See, e.g.*, Grant v. Suntrust Bank (*In re* L. Bee Furniture Co.), 200 B.R. 68, 71 (Bankr. M.D. Fla. 1996).

113. *See generally* Willson v. MLA, Inc. (*In re* Ascot Mortgage, Inc.), 153 B.R. 1002 (Bankr. N.D. Ga. 1993); Scroggins v. BP Exploration & Oil, Inc. (*In re* Brown Transp. Truckload, Inc.), 161 B.R. 735 (Bankr. N.D. Ga. 1993).

approach, it would join the Courts of Appeals for the Second,[114] Third,[115] Fourth,[116] Sixth,[117] Seventh,[118] Eighth,[119] Ninth,[120] and Tenth Circuits.[121] However, this apparent consensus among the circuits is deceiving. There are subtle but important shadings of interpretational difference between and among the circuit decisions adopting an objective standard,[122] and this lack of unanimity is one more reason why section 547(c)(2) is in need of repair.

B. *The Latest Trend—An Objective Look at Industry Norms*

The trend among the courts of appeals to break from the subjective interpretation of subsection C began in 1992.[123] The Sixth Circuit was the

114. Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 78 F.3d 30, 40 (2d Cir. 1996).

115. *See, e.g.*, Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods., Inc.), 18 F.3d 217, 225–26 (3d Cir. 1994).

116. *See, e.g.*, Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1050 (4th Cir. 1994).

117. *See, e.g.*, Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org. Inc.), 957 F.2d 239, 244 (6th Cir. 1992). The Sixth Circuit elaborated on its original holding in *Fred Hawes* in Luper v. Columbia Gas of Ohio, Inc. (*In re* Carled, Inc.), 91 F.3d 811, 818 (6th Cir. 1996).

118. *See, e.g.*, *In re* Tolona Pizza Prods. Corp., 3 F.3d 1029, 1033 (7th Cir. 1993); *see also In re* Midway Airlines, Inc., 69 F.3d 792, 797 (7th Cir. 1995) (expanding upon *Tolona Pizza*).

119. *See, e.g.*, Jones v. United Sav. & Loan Ass'n (*In re* U.S.A. Inns), 9 F.3d 680, 684 (8th Cir. 1993).

120. *See, e.g.*, Mordy v. Chemcarb, Inc. (*In re* Food Catering & Hous., Inc.), 971 F.2d 396, 398 (9th Cir. 1992).

121. *See, e.g.*, Clark v. Balcor Real Estate Fin., Inc. (*In re* Meridith Hoffman Partners), 12 F.3d 1549, 1553 (10th Cir. 1993). As of this writing, the U.S. Courts of Appeals for the First and Fifth Circuits have not addressed the exception, although bankruptcy courts within each circuit have adopted the objective approach. *See, e.g.*, Gray v. Huntsman Chem. Corp. (*In re* Dooley Plastics Co.), 185 B.R. 389 (Bankr. D. Mass. 1995) (First Circuit); Miller v. Perini Corp. (*In re* A.J. Lane & Co.), 164 B.R. 409, 416 (Bankr. D. Mass. 1994) (First Circuit); Krafsur v. Scurlock Permian Corp. (*In re* El Paso Refinery, L.P.), 178 B.R. 426 (Bankr. W.D. Tex. 1995) (Fifth Circuit); Estate of SPW Corp. v. A.P.V. Equip., Inc. (*In re* SPW Corp.), 96 B.R. 683, 689 (Bankr. N.D. Tex. 1989) (Fifth Circuit).

122. For a detailed review of some of the differences from circuit to circuit, see Braunstein v. Rockwell Int'l Corp. (*In re* Broderick Co.), No. 92-11974-CJK, 1996 Bankr. LEXIS 105 (Bankr. D. Mass. 1996).

123. *See El Paso Refinery*, 178 B.R. at 440 (suggesting that "very little controversy remains" insofar as proper interpretation accorded to subsection C). It is perhaps more proper to express the standard under § 547(c)(2) as now containing both an objective and a subjective prong, since subsections A and B are still determined with reference to the practice of the particular parties. *See generally* WJM, Inc. v. Massachusetts Dep't of Pub. Welfare, 840 F.2d 996, 1011 (1st Cir. 1988) (characterizing need to prove consistency with other business transactions between debtor and transferee as "cornerstone" of § 547(c)(2)(B)). *See also* McCord v. Venus Foods, Inc. (*In re* Lan Yik Foods Corp.), 185 B.R. 103 (Bankr. E.D.N.Y. 1995) (noting that subjective inquiry is called for under subsections A and B).

first of the originally subjective approach courts to adopt the objective standard.[124] In *Logan v. Basic Distribution Corp. (In re Fred Hawes Organization, Inc.)*,[125] the Sixth Circuit specifically rejected the subjective approach, claiming that each subsection of the statute must be satisfied in order for the creditor to retain a preferential payment.[126] In support of its departure from earlier authority and the then-majority rule, the court recognized that section 547(c)(2) is written in the conjunctive, indicating clear congressional intent that separate showings are required.[127]

In establishing the objective requirement of subsection C, the court did not, as it had earlier,[128] rely on congressional intent. Instead, the court erroneously cited the First Circuit's language in *WJM, Inc. v. Massachusetts Department of Public Welfare*[129] as authority for the proposition that subsection C, by its terms, requires proof of industry standards.[130] Despite having already found that the payments in question did not satisfy the exception because they did not meet subsection B,[131] the *Fred Hawes* court felt obliged to address the proper interpretation of

124. *See* Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org., Inc.), 957 F.2d 239, 243–44 (6th Cir. 1992) ("While this court has not expressly established the requirement that fulfillment of each subsection is necessary in order to receive the benefit of the exception, it does so now."). In 1986, a bankruptcy court in the Sixth Circuit decided Production Steel, Inc. v. Sumitomo Corp. of Am. (*In re* Production Steel, Inc.), 54 B.R. 417 (Bankr. M.D. Tenn. 1985). In that case, the court required proof of objective standards of the industry. However, the bankruptcy court did not cite to any Sixth Circuit precedent for this interpretation. *Id.* at 423–24. Six years later, the Sixth Circuit officially adopted the objective interpretation in *Logan*. For further discussion about these developments in the Sixth Circuit, see *infra* notes 164–169 and accompanying text.

125. 957 F.2d 239 (6th Cir. 1992).

126. *See id.* at 243–244. District courts within the Sixth Circuit have at times considered the objective prong along with the subjective test. *See, e.g.*, Remes v. ASC Meat Imports, Ltd. (*In re* Morren Meat & Poultry Co.), 92 B.R. 737, 741 (W.D. Mich. 1988) (finding payment within exception after looking at industry terms). However, the Sixth Circuit has not previously mandated such consideration. *See Fred Hawes*, 957 F.2d at 243.

127. *Fred Hawes*, 957 F.2d at 244.

128. *See supra* note 103.

129. 840 F.2d 996 (lst Cir. 1988).

130. *See Fred Hawes*, 957 F.2d at 244. The Sixth Circuit cited *WJM* despite the fact that the *WJM* opinion does not refer to "industry standards." In fact, the decision dealt only with subsection B which focuses on payments "made in the ordinary course of business or financial affairs of the debtor and the transferee." *See WJM*, 840 F.2d at 1011. The only mention of subsection C in *WJM* is for the proposition that it is an element that must be proven separately. *See id.* In this connection, however, the *WJM* court did not establish how this separate proof of ordinary business terms is achieved, that is, by showing industry standards or by establishing conformity with terms between the individual creditor and debtor. *See id.* Thus, the Sixth Circuit's reliance on *WJM* for the proposition that subsection C requires proof of industry standards is clearly misplaced.

131. *Fred Hawes*, 957 F.2d at 245.

the "ordinary business terms" language in subsection C.[132] The court concluded that a creditor cannot rest on evidence of the standards between itself and its other debtors. Rather, "the particular transaction in question [must] comport[] with the standard conduct of business within the industry."[133] The creditor in this case, Basic, attempted to establish industry standards by introducing evidence of what was ordinary between Basic and its approximately 1500 electrical subcontractors, rather than the industry as a whole.[134] Basic argued that such evidence was more probative of ordinary business terms than industry-wide practices because of differences in the "credit policies adopted by various suppliers in the industry."[135] The court rejected this contention.[136] Instead, the court found that even if subsection B had been satisfied, the creditor could not have prevailed because of the lack of proof that its payment practices coincided with prevailing payment practices in its industry.[137]

1. The Purposes Underlying the Objective Approach

Although the Sixth Circuit offered no unique justification for its abrupt shift to an objective interpretation of the ordinary business terms requirement, a year later in *In re Tolona Pizza Products Corp.*,[138] Judge Posner of the Seventh Circuit provided what has become the generally accepted rationale for the industry standards, objective approach to section 547(c)(2)(C). Specifically, Judge Posner found two functions for the newly minted interpretation of "ordinary business terms" in subsection C. First, proof of industry standards satisfies an evidentiary standard.[139] Judge Posner explained: "If the debtor and creditor dealt on terms that the creditor testifies were normal for them but that are wholly

132. *Id.*

133. *Id.* at 246. Later, in Luper v. Columbia Gas, Inc. (*In re* Carled, Inc.), 91 F.3d 811 (6th Cir. 1996), the Sixth Circuit softened its stance somewhat under circumstances where the defendant-creditor introduced evidence to show that it was not possible to obtain information concerning competitors' billing practices. *Id.* at 818.

134. *Fred Hawes*, 957 F.2d at 245.

135. *Id.* at 246.

136. *Id.*

137. *Id.* The standard under both subsections A and B of § 547(c)(2) continues to be governed by a subjective test. *See, e.g.*, Redmond v. Ellis County Abstract & Title Co. (*In re* Liberty Livestock Co.), 198 B.R. 365, 373 (Bankr. D. Kan. 1996); Styler v. Landmark Petroleum, Inc. (*In re* Peterson Distrib., Inc.), 197 B.R. 919, 922 (D. Utah 1996); Precision Walls, Inc. v. Crompton, 196 B.R. 299, 309 (E.D.N.C. 1996).

138. 3 F.3d 1029 (7th Cir. 1993).

139. *Id.* at 1032.

unknown to the industry, this casts some doubt on his (self-serving) testimony."[140] Second, proof of industry standards quells the fear of some creditors that another creditor worked out a "special deal" with the debtor before the preference period to give that creditor special treatment in the event of a bankruptcy filing.[141] Curiously, both aspects of this explanation focus on "preferential intent" as the determinative factor, in spite of the deliberate decision in the drafting of the Bankruptcy Reform Act to denude preference law of its subjective components.

Another frequently offered explanation for requiring that the transfer be "ordinary" in an objective (industry norms), as well as a subjective, sense is that the "plain meaning" of the provision supports the requirement of industry standards.[142] The argument goes that while subsections A and B specifically refer to the ordinary course of business between the debtor and creditor, subsection C does not mention the parties. Therefore, proof of industry standards is required by inference since some standard is obviously needed.[143] Clearly, the omission of any reference to the parties' conduct means something. That it necessarily implies incorporation of industry standards, however, is a different kettle of fish entirely.

2. *The Practical Effect of the Objective Approach*

It is our contention that through adoption of an objective interpretation of subsection C requiring observance of industry terms and practices, the courts have weakened the goals of preference law and undermined the integrity of the ordinary course exception. Somewhat ironically, it might appear at first blush that requiring conformity with industry standards actually places all creditors or potential creditors on a more equal footing in at least two ways: (1) in the pre-bankruptcy stage the creditors are equal because they must adhere to the same standards; and (2) in

140. *Id.*

141. *Id.*

142. *See, e.g.*, Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1048 (4th Cir. 1994) ("Because subsections B and C are written in the conjunctive, the use of subsection B's subjective approach under subsection C would render subsection C superfluous."); *see also* Richardson v. Philadelphia Hous. Auth. (*In re* Richardson), 94 B.R. 56, 59–60 (Bankr. E.D. Pa. 1988) (distinguishing nature of inquiry under subsections B and C); *supra* notes 31–33 and accompanying text.

143. *See* Martino v. First Nat'l Bank (*In* re Garofalo's Finer Foods, Inc), 186 B.R. 414 (N.D. Ill. 1995) (holding that purely subjective interpretation of § 547(c)(2) would render subpart C superfluous); *see also* Broome, *supra* note 3, at 86; Thomas W. O'Neal, *Protecting Long-Term Transfers Under Bankruptcy's Ordinary Course Defense*, 79 Ill. B.J. 342, 344 (1991).

bankruptcy creditors as a class have a greater chance of being treated equally because there are fewer creditors being favored. However, employing this standard of equality, as opposed to use of that term in the traditional sense of equality among all similarly situated creditors, produces a losing situation for individual creditors whose services, goods, and money could help keep a debtor out of bankruptcy. The point is that equality is irrelevant to the *application* of § 547(c)(2), even though, to a considerable extent, it should figure into the *formulation* of the exception.[144] The forty-five day limitation served that role in a relatively principled manner. It ensured that any inroads on the general equality goal in bankruptcy were limited to a particular type of credit arrangement where the goals of the exception were most squarely and unambiguously implicated placing creditors on an equal footing by incorporating an industry standards component into the ordinary course of business defense might be effective in simply limiting the absolute number of cases to which the exception pertains now that the forty-five day rule is no more.[145] The problem, however, as will be shown,[146] is that in serving this limiting function the industry standards requirement, unlike a temporal requirement, is incapable of discriminating between those cases where the purposes for the exception are implicated and those cases where they are not.

