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Lessons Learned from "Zombie Restaurants": A Cause of Indigestion for a Creditor

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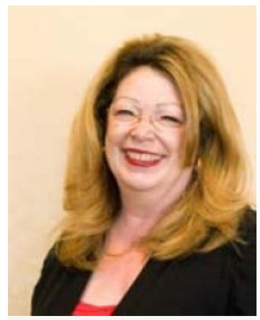

Virginia Soderman

Restaurants have been one of the more popular sectors for private equity investors and hedge funds over the last two years. In 2010, buyout firms purchased at least 24 restaurant holding companies with disclosed deal values added up to $5.66 billion, according to Thomson Reuters. The acquisitions continued into 2011, with Golden Gate Capital taking California Pizza Kitchen Inc. private, Roark Capital Group buying Il Fornaio and Corner Bakery Café and Bain Capital purchasing Japanese restaurant chain Skylark for $2.1 billion.

The food and drink business, particularly in this volatile economy however, can be cyclical and prone to a falloff of revenues and an erosion of profit margins. Furthermore, restaurants are vulnerable to consumer confidence, dining trends and commodity prices. The economic downturn, rising food prices and the cost of advertising have had a significant affect on the number of Chapter 11 filings in the food industry.

A recent New York Times article refers to companies filing Chapter 11 in the food industry as "zombie restaurants". Although

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Putting Ordinary Back into the Ordinary Course of Business Defense

Bradley D. Blakeley, Esq.

Controllers and credit managers are always searching for insight on what facts courts consider to be within the ordinary course of business, and Continental AFA Liquidation Trust ("Plaintiff") v. Human Resource Staffing, LLC ("Defendant") provides just that. A common complaint is that the U.S. preference laws simply do not make sense. The U.S. Bankruptcy Court in the Eastern District of Missouri provides a thorough review of the evidence Defendant provides in support of its asserted subjective and objective ordinary course of business defenses. As set forth below, the Court strongly emphasizes the consistency of a variety of factors when analyzing the pre-preference and preference periods in connection with the ordinary course of business defense. When consistency in the factors is found, the creditor will prevail.

Plaintiff filed a complaint against Defendant to avoid and recover preferential transfers in the amount of $103,856.28 ("Transfers"), and then filed a motion for

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Special points of interest:

- "Zombie Restaurants"
- Ordinary Course
- Creditor's Attorney's Fees
- Mechanic's Liens
- New Value

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A Creditor's Attorney's Fees May Be Paid By The Estate Through A Chapter 11 Plan

Ronald A. Clifford, Esq.

Most trade vendors are acutely aware of the American Rule regarding the awarding of attorneys' fees in litigation, which rule states that, as a general proposition, and absent a written agreement to the contrary, parties in litigation bear their own attorneys' fees. What is more, and to the contrary, the concept of a Chapter 11 bankruptcy estate being responsible for the attorneys' fees of key players (i.e., creditors' committees and the debtor) in a Chapter 11 case is also a familiar concept to most trade vendors. Counsel to unsecured creditors' committees and counsel to the Chapter 11 debtors have their fees paid by the estate as an administrative expense priority claim, because, the Bankruptcy Code reasons, their efforts benefit the estate.

The Bankruptcy Code also provides a unique mechanism by which an individual creditor, rather than one of the key players, may be able to obtain payment of their attorneys' fees incurred related to their participation in a Chapter 11 case. Under Section 503(b) of the Bankruptcy Code, should a creditor be able to show that the attorneys' fees it incurred in a Chapter 11 case provided "substantial benefit" to the estate, those attorneys' fees may be allowed as an administrative expense priority claim by the Bankruptcy Court, and ordered to be paid through a plan of reorganization. An example of a Section 503(b) claim is where an unsecured creditor in a Chapter 11 case single handedly negotiates substantially better treatment for all unsecured creditors under a debtor's Chapter 11 plan, especially when there is no creditors' committee or any other active creditors in the case. The debtor's estate benefited from the single unsecured creditor's actions, and so the Bankruptcy Code charges the estate for that benefit by reimbursing that unsecured creditor for its costs associated with those negotiations. To the extent a real and "substantial benefit" to the estate can be shown, it should be the estate, not an individual creditor of the estate that should shoulder those costs.

A unique situation is presented when an individual creditor, or group of creditors, seeks reimbursement for their attorneys' fees incurred in a Chapter 11 case, not for their efforts on behalf of the estate, but for their looking solely after their own claims in the case. This scenario was recently played out in the *In re Adelphia Communications Corp.* case. In the *Adelphia* case, several creditors, and ad-hoc committees of creditors, engaged in a series of inter-creditor disputes that threatened the ability of the debtor to confirm a plan of reorganization. In the end, cooler heads prevailed, and a global settlement was reached among all of the warring creditors, which global settlement became part of the eventually confirmed plan of reorganization of the debtor. A key provision to that settlement, which eventually made its way as a term of the plan of reorganization, was that the attorneys' fees of the groups involved in the inter-creditor disputes would be paid by the estate through the plan of reorganization. The requested fees totaled $88 million.