The creditors' losing situation is exemplified by the Ninth Circuit's unpublished opinion in *Unicom Computer Corp. v. International Business Machines Corp. (In re Unicom Computer Corp.)*.[147] In *Unicom*, the Ninth Circuit reversed the bankruptcy court's finding that forty payments to IBM (the creditor) that followed "a pattern of dealing established well before the preference period" were well within the

144. It is not fair to criticize an exception on the basis that it is contrary to the general rule. *See* Countryman, *supra* note 3, at 775 (calling for repeal of § 547(c)(2) on this basis). Several commentators have fallen into the logical trap of requiring the exception to be faithful to the rule. *See* text accompanying *supra* note 63. Structurally, however, it is the nature of an exception to advance a purpose different, and even at odds with, the rule it qualifies. Thus, in the application of § 547(c)(2) it is irrelevant that the defense does not fit within the broader purposive objectives of the rule, *provided* that the exception is narrowly drafted and properly contained so as not to eclipse the rule. It is in this latter sense, that is to say in the *formulation* of the exception, that equality policy plays a pivotal role.

145. It is also possible, of course, that equality considerations of this ilk poorly serve even this more narrow function of preventing the exception from enveloping the rule. Thus, as is developed more fully, *infra* text accompanying notes 257–259, we believe inclusion of some temporal connection between the incurring of the debt and the payment as an element of the defense would serve as a more principled limitation on the scope of the exception.

146. *See infra* part IV.C.

147. No. 92-17070, 1994 WL 134191 (9th Cir. Apr. 13, 1994).

ordinary business exception.[148] Even though the debtor in this case always paid late, IBM's failure to prove that its practices complied with industry standards allowed the trustee to avoid most of the payments at issue.[149] In *Unicom*, the benefit of the preference law clearly went to the trustee and the unsecured creditors as a group who shared equally in a somewhat larger debtor's estate. The direct loser was IBM, the creditor that had continued to conduct business as usual with the debtor during its slide into bankruptcy,[150] and for whom no one is likely to shed crocodile tears. However, the real losers are future customers who, as a result of this holding, can expect the screws to be tightened as soon as word of their financial problems spreads. The point is that the result in the case might have been perfectly justified to the extent the transfers at issue were either installment payments made on a term loan extended long before the debtor encountered financially troubled waters or made on account of an isolated, non-recurring transaction. Special treatment in those circumstances could neither be justified on the basis of equity nor as providing incentive to induce creditor assistance in keeping the debtor alive and out of bankruptcy. Defending the outcome becomes much more problematic, however, when the payments at issue are on account of debts for supplies and materials needed for current operations and incurred by the debtor in a perilous economic climate.

Although the debtor in the *Unicom* case obviously failed anyway, it is neither appropriate nor wise to assess the merits of the rule based purely on an *ex post* perspective aided by the benefit of 20/20 hindsight. Unquestionably, in the actual case, as in any case where bankruptcy actually ensues, the equities appear strongly in favor of permitting the estate's recovery of the challenged payments so as to ensure substantially equal treatment among general creditors. The counterargument, however, is that not every case ends up in bankruptcy, only the ones we see. By contrast, therefore, when the situation is examined from an *ex ante* perspective the picture develops a little differently, and, concomitantly, so does the analysis. The crippling effect that any interruption in the flow of routine, ordinary course credit can have on even a healthy debtor tends to operate in favor of a standard that protects such transactions in the

148. *Id.* at *1–*2.

149. *See id.* at *3.

150. The 40 payments at issue, totaling over $730,000, were made pursuant to invoices that IBM had sent the debtor primarily for installation of equipment on the premises of the debtor's clients, and also for other services. Accordingly, while it is somewhat unclear from the decision, it appears these payments were on account of current services that permitted the debtor to continue to operate in the critical days prior to bankruptcy. *Id.* at *1.

hope that they might help avert a bankruptcy entirely. Such a standard would, necessarily, protect these transactions without regard to the creditor's awareness of the debtor's financial situation at the time the credit is extended or either parties' state of mind at the time payment thereon is received.[151] This point begins to illustrate why an objective approach to ordinary business terms, particularly to the extent it is defined in terms of industry standards, is an awkward and ineffective mechanism for accomplishing the purposive aims of the exception.

The objective approach creates several more problems aside from "punishing" a creditor for doing business as usual. For example, although the majority of courts have uniformly adopted the objective requirement of industry standards, proof of these standards is not uniform among the circuits.[152] The basic method for examining industry terms can be described as follows: If there is any proof that similar businesses as a whole deal on the same terms that the particular creditor and debtor did, then the transfers may be protected under the exception.[153] When the proof is lacking, however, the exception cannot stand.[154] This basic examination is not always followed, however, especially as creditors and courts become more creative with their definition of industry terms. Consequently, courts have deviated from the basic proof requirements by (1) manipulating the definition of the proper industry,[155] (2) establishing a range of terms that can satisfy the subsection C's "ordinary business terms" requirement,[156] and (3) de-emphasizing the significance of industry terms in certain cases.[157] Some of these deviations undermine the purpose of the exception; others arguably support it. Regardless, a consistent interpretation of industry

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151. *See* Ponoroff, *supra* note 3, at 1492; *infra* notes 250–252 and accompanying text.

152. *See generally* Braunstein v. Rockwell Int'l Corp. (*In re* Broderick), No. 92-11974-CJK, 1996 Bankr. LEXIS 105 (Bankr. D. Md. Jan. 4, 1996).

153. *See* Sulmeyer v. Pacific Suzuki (*In re* Grand Chevrolet, Inc.), 25 F.3d 728, 733 (9th Cir. 1994) (finding that because banks generally take from two weeks to one month to honor 72-hour automobile purchase draft, late payments satisfy exception); *see also* Bell Flavors & Fragrances, Inc. v. Andrew (*In re* Loretto Winery, Ltd.), 107 B.R. 707, 709 (B.A.P. 9th Cir. 1989); *cf.* Iannacone v. Klement Sausage Co. (*In re* Hancock-Nelson Mercantile Co.), 122 B.R. 1006, 1011–12 (Bankr. D. Minn. 1991) (noting that one effect of overlaying objective standard is to lessen availability of exception for late or irregular payments).

154. *See* Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org.), 957 F.2d 239, 246 (6th Cir. 1992) (finding that only evidence of industry standards came from creditor's president whose testimony was suspect due to his position).

155. *See infra* text accompanying notes 159–182.

156. *See infra* text accompanying notes 183–206.

157. *See infra* notes 203–206 and accompanying text.

terms is lacking and unlikely to ever be settled satisfactorily. This erodes the goal of the ordinary course of business exception and, at the same time, negates any attempt to justify an industry standards approach as advancing the important commercial policies of finality and repose.[158]

a. Defining the Proper Industry

Some courts have defined the relevant industry narrowly. In *Advo-System, Inc. v. Maxway Corp.*,[159] the Fourth Circuit analyzed subsection C using the creditor's own business as the proper industry.[160] Advo, the creditor, argued that as the only nationwide, direct-mail marketing firm, it alone represented the industry.[161] The court assumed arguendo that Advo's assertion was true, but still refused to protect the transfers at issue, finding that the credit terms Advo extended to the debtor represented a gross departure from its ordinary practices with other customers.[162]

Using the creditor itself as the industry undermines the point of looking at the industry as a whole. The Third Circuit has agreed: "[J]ust as one swallow does not a spring make, one firm does not an industry make."[163] Such a narrow definition of "industry" not only raises the risk that all of the debtor's creditors are on less than an equal footing, but also creates anomalies among same-industry debtors that deal with different suppliers. At the same time, however, *Advo-System* also served to expose the imprudence of the industry standards approach. By limiting its inquiry to the creditor's own practices with the customers, the court's

158. *See generally* Tabb, *supra* note 3, at 1026–29 (discussing policy of repose as justification for ordinary course of business exception).

159. 37 F.3d 1044 (4th Cir. 1994).

160. *Id.* at 1050–51.

161. *Id.*; *cf.* Hovis v. Powers Constr. Co. (*In re* Hoffman Assocs., Inc.), 194 B.R. 943, 955 (Bankr. D.S.C. 1995) (refusing to accept defendant's contention that relevant industry in this case was industry composed of entities in which debtor's principal had ownership interest, and not construction industry at large).

162. *See Advo-System*, 37 F.3d at 1050–51.

163. Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods., Inc.), 18 F.3d 217, 227 (3d Cir. 1994). Of course, the *Fiber Lite* court did acknowledge that an "exceptionally large firm may be an industry into itself." *Id.* However, there is also authority for the proposition that "the proclivities of a monopolistic enterprise may not necessarily constitute ordinarily business terms." Bulan v. Niagara Mohawk Power Corp. (*In re* Al Cohen's Rye Bread Bakery, Inc.), 202 B.R. 546, 548 (Bankr. E.D.N.Y. 1996). The *Advo-System* definition of the relevant industry also appears to be in conflict with the Sixth Circuit's approach articulated in Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org., Inc.), 957 F.2d 239, 243–44 (6th Cir. 1992). *See supra* text accompanying notes 134–137.

analysis was faithful to the stated purpose of the exception—to allow normal business relations during the crisis period to continue in the regular course. An examination of how the defendant-creditor deals with all of its debtors provides no less assurance that the creditor did nothing "unusual" when dealing with the now-bankrupt debtor then would an examination of the practices of the defendant-creditor's competitors. The point to be made, however, is that the former analysis is not an industry standards analysis in any normal sense of the term. Nevertheless, courts such as the Fourth Circuit in *Advo-System* fail to appreciate that distinction in their articulation, as distinguished from their application, of the standard.

The Sixth Circuit also has permitted the creditor's own practices to define the relevant industry, but only under special circumstances. In *Luper v. Columbia Gas, Inc. (In re Carled, Inc.)*,[164] the trustee sought to set aside payments made by the debtor for gas service to its three restaurants. Testimony reflected that the payments were made late, but within the billing cycle, a pattern that was not only typical of the debtor's payment practices, but those of a number of the defendant, Columbia's, other commercial customers as well.[165] Columbia also introduced evidence relating to the billing practices of several public utilities from other states with which Columbia was affiliated, and one other utility operating in Ohio. Columbia explained the absence of additional evidence relating to the practices of its direct competitors based on the proprietary nature and general unavailability of such information.[166] After reviewing and rejecting the standards for determining compliance with "ordinary business terms"[167] applied by the lower courts, the Sixth Circuit concluded that "Columbia's evidence showed that it is not aberrational, unusual, or idiosyncratic for utility companies to accept late payment on their invoices as long as payment is received within the forty-one day billing cycle,"[168] and, thus allowed the transfer to stand.[169]

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164. 91 F.3d 811 (6th Cir. 1996).

165. According to the testimony of one of its managers, 20% of Columbia's customers, including 10% of its commercial customers, paid their bills after the 30th day in the billing cycle. *Id.* at 814.

166. *Id.*; *cf. Al Cohen's Rye Bread Bakery*, 202 B.R. at 548 (stating that for utilities, ordinary business terms should be defined by applicable regulatory mandates).

167. The bankruptcy and district courts ruled that Columbia was required to show that particular customers routinely paid their bills late. More specifically, the bankruptcy court held that Columbia must show a pattern of lateness for a *significant* percentage of its customers in order to satisfy the third prong of § 547(c)(2). Luper v. Columbia Gas, Inc. (*In re* Carled, Inc.), 170 B.R. 355, 358 (Bankr. S.D. Ohio 1994), *rev'd*, 91 F.3d 811 (6th Cir. 1996).

168. *Luper*, 91 F.3d at 818.

169. *Id.*

In *Tolona Pizza*,[170] the Seventh Circuit appeared to adopt an intermediate position. Initially, the court acknowledged that it is difficult to define the industry whose norms will govern any particular case.[171] The court was able, however, to relegate that inquiry to secondary importance by noting that the creditor does not have to establish a single, uniform industry norm, irrespective of whatever "the industry" may be. Instead, the creditor need only demonstrate that the payment in question did not exceed the "outer limits of normal industry practices,"[172] with the relevant industry flexibly defined. Thus, the creditor in *Tolona Pizza* was able to sustain its burden that the payment was made according to ordinary business terms even though the creditor apparently dealt differently with the debtor than it did with the vast bulk of its customers, and differently than the way that most of the creditor's competitors dealt with their open accounts.[173] At bottom, *Tolona Pizza* might be read as establishing a very low standard for satisfying the objective test in subsection C, namely, that the payment arrangement not be wholly unknown in the specific or related industries.[174] Nevertheless, others have interpreted *Tolona Pizza* as requiring a creditor to present at least some evidence of its competitors practices in order to establish compliance with the "ordinary business terms" requirement of subsection C,[175] and

170. *In re* Tolona Pizza Prods. Corp., 3 F.3d 1029 (7th Cir. 1993).

171. *Id.* at 1033. In this case, the trustee sought to recover eight payments made by the debtor, a pizza maker, to its sausage supplier. In deciding which industry's norms should govern, the court noted that the possibilities included the sale of sausage to makers of pizza, the sale of sausages to anyone, or the sale of anything to makers of pizza. *Id.*

172. *See infra* notes 187–190 and accompanying text. In Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 78 F.3d 30 (2d Cir. 1996), the Second Circuit seemed to endorse this view in general, holding that the payment for which protection is sought must fall within the bounds of ordinary practice of others similarly situated, but abjured from making a conclusive determination. *Id.* at 39–41. Instead, the court stated that the determination of the relevant industry should be left to the bankruptcy courts to make on a case-by-case basis heavily dependent on the factual circumstances present in the individual case. *Id.*

173. In a dissenting opinion, Judge Flaum argued that the creditor had failed to make a sufficient showing that the challenged payments were made in accordance with industry standards in order to "defeat the inference that the payments were preferential." *Tolona Pizza*, 3 F.3d at 1034 (Flaum, J., dissenting). In essence, the dissent points up how weak the evidence of conformity to industry practice and standards really was, despite the fact that the majority used this decision as the occasion to adopt the objective approach to the "ordinary business terms" language in § 547(c)(2)(C). *Id.* (Flaum, J., dissenting).

174. This position is consistent with the view that subsection C serves a purely evidentiary function to control self-serving testimony in those cases where the payment practice is absolutely unknown in the industry. *See supra* note 99 and accompanying text.

175. *See, e.g.*, Jones Truck Lines, Inc. v. Central States, S.E. & S.W. Areas Pension Funds (*In re* Jones Truck Lines, Inc.), No. 91-1547514, 1995 Bankr. LEXIS 2031 (Bankr. W.D. Ark. Sept. 27, 1995); Steege v. AT&T (*In re* Superior Toy & Mfg. Co.), 183 B.R. 826 (Bankr. N.D. Ill. 1995);

the Seventh Circuit subsequently confirmed this interpretation in *In re Midway Airlines, Inc.*[176]

In *Midway Airlines*, the creditor, Jensen Cabinet, was a manufacturer and supplier of custom cabinetry, selling primarily to airline industry customers. Jensen received six invoice payments from the debtor, Midway Airlines, within ninety days of the filing. In each case the payment was late, although Jensen maintained that it never received timely payments from any of its airline customers. The principal issue on appeal was whether the district court erred in finding against Jensen based on Jensen's failure to introduce evidence of sales terms and practices among its competitors.[177] Resolution of that issue required as a threshold matter identifying the relevant industry. Jensen argued that because the airlines are uniform in terms of their payment practices, the court should consider the payment practices in the airline industry.[178] The trustee supported the bankruptcy court's definition which, over Jensen's objection, included not only the practices employed by other cabinetry companies, but also millwork firms selling to non-airline customers.[179]

Relying on its earlier opinion in *Tolona Pizza*, the Seventh Circuit concluded that the relevant industry was the creditor's, not the debtor's industry. Thus, even though less than one percent of Jensen's business was non-airline cabinetry work, and even though the airline industry apparently dictated payment terms to its suppliers,[180] the court refused to limit the industry definition to millwork firms employed by airline

Solow v. Ogletree, Deakins, Nash, Smoak & Stewart (*In re* Midway Airlines, Inc.), 180 B.R. 1009 (Bankr. N.D. Ill. 1995); NMI Sys., Inc. v. Pillard (*In re* NMI Sys., Inc.), 179 B.R. 357 (Bankr. D.D.C. 1995); Kepler v. Aetna Fin. Co. (*In re* Ausman Jewelers, Inc.), 177 B.R. 282 (Bankr. W.D. Wis. 1995); Cocolat, Inc. v. Fisher Dev., Inc. (*In re* Cocolat, Inc.), 176 B.R. 540 (Bankr. N.D. Cal. 1995).

176. 69 F.3d 792 (7th Cir. 1995). See *infra* text accompanying notes 177–179 for a more detailed discussion of *In re Midway Airlines.*

177. *Midway Airlines*, 69 F.3d at 794. The bankruptcy court had granted the trustee's petition to set aside the disputed payments on the ground that Jensen had failed to offer any evidence of its competitors' credit practices. *Id.* The same basic issue is also discussed *infra* part IV.B.2.c.

178. *Midway Airlines*, 69 F.3d at 795. In view of the fact that virtually all of Jensen's business was with airline industry customers, and the airlines apparently dictated payment terms to their construction suppliers which the suppliers were powerless to alter, the argument that the bankruptcy court erred in its ruling that the relevant industry included millwork firms selling to non-airline customers was hardly specious. Ultimately, however, because of the court's insistence that evidence of Jensen's practices with other customers could not alone establish the required proof that the payments were made according to ordinary business terms, the question of what was the relevant industry effectively was mooted.

179. *Id.*

180. *Id.* at 796 n.4.

customers. The effect of this determination was to foreclose any opportunity for Jensen to argue that its relations and practices with its other customers itself provided an "industry" using unified terms. Thus, it seems, the current position of the Seventh Circuit in relation to the question of which industry's standards will control is on the face of it directly in opposition to the Fourth Circuit's analysis in *Advo-System*,[181] and, at least to a certain extent, at odds with the more flexible approach adopted by the Sixth Circuit in *Carled*.[182] The confusion is exacerbated by an even greater divergence of opinion on the related issues, to which attention is turned next, of what is meant by "standards prevailing in the industry," once the relevant industry has been defined, and what kind of proof is necessary or required to establish conformity with those standards.

b. Defining the Proper Standards

1) National Standards

Assuming the relevant industry has been identified, courts have endorsed multiple interpretations for determining the applicable standards within the industry. One view is a strict showing of *national* industry standards. In *Unicom Computer Corp.*[183] the Ninth Circuit found thirty-two of forty preferential payments avoidable because the creditor could not establish that nationwide industry standards regularly permitted a debtor to pay more than thirty days after payment was due.[184] Despite evidence that the debtor and creditor had a pattern of payments beyond the thirty-day grace period, and that the creditor's local branch had sometimes dealt with other debtors the same way, the court required a

181. In *Advo-System*, it will be recalled, the court looked to the dissimilarity between the payments in question and the creditor's usual practices with its other customers. Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1050–51 (4th Cir. 1994); *supra* text accompanying notes 159–169. Because, however, the court in *Advo-System* found that the defendant-creditor effectively comprised the entire industry, the two decisions can be reconciled, but clearly the Fourth Circuit made its own distinct contribution to the analysis of this question which represents an expansion of the parameters set in by the Seventh Circuit in *Tolona Pizza*.

182. *See supra* text accompanying notes 164–169. It should be noted, however, that the *Carled* opinion cites both *Tolona Pizza* and *Midwest Airlines* with approval. Luper v. Columbia Gas Co. (*In re* Carled, Inc.), 91 F.3d 811, 815–16 (6th Cir. 1996).

183. No. 92-17070, 1994 WL 134191 (9th Cir. Apr. 13, 1994).

184. *Id.* at *2–*3. In Sulmeyer v. Pacific Suzuki (*In re* Grand Chevrolet, Inc.), 25 F.3d 728 (9th Cir. 1994), the Ninth Circuit found, without extensive discussion, that the creditor satisfied its burden of showing that the payments at issue were not unusual in relation to industry standards by virtue of testimony from automobile financial industry experts. *Id.* at 733.

showing of conformity with *nationwide* industry standards.[185] The court then found such standards in IBM's national grace-period policy.[186] Apparently, because this policy was established in conjunction with an "industry-wide trade association of equipment lessors," the court was willing to accept it as evidence of the nationwide standard that other similar creditors use. Upon application of the standard, the court found only the eight transfers satisfying this criterion were entitled to protection under the ordinary course of business defense.

Requiring every creditor to comply with nationwide standards not only bears no relationship to the purposes of the preference law or the preference defenses, but it interferes with the strong bankruptcy policy favoring rehabilitation. Many debtor-creditor relationships are local, negotiated by local representatives, and tailored to meet local needs. Bankruptcy law should not disrupt these relationships. Moreover, requiring a creditor to prove a set of national standards is difficult. In *Unicom*, the court looked to a policy that the creditor's main office had worked out with a group of potential debtors. This approach ignores not only local custom, but the particular terms and course of dealing between the parties to the transactions, as well as the practices of similar creditors that do not maintain a national policy. It may also adversely impact smaller, local creditors to the extent that it requires them to demonstrate compliance with a standard set by a national company.

2) The Sliding Scale

Many courts allow a broad range of industry standards in determining whether a particular payment satisfies the "ordinary business terms" requirement. The Seventh Circuit in *Tolona Pizza*[187] established a lenient definition of both industry and industry standards. While emphasizing that subsection C clearly requires a showing of ordinariness outside of the terms established between the specific creditor and debtor, the court concluded that the creditor need not establish "the existence of some single, uniform set of business terms."[188] Instead, the court interpreted

185. *Unicom Computer Corp.*, 1994 WL 134191, at *3. Arguably, this evidence would have been sufficient to satisfy the Seventh Circuit under its more lenient definition of industry standards. *See infra* text accompanying notes 187–190.

186. *Unicom Computer Corp.*, 1994 WL 134191, at *2.

187. *In re* Tolona Pizza Prods. Corp., 3 F.3d 1029 (7th Cir. 1993).

188. *Id.* at 1032–33. Recently, the Second Circuit also endorsed the approach adopted by the Seventh Circuit in *Tolona Pizza*. *See* Lawson v. Ford Motor Co. (*In re* Roblin Indus., Inc.), 78 F.3d 30, 41 (2d Cir. 1996) (describing formulation as "the most reasonable interpretation of

"ordinary business terms" as encompassing the *range of terms* in which firms "similar in some general way to the creditor in question engage."[189] Thus, only those payments made according to terms that are so "idiosyncratic" that they fall outside the broad range of terms common in the industry should be deemed outside of the exception.[190]

In *Molded Acoustical Products Inc.*,[191] the Third Circuit adopted the Seventh Circuit's standard but with an important added twist.[192] The *Molded Acoustical* court ruled that when interpreting ordinary business terms, the duration of the parties' relationship plays a pivotal role.[193] "[T]he more cemented (as measured by its duration) the pre-insolvency relationship between the debtor and the creditor, the more the creditor will be allowed to vary its credit terms from the industry norm yet remain within the safe harbor of § 547(c)(2)."[194] In *Molded Acoustical*, the court initially accepted weak evidence of a forty-five day industry standard.[195] Next, the court determined that an eighteen-month relationship between the creditor and debtor, while "not extremely lengthy, [was] of a sufficiently long duration that the relationship is entitled to some leeway, meaning [the court] might approve a not insubstantial departure from the established 45-day industry norm."[196] The Third Circuit then suggested that even a fifty-eight day average may

§ 547(c)(2)(C) because it balances the competing interests involved with respect to voidable preferences").

189. *Tolona Pizza*, 3 F.3d at 1033; *accord* Cocolat, Inc. v. Fisher Dev., Inc. (*In re* Cocolat, Inc.), 176 B.R. 540, 550 (Bankr. N.D. Cal. 1995) (holding that to satisfy subsection C defendant must submit evidence that challenged transaction was consistent with practices common to businesses similar to debtor and transferee). In Kepler v. Aetna Fin. Co. (*In re* Ausman Jewelers, Inc.), 177 B.R. 282 (Bankr. W.D. Wis. 1995), the court refused to allow the defendant the benefit of the ordinary course of business defense where the defendant failed to supply any evidence that the transaction was ordinary for the industry as a whole.

190. *Tolona Pizza*, 3 F.3d at 1033. *But see* Advo-System., Inc. v. Maxway Corp., 37 F.3d 1044, 1050 (4th Cir. 1994) (noting that evidence of ordinary business terms cannot be at too high level of generality).

191. Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods., Inc.), 18 F.3d 217, 227 (3d Cir. 1994).

192. *Id.* at 224.

193. *Id.*; *accord* Huffman v. New Jersey Steel Corp. (*In re* Valley Steel Corp.), 182 B.R. 728, 739–40 (Bankr. W.D. Va. 1995); Solow v. Hilton Inn of Oak Lawn, Ltd. (*In re* Midway Airlines, Inc.), No. 95-C-0023, 1995 U.S. Dist. LEXIS 7501 (N.D. Ill. May 25, 1995) (commenting on expansion of *Tolona Pizza* accomplished by Third Circuit in *Molded Acoustical*, but determining that, even if applicable in Seventh Circuit, it would not aid defendant that failed to offer any evidence of industry norms).

194. *Molded Acoustical*, 18 F.3d at 225.

195. *Id.* at 227.

196. *Id.*

be in that window. Nevertheless, because during the preference period the average time for payment greatly exceeded what it had been for the greater part of the debtor-creditor relationship prior to the preference period, the court concluded that the transfers under scrutiny could still be recovered as preferences.[197]

Following *Molded Acoustical*, the bankruptcy court in *Huffman v. New Jersey Steel Corp. (In re Valley Steel Corp.)*[198] observed that:

> The emphasis on the duration of the parties' relationship serves to effectuate the two major policies of the law of preferences. By offering some protection to creditors who are willing to deal with troubled businesses, the possibility of survival will increase for businesses that are on the edge of bankruptcy, but still susceptible to resuscitation. Moreover, the likelihood of undiscovered overreaching by a preferred creditor is minimized if an enduring relationship is available to compare with the creditor's conduct during the preference period. Conversely, where the relationship is short, the terms must be consistent with the objective norms of the creditor's industry to avoid the appearance and risk of favoritism.[199]

Of course, these same statements might just as easily have been made in justifying the pre-1992 standards governing "ordinary business terms" that relied exclusively on the past dealings of the parties, except in those limited circumstances where no such prior course of conduct existed.[200]

Put another way, for better or worse, application of the sliding scale rule appears to abrogate the objective requirement of subsection C by approving transfers made within a long standing relationship, even though they are contrary to industry practice. As the Third Circuit

197. *Id.* at 227–28. Additionally, the Fourth Circuit explicitly adopted the sliding scale determination of industry standards. *See* Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1050 (4th Cir. 1994). The court cautioned, however, that this approach "never tolerates a gross departure from the industry norm, not even when the parties have an established and steady relationship." *Id.* The Second Circuit has neither accepted nor rejected *Advo-System*'s embellishment on the *Tolona Pizza* standard, instead determining that defining the relevant industry standards is appropriately left to the bankruptcy courts to decide as a question of fact heavily dependent upon the circumstances in each case. However, at least one bankruptcy court in the Sixth Circuit has expressly declined to accept the argument that payments made outside the "broad range of terms" referred to in *Tolona Pizza* may nevertheless be considered according to ordinary business terms because of a long-standing relationship between the parties. *See* Frank v. Volvo Penta of the Ams. (*In re* Thompson Boat Co.), 199 B.R. 908, 915–16 (Bankr. E.D. Mich. 1996) (relying on Logan v. Basic Distrib. Corp. (*In re* Fred Hawes Org., Inc.), 957 F.2d 239 (6th Cir. 1992)).

198. 182 B.R. 728 (Bankr. W.D. Va. 1995).

199. *Id.* at 740.

200. *See supra* notes 92–96 and accompanying text.

recognized: "[W]e think that a trade debt payment made according to longstanding practice between two solvent parties most often does not 'prefer' that creditor to the disadvantage of the debtor or other creditors."[201] We are in full agreement, but this appreciation only serves to call into question the wisdom of the original decision to rely on industry standards in the first place. In addition, despite the apparent pull-back, which the *Molded Acoustical* approach represents, "industry standards" has become firmly rooted in the articulation of what is meant by "ordinary business terms" in subsection C and, thus, the potential for further mischief exists each time the standard is invoked.

Paradoxically, then, the result of this sliding scale when carried to its logical conclusion is that the courts that follow this approach could end up in many cases determining the "industry terms" by looking solely at the parties' past practice.[202] For example, in *Molded Acoustical*, the court explained:

> But what is clearly the dispositive factor in this case, which allows us to conclude as a matter of law that the payments at issue here were not "made according to ordinary business terms," is the evidence that the terms dominating throughout the pre-insolvency relationship between the parties . . . were far shorter than the preference . . . period payment terms.[203]

So construed, the sliding scale actually signals a return of sorts to the subjective interpretation of section 547(c)(2)(C). Obviously, a subjective approach supports neither Judge Posner's vision of, nor his explanation of the purposes for, the "ordinary business terms" requirement.[204] On the

201. *Molded Acoustical*, 18 F.3d at 225.

202. *But see* Official Comm. of Unsecured Creditors of R.M.L., Inc. v. Conceria Sabrina, S.P.A. (*In re* R.M.L., Inc.), 195 B.R. 602 (Bankr. M.D. Pa. 1996) (raising serious question as to whether or not under *Molded Acoustical* creditor could fail to proffer any evidence of industry standard and still qualify for protection under ordinary course of business defense).

203. *Molded Acoustical*, 3 F.3d at 228. Another good example of how the "sliding scale" approach can result in scant attention being paid to pervading industry practices is NMI Sys., Inc. v. Pillard (*In re* NMI Sys., Inc.), 179 B.R. 357 (Bankr. D.D.C. 1995). The alleged preference in that case involved bonus payments made to an employee of the debtor-corporation. The court found that the bonus arrangement was incurred, and the bonus draws paid, in the ordinary course of the financial affairs of the debtor and the company. As to the requirement of "according to ordinary business terms," the court concluded that this element was satisfied since the bonus payments were not a "flagrant departure" from relevant industry norms and the parties had engaged in this arrangement for a substantial period of time predating the company's insolvency. *Id.* at 373–74 nn.6, 7. Thus, the defendant was able to assert successfully the ordinary course of business defense in the case without, as a practical matter, producing any evidence to show similarity of the payments under scrutiny with payment practices followed by competitors or other companies in the industry.

204. *See supra* text accompanying notes 139–141.

other hand, it does advance the policy of allowing business to continue as usual which is, after all, both the stated purpose and the most defensible justification for the exception. Therefore, despite the circuitous process used to achieve that result, this modified approach could represent an acceptable accommodation of relevant policy goals, but for the continuing problem created by the U.S. Supreme Court's ruling extending the defense to payments on long-term debt.[205] The issues may be analytically discrete, but, as discussed below,[206] the two questions inevitably conflate and, practically speaking, need to be addressed at the same time.

3) Healthy vs. Troubled Debtors

Another wrinkle that has arisen in assessing compliance with an objective industry terms standard has been gauging the effect of the difference between terms that creditors use when dealing with troubled debtors as opposed to healthy debtors. In *Jones v. United Savings & Loan Association* (*In re U.S.A. Inns*),[207] the Eighth Circuit endorsed a view that was lenient toward creditors that adjusted or restructured their payment terms to accommodate troubled debtors. In *U.S.A. Inns*, the debtor was in default and made payments to the creditor according to a "workout process."[208] Recognizing that ordinary business terms will vary from industry to industry, the court found that such payments could fall within the exception.[209] Because the creditor presented ample evidence that it was a common industry practice to work with a troubled debtor as long as it remitted *some* form of payment, the court concluded that the creditor satisfied subsection C.[210] In *Lawson v. Ford Motor Co.* (*In re*

205. *See infra* notes 249–251 and accompanying text.

206. *See infra* text accompanying notes 253–254.

207. 9 F.3d 680 (8th Cir. 1993).

208. *Id.* at 685.

209. *Id.* (noting that proof of ordinary business terms "requires evidence of a prevailing practice among similarly situated members of the industry facing the same or similar problems"); *see also* Gray v. Huntsman Chemical Corp. (*In re* Dooley Plastics Co.), 185 B.R. 389, 394 (Bankr. D. Mass. 1995) (implying that specific proof of similar workout arrangements with other delinquent debtors might be sufficient).

210. *U.S.A. Inns*, 9 F.3d at 685–86. The Fourth Circuit has also implied that evidence supporting an industry standard to work with troubled debtors would be enough to satisfy subsection C. *See* Advo-System, Inc. v. Maxway Corp., 37 F.3d 1044, 1051–52 (4th Cir. 1994). However, the *Advo-System* court ultimately determined that the record "clearly show[ed] that it was unusual for [the creditor] to extend credit and it was unusual for [the creditor] to work with delinquent customers." *Id.* at 1052.

Roblin Industries, Inc.),[211] the Second Circuit signaled its concurrence with *U.S.A. Inns* when it expressly rejected the bankruptcy court's determination that the payment in question could not be protected under section 547(c)(2) because a restructured payment on a defaulted debt can never be considered ordinary.[212] Specifically, the court observed: "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."[213]

In direct contrast to this approach, the Tenth Circuit refused to adopt the troubled-debtor interpretation in *Clark v. Balcor Real Estate Finance, Inc. (In re Meridith Hoffman Partners*).[214] In *Meridith Hoffman*, the debtor and creditor entered into an escrow agreement that evidence showed to be common with delinquent debtors.[215] The court found that such an arrangement clearly contradicted the "dangers that the preference section seeks to avoid," because the creditor may be given an advantage as a result of such arrangements.[216] Under *Meridith Hoffman*, "ordinary business terms" are only those used "in ordinary circumstances, when debtors are healthy."[217] As a consequence of the antipodal holdings of *Meridith Hoffman* and *U.S.A. Inns*, late payments and payments made pursuant to special arrangements deliberately intended and designed to keep the debtor out of bankruptcy are avoidable without exception in at least one but not all circuits.

211. 78 F.3d 30 (2d Cir. 1996).

212. *Id.* at 41–42.

213. *Id.* at 42 (citing *U.S.A. Inns*, 9 F.3d 680 (8th Cir. 1993)); *accord* Bulan v. Niagara Mohawk Power Corp. (*In re* Al Cohen's Rye Bread Bakery, Inc.), 202 B.R. 546 (Bankr. E.D.N.Y. 1996) (declining to adopt view that payment made pursuant to debt restructuring agreement can never be ordinary); Braunstein v. Rockwell Int'l Corp. (*In re* Broderick Co.), No. 92-11974-CJK, 1996 Bankr. LEXIS 105, at *29–*31 (Bankr. D. Mass. Jan. 4, 1996) (noting that taking measures to accommodate troubled debtor is consistent with aim of ordinary course of business exception, which is to leave normal debtor-creditor relationships undisturbed). *But see* Frank v. Volvo Penta of the Ams. (*In re* Thompson Boat Co.), 199 B.R. 908, 916 (Bankr. E.D. Mich. 1996) (expressly rejecting holding of *U.S.A. Inns* as providing no limit to what would be ordinary business terms).

214. 12 F.3d 1549 (10th Cir. 1993).

215. *Id.* at 1554.

216. *Id.* at 1553 (holding that "ordinary business terms" are those used by parties when debtors are "healthy," and that arrangements that creditors use when debtor is struggling may give creditor advantage over others and, thus, detract from general policy of preference section); *accord* Kirtley v. Consolidated Nutrition, L.C. (*In re* Freeny), 187 B.R. 711, 716 (Bankr. N.D. Okla. 1995).

217. *Meridith Hoffman*, 12 F.3d at 1553; *see also* Jobin v. McKay (*In re* M & L Bus. Mach. Co.), 84 F.3d 1330 (10th Cir. 1996) (reaffirming holding in *Meridith Hoffman*), *petition for cert. filed*, 65 U.S.L.W. 3310 (U.S. Oct. 10, 1996) (No. 96-569). *But see* Luper v. Columbia Gas Co. (*In re* Carled, Inc.), 91 F.3d 811, 818 (6th Cir. 1996) (declining to take position of whether special rule of ordinariness ought to apply for industry participants in distress).

Limiting industry standards to relationships with healthy debtors is unrealistic. Creditors inevitably encounter troubled debtors within the ordinary course of their businesses and sophisticated businesses generally have set policies for dealing with troubled debtors. Discouraging creditors from using other terms to deal with delinquency undermines the objective of continuing normal business relations and interferes with the ultimate goal of minimizing the absolute number of business failures.[218] The problem, however, is that it is in the nature of an industry norms approach to exclude from the range of "ordinary" terms those made specially to accommodate a financially beleaguered debtor. Thus, the *Meridith Hoffman* holding, while perhaps unduly harsh and unquestionably contrary to the purposive objectives of the preference law, is also quite rational and even defensible given the initial premise (however dubious) that the "ordinary business terms" language in section 547(c)(2)(C) should be defined with reference to the credit practices employed by other noncreditor parties in the industry.

The foregoing indicates that the shift to an objective standard was flawed in conception and has proved unworkable in application. By allowing courts to manipulate the definition of the industry and the proper standards within the industry, the objective approach seems to have become little more than a way for courts to implement their own views of the ordinary course of business exception, and, more generally, their own visions about what makes a transfer a preference to begin

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218. In *Meridith Hoffman*, the court stated that:

> The preference section does not discourage "unusual action" simply because others in the industry wouldn't respond to similar circumstances in the same way. It discourages "unusual action" that may favor certain creditors or hasten bankruptcy by alarming other creditors and motivating them to force the debtor into bankruptcy to avoid being left out.

12 F.3d at 1553. Obviously, the court's fixation was on deterrence of precipitous collection activity and transfers obtained with the motivation of achieving a preferential advantage. There is, however, another view of the end to be achieved by the policy of "not disturbing normal financial relations." That is, that it encourages creditors that supply critical operating capital to continue to do business with the debtor, thus preserving the hope that the debtor will be able to stay afloat long enough to reverse its financial misfortunes. This view of the purpose for § 547(c)(2) recognizes a more flexible standard for troubled debtors. *See* Cocolat, Inc. v. Fisher Dev., Inc. (*In re* Cocolat, Inc.), 176 B.R. 540, 550 (Bankr. N.D. Cal. 1995) (holding that creditors may exert some degree of collection pressure without rendering resulting payment outside of ordinary course). Of course, this view of the purpose of the ordinary course defense presumes that the exception should be limited to short-term debt. *See infra* text accompanying note 250; *see also* Miller v. Kibler (*In re* Winters), 182 B.R. 26, 29 (Bankr. E.D. Ky. 1995) (observing that it is clear that § 547(c)(2) applies only where debtor and transferee have "on-going, 'recurring' business relationship").

with.[219] Moreover, as discussed in the material to follow, in certain key respects this vision of the preference law contains an antiquated, but stubbornly persistent, notion that what makes a transfer a preference is the *intent* to prefer, rather than the preferential effect.

c. *Proving Compliance with Industry Standards*

Even once the relevant industry standards have been located and identified, an issue of considerable practical importance remains. How does the creditor go about proving that in this particular instance the payment the trustee is seeking to recover complied with those standards? In *Tolona Pizza*, the Seventh Circuit created a strong impression that proof of conformity with the creditor's practice with respect to other same-industry debtors would not suffice.[220] Then, in *Midway Airlines*, the court eliminated any lingering doubt about the issue, emphasizing the need for the creditor to come forward with specific evidence of the practices and payment terms used by the creditor's competitors.[221] However, the court in *Midway Airlines* specifically ruled that this evidence need *not* consist of either expert testimony or testimony directly from representatives of the defendant-creditor's competitors. Instead, the court observed that, while these two sources of proof are available to creditors, showing compliance with industry practices might be established in other ways, such as testimony by the creditor's own executives.[222]

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219. *See, e.g.*, Weisberg *supra* note 3, at 124–26 (describing range of different judicial attitudes to defense, but concluding that "[t]he norm underlying section 547(c)(2) can be characterized as a mens rea standard").

220. *See supra* note 175 and accompanying text.

221. *Accord* Lawson v. Ford Motor Co. (*In re* Roblin Indus.), 78 F.3d 30, 43 (2d Cir. 1996); Fitzpatrick v. Rockwood Water, Wastewater & Natural Gas Sys. (*In re* Tennessee Valley Steel Corp.), 201 B.R. 927, 936–37 (Bankr. E.D. Tenn. 1996) (indicating that because timely payments are presumed to be norm in natural gas industry, if challenged payments were made in timely fashion that should obviate need for "industry standards" analysis altogether); Sacred Heart Hosp. v. E.B. O'Reilly Servicing Corp. (*In re* Sacred Heart Hosp.), 200 B.R. 114 (Bankr. E.D. Pa. 1996); Hassett v. Goetzmann (*In re* CIS Corp), 195 B.R. 251 (Bankr. S.D.N.Y. 1996); Dery v. Detroit Edison (*In re* Dobbs Inc.), No. 94-CV-71689-DT, 1995 U.S. Dist. LEXIS 16303, *15–*17 (E.D. Mich. Sept. 29, 1995); Milwaukee Cheese Wis., Inc. v. Straus (*In re* Milwaukee Cheese Wis., Inc.), 191 B.R. 397, 401 (Bankr. E.D. Wis. 1995); Gilbert v. Blosser Color Lab., Inc. (*In re* Centric Communications, Inc.), No. 94-329, 1995 Bankr. LEXIS 1556 (Bankr. S.D. Ohio Oct. 2, 1995); *cf. In re Carled*, 91 F.3d at 819 (accepting evidence to effect that obtaining information concerning competitors' billing practices was not possible as excuse from requirement of presenting such information in order to satisfy subsection C).

222. *In re* Midway Airlines, Inc., 69 F.3d 792, 796–97 (7th Cir. 1995); *see also* Solow v. Ogletree, Deakins, Nash, Smoak & Stewart (*In re* Midway Airlines, Inc.), 180 B.R. 1009, 1015–17

There is a subtle illogicalness in the court's insistence in *Midway Airlines* on evidence that the transactions at issue comported with the practices of similar businesses, and, at the same time, in its willingness to acquiesce in such proof in the form solely of testimony from the representative of the defendant-creditor. Obviously, if one of the concerns addressed by the ordinary terms requirement is, as Judge Posner suggested, to police "special deals" between debtor and creditor,[223] it makes little sense to accept as proof of ordinary business terms testimony from the very party whose objectivity and veracity are open to question in the first place. Although it may be the case that the existence of this potential bias should only affect the weight accorded and not the admissibility of the testimony, that is something quite different from saying that no additional kind of proof is needed. In fact, permitting the defendant's testimony alone to satisfy the industry terms standard belies the original purpose for an objective standard, which is to bring to bear a neutral, outside evaluation of conduct.[224] Nevertheless, under *Midway Airlines*, the defendant-creditor's testimony could be regarded as not just probative, but actually dispositive of the issue of compatibility with industry-wide practices. In our view, all of this demonstrates the magnitude of the error in judgment and methodology entailed in the initial decision to employ an industry terms test for satisfying an objective approach to subsection C. In the final analysis, that may be the most telling point to be made here.[225]

(Bankr. N.D. Ill. 1995) (holding that testimony from debtor's managing partner as to range of credit practices used by similar firms was sufficient proof of industry business terms).

223. *See supra* note 141 and accompanying text.

224. An instructive analogy can be found in the Uniform Commercial Code. Section 1-201(19) contains the general definition of "good faith," which adopts a subjective standard of honesty in fact. U.C.C. § 1-201(19) (1994). However, in Article 2, in the case of merchants, there is a supplemental definition of "observance of reasonable commercial standards of fair dealing in the trade." U.C.C. § 2-103(1)(b) (1994). The inclusion of an objective standard in this context is intended to make clear that in the case of a merchant, a good heart, and an empty head will not necessarily satisfy the requirement of good faith when, judged by generally accepted standards in the trade, the merchant's exercise of judgment was not reasonable. *See, e.g.*, Neumiller Farms, Inc. v. Cornett, 368 So. 2d 272 (Ala. 1979) (involving merchant-buyer's attempt to reject goods as not being satisfactory). Of necessity, then, and in spite of the court's allusion in *Midway* to the contrary, a creditor seeking to establish conformity with industry practices will never be well advised to rely solely on testimony from its own personnel. Thus, the practical effect of the core holding in *Midway* will be to increase the complexity, and correspondingly the expense, of litigation under § 547(c)(2), a result that inures to nobody's benefit, not to the creditor's, not to the estate's, and not to the system's.

225. We would propose to eliminate any industry-wide comparison from the analysis of the ordinary course of business defense. *See infra* text accompanying notes 272–275.

The other justification offered in *Tolona Pizza* for requiring proof of industry standards, that of serving an evidentiary function,[226] even more palpably reveals the circularity in reasoning going on in the case law. If some resemblance to common industry practices is necessary to bolster the inherently self-serving testimony of the defendant-creditor that the payment arrangements at issue were normal for this debtor and creditor, then certainly that objective is attained only if the testimony comes from someone other than the party whose attestations are in need of reinforcement. The suggestion in *Midway Airlines* that validation can be supplied by the same party whose statement requires validation is, therefore, an exercise in pure flummery, and necessarily implies that either the formulation is itself misguided or the initial premise is in need of reexamination. Because we do not believe that the testimony of industry experts or competitors adds anything to the analysis of whether the transfer *should* be protected from preference liability, we are persuaded by the latter view. In short, we are convinced that a careful examination of the prevailing approach to establishing conformity with industry standards not only exposes the shortcomings in the current interpretation of section 547(c)(2)(C) but strengthens the case for legislative reform.[227]

Two recent bankruptcy court cases sharply illustrate the uncertainty created by the objective standard, an uncertainty exacerbated by the differing views of courts as to the question of what constitutes sufficient forms of proof as to adherence with industry terms. In *Roberts v. Service Transport, Inc. (In re Ideal Security Hardware Corp.)*,[228] the trustee sought to recover allegedly preferential transfers consisting of payments made to a carrier that had hauled freight for the debtor on an open account basis. The creditor argued that the payments were made in the ordinary course of business based on an affidavit of its controller who testified that the debtor was regularly late with its payments and that late payments were common in the industry. Citing the bias of the affiant in addition to the absence of other evidence of industry terms, the court ruled that subsection C could not be satisfied by the self-serving testimony of the defendant's officer "because it is to be expected that the testimony of an officer of the defendant would be favorable to the

226. *In re* Tolona Pizza Prods. Corp., 3 F.3d 1029, 1032 (7th Cir. 1993); *see supra* notes 139–140.

227. *See infra* text accompanying notes 233–241.

228. 186 B.R. 237 (Bankr. E.D. Tenn. 1995).

defendant's position."[229] In contrast, the defendant-creditor in *McCord v. Venus Foods, Inc. (In re Lan Yik Foods Corp.)*[230] attempted to supply proof of "ordinary business terms" by offering the testimony of its vice-president to the effect that tolerance for late payments was not only the defendant's normal practice with its customers but was also the normal practice in the industry.[231] Although this evidence was hardly any less self-serving than that presented in *Ideal Hardware*, the court concluded that such testimony could nevertheless suffice to establish "ordinary business terms" for a particular industry, over the objection of the trustee, so long as there is no specific evidence to the contrary.[232]

C. Compatibility of the Objective Approach with the Purpose for an Ordinary Course Exception

The objective standard in subsection C, as applied by the courts, is incompatible with the goal of the ordinary course of business exception for several reasons. First, in its basic form, the industry terms standard "punishes" creditors for doing business as usual, whether it is business as usual with a long standing debtor who has come upon hard times or whether it is business as usual according to local terms and not nationwide standards. In direct contravention of the core policy underlying the original six preference exceptions,[233] an industry standards requirement actually discourages individuals and business

229. *Id.* at 239 (citing Finley v. Mr. T's Apparel, Inc. (*In re* Washington Mfg. Co.), 144 B.R. 376, 380 (Bankr. M.D. Tenn. 1992)); *see also* Heyman v. Woldman (*In re* Elton Trucking, Inc.), No. 94-B-17989, 1996 Bankr. LEXIS 516 (Bankr. N.D. Ill. May 2, 1996) (observing that self-serving statements are insufficient to establish requisite elements of defense under § 547(c)(2)); Trinkoff v. Porters Supply Co. (*In re* Daedalean, Inc.), 193 B.R. 204 (Bankr. D. Md. 1996) (refusing to grant summary judgment on creditor's § 547(c)(2) claim based on disagreement established by parties' affidavits as to what standard industry practices were in regard to late payments); Anderson-Smith & Assocs. v. Xyplex, Inc. (*In re* Anderson-Smith & Assocs., Inc.), 188 B.R. 679, 688 (Bankr. N.D. Ala. 1995) (noting that self-serving testimony is not determinative of ordinary course of dealings between parties).

230. 185 B.R. 103 (Bankr. E.D.N.Y. 1995).

231. *Id.* at 114.

232. *Id.*; *see also* McLaughlin v. Hoole Mach. & Engraving Corp. (*In re* Parkline Corp.), 185 B.R. 164 (Bankr. D.N.J. 1995) (holding that well-established relationship between debtor and creditor permitted greater latitude in diverging from industry norms and, thus, testimony of defendant's president and officers of another creditor to effect that late payments were common in industry was sufficient to satisfy subsection C's ordinary business terms requirement).

233. The two exceptions added to § 547(c) subsequent to enactment of the Bankruptcy Code both serve different sorts of objectives, and, for that reason, are open to some question in terms of their concordance with the basic equality aim of the preference law. *See supra* note 30.

concerns from continuing to engage in routine credit transactions with a financially distressed debtor.

Second, the industry standards construction of the "ordinary business terms" language in subsection C has the courts engaging in exercises to define industry standards, and requisite levels of proof of compliance with such standards, that are not only beyond the scope of bankruptcy preference law, but that ultimately have nothing to do with bankruptcy proceedings. The only conceivable justification for laboring to make these distinctions would be to police intentional pre-bankruptcy transfers intended to prefer one creditor over others. But even assuming that such an inquiry mattered, there is absolutely no guarantee that compliance with "industry standards" assures that the parties were not colluding to favor the creditor over other unsecured claimholders. Thus, insistence on proof of industry standards reflects nothing more than an antiquated and futile attempt to retain some connection between moral culpability and the formulation of what constitutes a voidable preference, an obsession that has plagued the interpretation of the ordinary course of business defense from the very start. Moreover, as we have attempted to show, even if one accepts the validity of that objective, the industry standards requirement has been ineffective in terms of actually inhibiting opprobrious behavior on the part of ill-motivated debtors and creditors.[234]

Third, the industry standards requirement is unpredictable for creditors. Creditors cannot assume that conducting business according to their own terms will be sufficient to permit the retention of payments made in the ordinary course of business. As a result, creditors will be forced to cut off debtors who are at risk of sinking into bankruptcy. This severing of relations is typically much easier to do for a short-term creditor on a recurring monthly debt obligation, or a creditor that is financing current inventory purchases or covering the debtor's immediate working capital requirements, than it is for a long-term financier with a significant existing investment in the debtor-firm's capital structure. Admittedly, a creditor in the former category is far less likely than one in the latter to have much warning of the debtor's impending financial peril. Nonetheless, the consequent risk of losing short-term operating financing inevitably accelerates the slide into bankruptcy. This, in turn, subverts the goals of the exception, which are to maintain ordinary business

234. *See generally* Weisberg, *supra* note 3, at 121–29 (describing how courts have consistently managed to reimpose subjective criteria into analysis of voidable preferences in spite of legislative efforts to objectify inquiry). *See also In re* Tolona Pizza Prods. Corp., 3 F.3d 1029, 1032 (7th Cir. 1993) (suggesting that one function of subsection is to allay fears that one or more creditors have worked out special deals with debtor).

relations, and, by so doing, facilitate the continuation of these desperately needed short-term credit accommodations.[235]

Fourth, the industry standards approach is not necessarily good statutory interpretation as applied to section 547(c)(2)(C). "Ordinary business terms" might refer just as easily to the *particulars* of the parties' contracts as it does to the *performance* of those contracts, suggesting that it is the terms of the parties' agreements, not industry terms, that must be examined.[236] In this connection, the legislative history of section 547 is instructive. It states: "This section . . . modernizes the preference provisions and brings them more into conformity with commercial practice and the Uniform Commercial Code."[237] In the U.C.C., "term" is defined as "that portion of an agreement which relates to a particular matter."[238] Thus, conformity with terms in the industry is not the only possible meaning of "ordinary business terms"; rather the phrase could just as easily encompass the terms of a particular debtor and creditor's contract.

Fifth, industry standards are irrelevant to the goal of maintaining normal business practices when parties have a longstanding relationship. Examining the parties' practices alone indicates whether any unusual practices have occurred in the pre-bankruptcy stage. The sliding scale approach to defining industry standards implicitly recognizes this fact, even if it misses the broader point about the proper scope of the exception.[239]

Finally, the emergence of the objective standard as an additional barrier to establishing the ordinary course of business defense may be a subliminal judicial response to the perceived devitalizing of the goals of the preference law created by the combination of the 1984 Amendments and the U.S. Supreme Court's decision in *Wolas*. Indeed, the timing of the shift in subsection C interpretation is curious. It can be explained two

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235. Deterring wasteful collection actions in order to maximize value in bankruptcy is certainly not incongruent with the of the preference law, but it is not the preeminent objective of the preference defenses. *See supra* notes 28–29, 230 and accompanying text. For another criticism of an objective standard of subsection C based on related concerns, see Thabit, *supra* note 15, at 498–509.

236. This argument was first advanced in Hon. Jo Ann C. Stevenson & Norman C. Witte, *Bankruptcy*, 2 Det. C.L. Rev. 319, 338 (1993). The authors argued that the "objective test" should compare the parties' contractual terms, rather than their course of performance, to an objective standard. *Id.*

237. *Id.* at 339 (citing S. Rep. No. 95-989, § 87 (1978)).

238. U.C.C. § 1-201(42) (1989 & Supp. I 1996); *see also* Stevenson & Witte, *supra* note 236, at 337 n.106 (distinguishing U.C.C. § 1-205(1), which defines "ordinary course of dealing," as less analogous concept).

239. *See supra* text accompanying notes 201–206.

ways. First, courts and trustees may indeed have been sufficiently preoccupied with other aspects of the defense, such as, initially, the operation of the forty-five day requirement and, later, the question of whether payments on long-term debts could be considered within the ordinary course of business, as to overlook the significance of the separate requirement in subsection C of ordinary business terms. Once those basic issues were settled in 1991,[240] litigators and courts alike were able to concentrate on other aspects of the defense. Consequently, they "discovered" the long overlooked subsection C. The second, and perhaps more realistic explanation for the shift from subjective to objective interpretation of subsection C, is that the objective standard nominally gives more credence to the equality principle of the preference law that was dealt a severe blow by the one-two punch of the 1984 Amendments and *Wolas*.[241] The radical shift in interpretation, accomplished in an extraordinarily short period of time, might, therefore, be indicative of a reaction to the perceived threat to the preference law created by the U.S. Supreme Court's ruling that payments on long-term debt made in the ordinary course of business may qualify for protection under section 547(c)(2).

Regardless of the stated or inferential reasons for the shift, and despite our sympathy for the view that section 547(c)(2) after *Wolas* was dangerously overbroad, the trend toward an objective interpretation is leading courts in too many different directions. Even assuming that one views the industry terms interpretation as a mechanism for constraining the unbridled reach of the exception, thereby preventing section 547(c)(2) from subverting the role of the preference law in effectuating bankruptcy's equality policy—there is still a serious problem of "fit" created by the indiscriminate manner in which an industry terms outlook corresponds with the goals of the exception. Transactions left unprotected as a result of their failure to satisfy this new standard are no more likely to be those undeserving of the protection of the exception as they are to be ones that actually may have made a difference in terms of assisting the debtor in fending off the inevitably of a trip to the bankruptcy court. Clearly, then, not only is guidance needed to settle the question of the expedient operation of subsection C, but, ideally, that guidance must be oriented in a manner that is consonant with both the

240. *See supra* part III.

241. *But see supra* text accompanying notes 144–145 (explaining why this is flawed conception of bankruptcy equality).

applicable statutory text and the larger goals of the preference law and defenses.

V. POSSIBLE REMEDIAL RESPONSES: REALIGNING APPLICATION WITH PURPOSE

Despite relatively longstanding global criticism of the exception,[242] exacerbated by the more recent confusion over the proper interpretation of subsection C, we do not favor the repeal of section 547(c)(2).[243] Properly defined, the ordinary course of business defense serves a valid purpose within commercial relations and bankruptcy law. It allows debtors and creditors to continue normal financial relations and enhances prospects for the debtor to remain out of bankruptcy altogether. Historically, this defense has been rationalized with a distributive equality explanation of the preference law,[244] and that rationale applies today with equal force. In its present form, however, section 547(c)(2) has become wholly disassociated from any principled or defensible justification for an ordinary course of business exception. Consequently, several alternative proposals for reform have been proffered that, if adopted, would tend to realign the exception's use with its purpose by defining the phrase "ordinary business terms" in a manner that does not create the intractable problems involved in deferring to industry standards.

One alternative would be for courts to interpret, or preferably Congress to reword, subsection C to read: "made according to ordinary business terms as determined from the written agreements of the parties, unless no such agreements exist, in which case the transfer shall have been made according to ordinary business terms in the creditor's industry."[245] This revision takes into account the concerns of the objective standard, but only when they are relevant to protecting normal

242. At least two commentators, it will be recalled, have called for the outright repeal of § 547(c)(2). *See supra* note 58.

243. *See generally* Ponoroff, *supra* note 3, at 1492–94 (arguing that ordinary course of business exception should be restored to its original incarnation and retained).

244. *See supra* note 41.

245. A related approach is that suggested in Stevenson & Witte, *supra* note 236, at 338–41, who, first contend that extension of the objective standard to also require proof of general trade usage within the industry accomplishes little, and then suggest in the alternative that the focus under subsection C should be on whether the contract terms themselves, rather than the particular transaction itself, conform to industry norms. *Id.* at 338; *see also* Thabit, *supra* note 3, at 501–09 (rejecting industry terms approach to subsection C, as inconsistent with deterrence function of preference law, and favoring approach that emphasizes prior dealings between parties).

financial relations. Also, the word "terms" is further defined so as to afford subsection C meaning distinct from the operation of subsections A and B. Although this definition of "industry" is purposely vague, it allows for some measure of flexibility from case to case. However, this flexibility is limited to situations where the parties have failed to reduce their payment terms and arrangements to writing. Of course, industry terms, or at least the creditor's practices in its dealings with its other debtors, would also continue to play a role under the subjective standards in subsections A and B in circumstances where the payment is a first-time transaction between the parties.[246]

A second, purely legislative, alternative would be to eliminate subsection C entirely.[247] Such a repeal would reinstate the original subjective approach that the majority of courts followed prior to 1992. Although many courts and commentators now disagree, the subjective approach clearly satisfies the stated goal of the exception to protect normal financial relations. Eliminating any objective component from the analysis would also allow more flexibility for creditors to change payment terms to assist struggling debtors without risking loss of protection under § 547(c)(2), provided enough time has elapsed between the change and the challenged transfers so as to establish the new payment practice as ordinary. Concededly, it does not provide as thorough of a "check" against "evil intentions" of debtors and creditors as would an objective approach, but that is not really the point of the exception.[248]

Of these two options the first alternative may be most in tune with the prevailing mood of the courts as it relates to this defense. Not only would that option, if implemented, preserve the goal of the exception—to encourage the availability of critically needed trade debt—but, subject to the caveat discussed below, it is also the most compatible with the persistent sentiment that one of the aims of the ordinary course of business defense is to provide a safe harbor for transfers that have a low probability of having been motivated by the desire to secure a distributional advantage in bankruptcy

Even were one of these alternatives to be implemented, however, two serious problems would remain. First, neither of these proposals explicitly advances what we regard as the primary justification for the ordinary course of business exception, namely, to ensure the availability

246. *See supra* note 96.

247. *See* Lupinacci, *supra* note 15, at 167–68 (calling for outright repeal of subsection C).

248. *See generally* Ponoroff, *supra* note 3, at 1477–84.

of critically needed trade and other credit essential to continuing operations. In other words, neither approach offers ironclad security or even reasonable assurance to the creditor that elects to do business with the debtor after the onset of financial difficulties that payments received on account of such credit will be entitled to any special protection from the trustee's preference recovery authority should a bankruptcy administration ensue.

Second, neither of the proposals addresses the dilemma created by the U.S. Supreme Court's decision broadening the ordinary course of business exception to cover payments made on debts incurred months or even years prior to the onset of the debtor's financial troubles. Creditors whose debts were incurred long before the preference period transfers at issue, or that were intended to provide a source of long-term financing, ordinarily should not be entitled to have preference period payments made on their claims differentiated from those of other unsecured creditors, even where the debt was incurred and the payment made in the normal course of business between the debtor and creditor. This conclusion is consistent with the proper meaning of "equality" in the preference law.[249] By contrast, there is a principled basis for distinguishing the claims of those creditors whose debts were short-term to begin with and incurred in relatively close proximity to the preferential transfers made in payment thereon.[250] Although there is an undeniable diminishment of the estate as a result of such transfers, these transactions share in common with other protected transactions[251] the hope that the provision of such current supplies, services, or working capital needs will make the critical difference in terms of whether the debtor's slide into bankruptcy can be reversed. The same rationale does not support extending the scope of the defense to long-term debts or isolated transactions with non-regular creditors, regardless of whether or

249. *See supra* text accompanying note 144.

250. *See* Broome, *supra* note 3, at 117–18; Ponoroff, *supra* note 3, at 1491–93.

251. Although § 547(c)(1) & (4) are both premised on the absence of any diminishment of the estate as a result of a technical preference, they are also intended to serve the goal of encouraging creditors to continue to do business with a financially distressed debtor. *See, e.g.*, Mosier v. Ever-Fresh Food Co. (*In re* IRFM, Inc.), 52 F.3d 228, 232 (9th Cir. 1995) (identifying as rationale for § 547(c)(4) policy of encouraging creditors to continue doing business with financially troubled debtors with eye toward avoiding bankruptcy altogether); National Enters., Inc. Liquidating Trust v. Tee-Lok Corp. (*In re* National Enters., Inc.), 174 B.R. 429, 433 (Bankr. E.D. Va. 1994) ("The new value exception of § 547(c)(4) embodies that same purpose [as the exceptions in § 547(c)(1) & (2)] of encouraging creditors to continue to deal with an unhealthy debtor."). The exception for purchase money loans made during the preference period is even more clearly based on the same policy. *See, e.g.*, Benjamin Weintraub & Alan N. Resnick, *Bankruptcy Law Manual* 7-35 (3d ed. 1992) (citing encouragement of credit to enable debtor to acquire new assets as purpose of exception).

not the payments occur in the ordinary course and happen to comport with prevailing industry norms.

In sum, in the absence of any requirement imposing some temporal connection between the incurring of the debt and the preferential payment, the exception in section 547(c)(2) becomes a vehicle for bootstrapping the issue of preferential motive squarely back into the analysis.[252] Leaving undisturbed normal financial relations is alone an inadequate justification for any preference exception. It is in the nature of a preference law to disturb normal financial relations. Expansion of the exception to regular installment payments on long-term debt severely erodes the equality objective of the preference law. Preference recovery becomes the exception rather than the rule. Requiring proof of compliance with industry standards as an additional element of the defense admittedly stems the tide to an extent, but it does so in a purely capricious manner. That is to say, while it may operate to deny the shelter of the exception in a certain number of cases that otherwise would have qualified for protection, there is no assurance that those cases involve the sorts of transactions that fall within the original design of the exception. In the process, the objective approach indefensibly moves the ordinary course of business defense even further away from that original purpose.

Obviously, the most direct solution to this second issue would be to limit the exception to suppliers of the kind of routine, short-term credit that is necessary to maintain ongoing, daily operations. Because of the practical difficulties involved in attempting to draft an exception explicitly tied to the character of the credit or the type of creditor (difficulties that apparently accounted for the forty-five day limitation in the original Code version of section 547(c)(2)),[253] the second best solution would be to reintroduce in every case some sort of a maximum time limit between the payment and the origination of the debt as a condition to the creditor's entitlement to invoke the ordinary course of business defense. In fact, we would support such a change, whether involving the original forty-five day rule or some variation on that theme.[254] As a matter of practical politics, however, we concede that at

252. In short, the only other plausible justification for protecting such transactions is the policy of finality and repose. However, that policy is equally served by a preference law that recognizes no exceptions. *See* Tabb, *supra* note 3, at 1027–29.

253. *See* Countryman, *supra* note 3, at 769 (suggesting that draftsmen must have despaired of trying to define "intensely undefined" term "trade debt").

254. *See, e.g.*, Ponoroff, *supra* note 3, at 1492–94 (calling for reintroduction of either original 45-day requirement or some similar variation creating temporal connection between debt and payment).

this stage in the game, with the formidable array of interests aligned against it, it is probably too late to expect realistically that any proposal involving an across-the-board dismantling of the change made to section 547(c)(2) in 1984 would have any hope for enactment—just as we consider unrealistic the call for the outright elimination of subsection C. Thus, to achieve the overall objective of tailoring the scope of the defense to coincide with those cases where its principal rationale is most directly implicated, any reform proposal for section 547(c)(2) must include a proxy provision for the old forty-five day rule to limit the protection of the exception to those creditors willing to do business with debtors operating on the edge of bankruptcy. This recognition leads us to offer not necessarily what might be our ideal proposal for reform of the ordinary course of business defense, but rather a proposal that we believe addresses the most serious flaws in the current version of the exception and yet might still be, if not wholly acceptable, then at least unobjectionable to a sufficient number of interested constituencies so as to hold out a realistic prospect for enactment.

VI. A PRACTICAL PROPOSAL FOR REFORM

Bearing in mind the goal of reformulating the ordinary course of business defense in a manner that expands its application with respect to transactions occurring in the shadow of insolvency and yet still constrains the exception from running roughshod over the rule, we would propose that section 547(c)(2) be amended to read as follows:

The trustee may not avoid under this section a transfer—

(2) to the extent such transfer was—

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

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

(C) if such transfer is made with respect to a debt incurred more than 60 days prior to such transfer, then either—

(i) made according to ordinary business terms as evidenced by the written agreements of the parties, unless no such agreements exist, in which case as

> *evidenced by the transferee's past dealings with other debtors; or*
>
> *(ii) made on account of a debt incurred by the debtor after the transferee had reasonable cause to believe that the debtor was insolvent.*

To begin with, it should be noted that under this proposal, subsections A and B remain unchanged. Thus, to be entitled to shelter under the revised rule, at a minimum, the transferee-creditor must establish that the transfer was "ordinary" as established under the traditional subjective standard derived principally from past practices and course of dealings between the parties.[255] Under this version of section 547(c)(2), however, subsection C would *only* be applicable if the debt was incurred more than sixty days prior to the payment in question. This limitation would operate to burden payments on long-term debt precisely because of the attenuated connection between those transactions and the essential justifications for the exception,[256] but it would not exclude such payments presumptively in the manner that the old forty-five day rule operated.

In assessing the merits of this proposal it is instructive initially to consider its impact on the complaints that triggered the elimination in

255. *See, e.g.*, Sulmeyer v. Pacific Suzuki (*In re* Grand Chevrolet, Inc.), 25 F.3d 728, 732 (9th Cir. 1994) (holding that late payments may be ordinary if previous course of conduct between parties themselves demonstrates that those types of payments were ordinarily made); McCord v. Venus Foods, Inc. (*In re* Lan Yik Foods Corp.), 185 B.R. 103, 111 (Bankr. E.D.N.Y. 1995) ("[The] subjective inquiry into "ordinariness" suggests some consistency with other business transactions between the parties rather than a rigid similarity to past transactions); Cocolat, Inc. v. Fisher Dev., Inc. (*In re* Cocolat, Inc.), 176 B.R. 540, 549 (Bankr. N.D. Cal. 1995) (holding that whether payment is made in ordinary course of business is judged by subjective standard of what parties themselves considered ordinary); *see also supra* note 106–108.

The issue of whether a particular transaction is in the ordinary course of a debtor's business also arises under §§ 363 and 364 dealing, respectively, with use of property of the estate and post-petition financing. In those contexts, the courts have generally adopted a two-step inquiry including a "horizontal dimension" test and a "vertical dimension" test. The former focuses on the transaction from an industry-wide perspective, while the latter, sometimes referred to as the "creditor's expectation test," considers whether the transaction subjects a creditor to economic risks of a different order from those it accepted when it decided to extend credit in the first instance. *See generally In re* Roth Am., Inc., 975 F.2d 949, 952 (3d Cir. 1992); *In re* Dant & Russell, Inc., 853 F.2d 700, 704–06 (9th Cir. 1988). Although helpful in a comparative sense, the differences in the context in which the issue of "ordinary course" arises in these cases, including in particular the fact that the transactions at issue involve post-petition activities, make the standards developed in these cases of limited utility in construing comparable claims under the preference statute.

256. *See supra* text accompanying notes 249–252; *see also* Miller v. Kibler (*In re* Winters), 182 B.R. 26, 29 (Bankr. E.D. Ky. 1995) (noting that § 547(c)(2) applies "if the debtor and the transferee have an ongoing, 'recurring' business relationship").

1984 of the forty-five day requirement as an element of the ordinary course of business defense.[257] First, the additional fifteen days, while concededly somewhat arbitrary, are intended to respond to complaints voiced at the time of the 1984 Amendments that the normal payment cycle in some industries exceeds forty-five days.[258] Of course, it is quite possible that customary trade terms in certain industries may exceed even sixty days. At some point, however, as the term of the credit increases, the transaction simply begins to look like something other than a recurring credit transaction intended to support current operations; that is, to say, it simply no longer fits within the parameters of the type of near-cash transaction that the exception, as originally designed,[259] was primarily intended to protect. Moreover, since the revised version of section 547(c)(2) does not preclude the possibility that under proper circumstances such longer term transactions might still find protection under the exception, cutting off the presumption of ordinariness based on conformity with past practices at sixty days is neither as arbitrary nor inequitable as it might appear at first blush.

The other complaint voiced by trade creditors in the course of the discussions culminating in the 1984 Amendments, including trade creditors whose normal credit terms were less than forty-five days, related to uncertainty over, and the consequent cost in establishing, when the debt was deemed to have been incurred and when payment was deemed to have been made.[260] In fact, however, that difficulty was not unique to section 547(c)(2). Essentially the same issues have always arisen, and continue to arise, under various other provisions of the preference law. For example, determination of when the debt was incurred and when the payment was made is necessary for purposes of deciding whether the transaction under scrutiny falls within the transferee's applicable preference period.[261] Likewise, the same questions

257. *See supra* notes 61–72.

258. *See* Broome, *supra* note 3, at 101 (citing testimony from hearing conducted during 1981 before Senate Judiciary Committee's Subcommittee on Courts to effect that more than 50% of all industry groups had normal payment periods of 45 days or longer).

259. *See supra* note 51.

260. For a representative sample of cases struggling with the proper interpretation of the 45-day rule, see Braniff Airways, Inc. v. Midwest Corp., 873 F.2d 805, 807 (5th Cir. 1989); Durham v. Smith Metal and Iron Co. (*In re* Continental Commodities, Inc.), 841 F.2d 527 (4th Cir. 1988); Bernstein v. RJL Leasing (*In re* White River Corp.), 799 F.2d 631(10th Cir. 1986); O'Neill v. Nestle Libbys P.R., Inc. 729 F.2d 35 (1st Cir. 1984); Remes v. Acme Carton Corp. (*In re* Fasano/Harriss Pie Co.), 43 B.R. 871 (Bankr. W.D. Mich. 1984), *aff'd*, 71 B.R. 287 (W.D. Mich. 1987).

261. As a threshold matter, there can be no preference to avoid or recover unless the complaining party can first establish that the debtor engaged in a transfer of property, or of an interest in property,

must be addressed in ascertaining whether the antecedent debt requirement in section 547(b)(2) has been satisfied,[262] as well as in connection with the applicability of the exceptions in sections 547(c)(1) and (4).[263] In all of these contexts, more than a decade of additional case law development has now established relatively clear standards.[264]

within the applicable period of time during which such transfers are proscribed by the statute: 90 days generally and one year in the case of an insider-transferee. *See* 11 U.S.C. § 547(b)(4) (1994). The Bankruptcy Code defines transfer to include virtually any form of disposition by the debtor of property. 11 U.S.C. § 101(54) (1994).

262. The antecedent debt provision is provision requires, of course, that the transfer be made "for or on account of an antecedent debt owed by the debtor before such transfer was made." 11 U.S.C. § 547(b)(2) (1994); *see also* 11 U.S.C. § 547(a)(2) (1994) (defining "new value for preference purposes). In general, the focus in determining when a debt is incurred is less upon the point in time when a binding legal relationship is established between the parties than it is upon when as a result of that relationship a legal obligation, no matter how remote or contingent, can be said to exist. *See generally* Energy Coop., Inc. v. SOCAP Int'l, Ltd. (*In re* Energy Coop., Inc.), 832 F.2d 997, 1002 (7th Cir. 1987); Barash v. Public Fin. Corp., 658 F.2d 504, 510 (7th Cir. 1981); Mendelsohn v. Louis Frey Co. (*In re* Moran), 188 B.R. 492, 495 (Bankr. E.D.N.Y. 1995). Recently, in Southmark Corp. v. Marley (*In re* Southmark Corp.), 62 F.3d 104 (5th Cir. 1995), *cert. denied*, 116 S. Ct. 815 (1996), one of the debtor's subsidiaries' executives received a settlement of his severance rights during the preference period in the amount of approximately $400,000. The court agreed with the bankruptcy court's assessment that because the debt was deemed to arise at the time of settlement, and not the earlier point in time when the employment relationship was established, the debt was not an antecedent debt subject to avoidance under § 547(b). *Id.* at 105–06.

263. Section 547(c)(1) contains the exception for substantially contemporaneous exchanges, whereas § 547(c)(4) provides an offset to the trustee's preference recovery to the extent of any unsecured new value advanced by the creditor to the debtor *after* the preference has been made. *See supra* note 251. In connection with both of these defenses, it is critical to establish when the preferential transfer or payment occurred in relation to the new value received from the creditor.

264. For many years, an issue that was a particular source of controversy and confusion was whether in the case of a payment made by check the transfer occurs at the time the check is delivered or the time when it is accepted for payment by the drawee bank. In Barnhill v. Johnson, 503 U.S. 393 (1992), the Court ruled that in the case of payment by ordinary check a transfer occurs on the date of honor, not before. However, the court was careful to limit its holding to § 547(b), and noted, without expressly deciding the issue, that "[t]hose Courts of Appeal to have considered the issue are unanimous in concluding that a date of delivery rule should apply to check payments for purposes of § 547(c)." *Id.* at 402 n.9. The legislative history specifically indicates that a "time of delivery" rule is appropriate for § 547(c)(1) & (2) purposes. *See* 1978 House Report, *supra* note 17, at 6329; 124 Cong. Rec. S17414 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini); 124 Cong. Rec. 31795, 32400 (1978) (statement of Rep. Edwards) (check is equivalent to cash payment, unless dishonored, both for purposes of section 547(c)(1) and (c)(2)). Although the legislative history does not speak directly to § 547(c)(4), after *Barnhill*, the majority of courts have adopted the view that a time of delivery rule is also appropriate under § 547(c)(4) as well. *See, e.g.*, Jones v. Aristech Chem. Corp., 157 B.R. 720, 722 (Bankr. N.D. Ga. 1993) ("[T]he majority and better view is that the date of receipt rule determines when a transfer by check occurs under Section 547(c)(4).").

Most courts also agree that timely payments of amount first coming due under an installment loan are properly treated as having been made on account of a debt incurred at the time the original loan was made and not the date on which the particular installments come due. *See* CHG Int'l, Inc. v. Barclays Bank (*In re* CHG Int'l, Inc.), 897 F.2d 1479, 1486 (9th Cir 1990); *Barash*, 658 F.2d at 512. *But see* Friedman v. Ginsburg (*In re* David Jones Builders, Inc.), 129 B.R. 682, 689 (Bankr. S.D. Fla.

Therefore, arguments against inclusion of any kind of temporal requirement (whether in the form of the original mandatory forty-five day requirement or the modified sixty-day rule we have proposed) predicated on the difficulties associated with establishing the time when the debt was incurred or paid are simply less compelling today than they were in the early 1980s when the new Code provisions lacked meaningful judicial interpretation.

The second type of complaint voiced in opposition to the old forty-five day rule came from the financial markets and the investment community, which argued that the requirement had the undesirable, and perhaps unintended,[265] effect of eroding the market for short-term commercial paper, typically issued by large corporations, with maturity dates exceeding forty-five days. Under this new proposal, the same objection would be resuscitated with respect to any instrument with a term of more than sixty days. However, payments on commercial paper carrying maturities in excess of sixty days, just like payments on any other sort of debt obligation, could still obtain the benefit of the defense upon demonstrating compliance with proposed section 547(c)(2)(C)(i). While the added burden of demonstrating conformity with the terms of the instrument could still adversely impact companies that prefer to issue commercial paper with longer maturities, it would not, in the manner of section 547(c)(2) as originally enacted, eliminate the market entirely.[266] Some chilling effect, which inheres in any commercial system that incorporates a preference law, should be tolerable, particularly since the purchasers of such paper carrying longer maturities are in substance indistinguishable from any other suppliers of unsecured debt financing. The risk of insolvency and preference recovery simply become part of

1991) (holding that timely payments of interest only, as distinguished from mixed payments of principal and interest, may be considered as having been given in current exchange transaction for use of principal, and, thus, not on account of obligation relating back to when loan was originally closed). This position derives from the view expressed by the Eighth Circuit in Iowa Premium Service Co. v. First Nat'l Bank (*In re* Iowa Premium Serv. Co.), 695 F.2d 1109, 1112 (8th Cir. 1982) (en banc).

265. *But see* Countryman, *supra* note 3, at 769 (suggesting that draftsmen of Code recognized and accepted prospect that their formulation would include all kinds of short-term debt including payments on commercial paper).

266. *See, e.g.*, Broome, *supra* note 3, at 104 n.118. Moreover, if the commercial paper market is in fact somehow special in the sense that it needs special protection to ensure the steady flow of badly needed capital to many corporation, the solution lies in a narrowly tailored preference exception, as at one time had been proposed, and not in the wholesale expansion of the ordinary course of business exception. *See* Countryman, *supra* note 3, at 771–72 (describing bill introduced by Sen. Dole in 1983 that would have created new exception for payments made on specially backed commercial paper regardless of its maturity date).

the cost of credit and, in fact, these creditors are far more likely and able to adjust the cost of credit to reflect the additional risk than, for example, the usually less sophisticated suppliers of ordinary trade debt.[267]

Lastly, the complaints of the providers of installment loans to consumer debtors were also a factor in the elimination of the old forty-five day rule.[268] However, those concerns were ultimately addressed directly by the adoption of section 547(c)(7) (renumbered (c)(8) by the 1994 Amendments) in 1984.[269] Thus, regardless of whether or not the consumer credit industry is satisfied with the specific terms of that provision,[270] their complaints are no longer relevant to the discussion of the manner in which section 547(c)(2) should operate.

As the foregoing illustrates, the instant proposal satisfactorily responds to the specific concerns that accounted for the elimination of the forty-five day rule. At the same time, it introduces an obstacle, but not an impenetrable barrier, for payments made on long-term installment debt obligations. If the challenged payment is made within sixty days after the debt was incurred, the creditor need only establish that the debt and the payment were "ordinary" in relation to past practices between the parties. Protection of these transactions is warranted because of the potentially crippling effect that any interruption in the flow of routine, customary credit transactions can have even on a healthy business. In the vast majority of these cases, the creditor is innocent of any intention to gain an advantage in light of the debtor's deteriorating financial condition. The proximity of the payment to the incurring of the debt provides sufficient assurance that the obligation was of this ilk so as to obviate the need for any additional proof. Moreover, the suppliers of

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267. The problems of "nonadjusting" unsecured creditors have received increased attention in the recent literature examining the efficiency of secured financing. *See, e.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 Yale L.J. 857 (1996); Lynn M. LoPucki, *The Unsecured Creditor's Bargain*, 80 Va. L. Rev. 1887 (1994).

268. *See* Broome, *supra* note 3, at 104–09.

269. Section 547(c)(7) excepts from preference recovery a transfer by "an individual debtor whose debts are primarily consumer debts" if "the aggregate of all property that constitutes and is affected by such transfer is less than $600." 11 U.S.C. § 547(c)(7) (1994). The term "consumer debt" is defined in § 101(8).

270. Recently, several courts have ruled that in determining the applicability of the "de minimis" exception in § 547(c)(8) with respect to any particular transfer, the dollar value of all transfers to the creditor during the preference period must be aggregated. *See, e.g.*, Electric City Merchandise Co. v. Hailes (*In re* Hailes), 77 F.3d 873 (5th Cir. 1996); Christians v. American Express Travel Related Servs. (*In re* Djerf), 188 B.R. 586 (Bankr. D. Minn. 1995); Alarcon v. Commercial Credit Corp. (*In re* Alarcon), 186 B.R. 135 (Bankr. D.N.M. 1995). *But see* Wilkey v. Credit Bureau Sys., Inc. (*In re* Clark), 171 B.R. 563 (Bankr. W.D. Ky. 1994) (holding that $600 exception applies separately to each transfer).

such credit can, as a matter of general business practice, continue to conduct business as usual with their customer base without incurring what would doubtless be the prohibitive costs of investigating the debtor's financial well-being in advance of each transaction, and without concern that the permissibility of any special accommodations made to a particular customer would be later judged based on the unrelated practices of their competitors.[271]

In the event that the payment is on account of a debt originating more remote than sixty days from the date of transfer, the connection between the goals of the exception and the transaction under scrutiny are more attenuated. Thus, amended subsection C would require either evidence of internal conformity or specific demonstration that the payment was made in respect of the type of credit that it is the policy of the preference law to encourage. Under the first prong of revised subsection C, entailing proof of what we refer to as "internal conformity," the court would simply be required to examine whether the debtor and creditor adhered to the specific terms of their own contracts or, absent a written agreement, with the creditor's practices with other similar debtors.[272] This requirement should provide adequate assurance of the absence of special deals without the necessity of incurring the expense, and, more importantly, without introducing the inevitable uncertainty associated with proving or disproving conformity with prevailing industry standards.[273] It also ensures that the inquiry under subsection C is not merely duplicative of the analysis under subsection A and B.

The requirements of proposed section 547(c)(2)(C)(i) are distinguishable from the current subsection B because a payment may be

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271. *See* Ponoroff, *supra* note 3, at 1492–93 (pointing out that relatively small size and routine nature of most recurring, short-term credit arrangements make it uneconomical to monitor closely debtor's financial situation).

272. This inquiry would permit the creditor to establish that the payment was made according to ordinary business terms by demonstrating that it was similar to its payment practices involving other same-industry customers. This proof is essentially the same test offered by the creditor in *In re* Midway Airlines, Inc., 69 F.3d 792, 797–98 (7th Cir. 1995), and rejected by the Seventh Circuit. *See supra* text accompanying notes 221–222.

273. Although it is far from a perfect way to ensure the absence of improper motive, it is no less effective than the industry terms approach. *See supra* text accompanying note 234. For a good example of a circumstance where this proposed approach would yield a result different than the current industry standards approach, see Dery v. Detroit Edison (*In re* Dobbs, Inc.), No. 94-CV-71689-DT, 1995 U.S. Dist. LEXIS 16303, at *12 (E.D. Mich. Sept. 29, 1995), wherein the transferee argued that the existence of a contractual provision allowing late payment was sufficient to satisfy subsection C. It should be noted, however, that in that case, the creditor would also have a problem satisfying the subjective prong of ordinary course under subsection B. Analysis required by that provision is not in anyway altered by the present proposal.

within the ordinary course of affairs of the debtor and transferee, yet be contrary to the terms of the contract (or vice versa). Interpreting subsection C in this manner also supports the goal of protecting normal financial relations by assuring that parties are not underhanded in their dealings or making sham contracts in order to deviate from regular business dealings. On the other hand, because it focuses on the internal relationship between the creditor and debtor, or, at most, the creditor's other debtors, lack of collusion is established without sacrificing the ability to predict, particularly at the point in crucial time that the credit is extended, what proof will be sufficient to shield later payments from preference recovery. An industry standards approach, by contrast, is unpredictable for creditors and that fact ultimately hurts debtors. Accordingly, we would resist preserving even a tertiary role for industry terms in cases of last resort.[274]

The alternative standard in proposed section 547(c)(2)(C)(ii) involves taking what has historically been an element of an avoidable preference[275] and standing it on its head. Specifically, instead of the trustee establishing the existence of some form of bad motive as an essential element of a voidable preference, the creditor would be required, as a condition to being permitted to retain the preference as an ordinary course payment, to show good motive at the time the original debt was incurred. Of course, for these purposes "good motive" is defined in terms of the creditor's conscious willingness to provide life-sustaining extensions of new credit *after* the debtor has encountered financial difficulties. If the creditor can in fact shoulder this added burden, the reasons for imposing a time limitation between the incurring of the debt and the payment simply become less urgent. Although, as a practical matter, the weaker the temporal connection between the debt and the payment, the less likely it is that the creditor will actually have had, or will be able to prove, the requisite state of mind, there is no compelling reason to deny the creditor at least the opportunity to try to make the case. At the same time, this requirement should serve to make the proposal more palatable than if the bar after sixty days were absolute.

Proposed section 547(c)(2)(C)(ii) would also be of particular utility in a case in which a creditor varied its payment terms, both from the terms of its written contracts and industry standards, in order to accommodate a financially flailing debtor. In this respect, the proposal actually goes

274. For an alternative proposal that eliminates the role for industry terms, see Thabit, *supra* note 15, at 506–09.

275. *See supra* note 22 and accompanying text.

further than the original version of section 547(c)(2) in promoting the primary goal of the ordinary course of business exception. At the same time, it provides a check on collusive behavior without introducing the complexity of an industry standards approach.

Finally, because any transfer that finds protection under section 547(c)(2) has diminished the distributable estate, and, therefore, done violence to the strong equality-based objectives of the preference law, the sixty-day limitation in proposed section 547(c)(2)(C)(ii), just like the industry standards interpretation of present subsection C, operates to constrain the potential reach of the exception. It does so, however, in a manner that we believe is far more principled, and administratively manageable, than the one-dimensional industry standards approach. Specifically, under this proposal, the exception would discriminate among cases based on factors sensitive to the purposive objectives of the statute, and not considerations that serve those interests in the random fashion of industry terms.

VII. CONCLUSION

For the reasons discussed, we believe that the phrases "ordinary course of business" and "ordinary business terms" should not be construed to require the examination of practices beyond the specific debtor-creditor relationship, even in extreme cases where there is no prior history and no written understandings or agreements between the parties. In those instances, the determination of "ordinariness" should be limited to an examination of the defendant-creditor's practices *vis-à-vis* its other debtors, rather than requiring congruence with industry-wide standards that are relevant only fortuitously, if at all.

The introduction of a new standard that restores the pre-1984 purely subjective analysis for payments on debts incurred within the preceding sixty days induces creditors as a matter of general business practice to continue to deal with distressed debtors. In the case of other payments, where justification for the defense is less clearly in focus, the added burden of establishing one of the two prongs of redrafted subsection C ensures either the normalcy of the transaction in more relevant terms than an industry standards test, or that the policy of encouraging the extension of credit to troubled debtors is in fact implicated in the transaction by virtue of the creditor's awareness of the debtor's precarious financial situation. Thus, for those preoccupied with the issue, there is relative comfort that the transaction is not the product of a collusive deal between the debtor and the favored creditor, and yet the chances for survival "without a costly detour through or a humbling ending in, the sticky web of bankruptcy"[276] are improved.

In urging this position, we do not wish to be understood as endorsing *Wolas*. It is simply now that that decision is on the books, we think it is unreasonable to expect that the Pandora's box opened by that decision can be restored to its original closed and locked position. Therefore, we are recommending that we use the occasion to fix the mess over proof of industry standards which has been spawned in the aftermath of that case to also limit in a principled way the reach of the ordinary course of business exception in cases involving transfers on long-term debt obligations. Because of the sensitive interaction between the two issues, neither ought to be addressed without full consideration of effect on the other.

In the final analysis, the ordinary course of business defense serves a legitimate commercial purpose, although that purpose is poorly served by section 547(c)(2) as currently articulated and understood in the case law. By eliminating the examination of industry standards in the determination of "ordinary business terms," and distinguishing between payments on long-term and recurring, customary and other short-term credit transactions, the defense can be rehabilitated to carry out its intended purpose in a more effective manner than is presently the case. However, until that rehabilitation is accomplished, the ordinary course of business exception will remain disturbingly at odds with the goals of the preference law, and both trustees and creditors will be forced to squander limited resources and, in the process, waste valuable judicial time litigating issues that relate tangentially, at best, to the advancement of those goals.

276. Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re* Molded Acoustical Prods., Inc.), 18 F.3d 217, 219 (3d Cir. 1994).