The *Adelphia* Court dealt with two questions regarding the requested attorneys' fees: (1) Can a creditor's attorneys' fees be paid through a plan of reorganization when the creditor seeking reimbursement of those fees cannot show a substantial benefit to the estate; and (2) must a showing of reasonableness be made before allowing those fees? The *Adelphia* Court answered both questions in the affirmative.

The *Adelphia* Court relied on Section 1123(b) of the Bankruptcy Code, which provides that a plan of reorganization may "include any other appropriate provision not inconsistent with the applicable provisions of this title." The Court held that this catch-all provision of the Bankruptcy Code, by itself, was enough to allow the approval of the settlement provision requiring compensation for the creditors' attor-

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California's New Mechanic's Lien Statute: The Basics

On July 1, California's new mechanic's lien statute came into effect, marking the culmination of a 13-year long project to improve the law. The law was passed in September 2010, but its implementation was delayed to allow the construction industry to digest the key changes, and prepare itself. You may have taken heed of the forthcoming changes months ago, and were able to seamlessly integrate the new provisions in to your business practices when the clock struck midnight on July 1, in which case you can stop reading now. But if you were unaware of the change, or are still coming to terms with the new law, here are a few of the key points.

Overview

The attempt to modernize the mechanic's lien law began in 1999, when the California Law Reform Commission was asked to study the existing framework, and recommend reforms. For a project so long in the making, its ambitions were relatively modest. The law makes no radical substantive changes; mostly just changes designed to make the law more user-friendly. The end-result could be described as a facelift. The old law, which contained language dating back to 1872, had not been drastically overhauled since 1969, and had been amended 70 times since in a piecemeal fashion. In the opinion of the California Law Reform Commission, it had "become increasingly difficult to use, generating litigation over confusing provisions, and often leaving unsophisticated participants unsure of their rights and obligations." The new law seeks to put that right. In the words of the legislative digest accompanying the original bill, it recodifies, reorganizes, and clarifies the mechanics lien statute; modernizes terminology and eliminates inconsistencies in language; makes provisions more readable and easier to use.

Determining What Law to Apply

With the law having only recently come into effect, you may be unsure of what law applies to projects that you worked on before July 1. What do you comply with if you are intending to file a mechanic's lien for work performed in June? What procedure should apply if you are moving to expunge an old mechanic's lien? The answer to both questions is that you should look to the new law. However, "the effectiveness of a notice given or other action taken on a work of improvement before July 1, 2012, is governed by the applicable law in effect before July 1, 2012" (Civ. Code § 8052). This means that in the latter hypothetical, where you are moving to expunge an old lien, you would apply the new procedural rules for expunging liens; however, you would analyze whether the mechanic's lien was proper in the first place under the old law.

Structure and Terminology

The new law is found between Sections 8000 and 9566 of the California Civil Code, and is split into three "Titles." The first of these relates to "Works of Improvement Generally." In here, you'll find all the statutory definitions, all of the requirements for notices generally (be sure to check the specific section for the notice in question also), and all of the new waiver and release forms. The second relates to "Private Works of Improvement," and the third to "Public Work of Improvement." This is thought to be an improvement on the more scattershot organization of the prior law. Definitions have been simplified, and language made clearer. In some cases, the terminology of the statute has changed. A "Stop Notice" is now a "Stop Payment Notice" to avoid confusion with a "Stop Work Notice"; the archaic "Materialman" is now a "Material Supplier"; and the "20 Day Preliminary Notice" is now just the "Preliminary Notice."

Important Changes Affecting Day to Day Business

While the effort to make the statute more readable and accessible to the average person is a laudable goal, the more important

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Johnny White, Esq.

A "STOP NOTICE" IS NOW A "STOP PAYMENT NOTICE" TO AVOID CONFUSION WITH A "STOP WORK NOTICE"; THE ARCHAIC "MATERIALMAN" IS NOW A "MATERIAL SUPPLIER"; AND THE "20 DAY PRELIMINARY NOTICE" IS NOW JUST THE "PRELIMINARY NOTICE."

Philadelphia Bankruptcy Judge Rejects Trustee's Unreasonably Narrow Range in Evaluating Ordinary Course of Business Defense

David Mannion, Esq.

THE PROBLEM WITH THIS APPROACH IS THAT IT IS USUALLY FAR REMOVED FROM THE REALITY OF CUSTOMARY CREDIT TRANSACTIONS THAT THE ORDINARY COURSE OF BUSINESS DEFENSE IS MEANT TO PROTECT

As most vendors will be painfully aware, payments they receive during the 90 day period before a debtor files bankruptcy can later be recovered by the debtor's bankruptcy trustee in a preference action under 11 U.S.C. § 547(b). Perhaps the most common defense to such an action is that the payments are not recoverable because they were made in a manner that was "subjectively ordinary" between the parties. That is to say, the characteristics of the payments the creditor received from the debtor during the 90 day period were consistent with the characteristics of payments they received from the debtor prior to the 90 day period (the "historical period").

In its application, the subjective ordinary course defense is a rich and interesting area of law. However, it is fair to say that one of the most important factors considered by courts evaluating the ordinariness of payments is timing. Was the timing of the payments the creditor received from the debtor during the 90 day period consistent with the timing of payments they received during the historical period?

After a creditor receives a bankruptcy trustee's initial preference demand and retains counsel, letters are usually traded by the parties explaining their positions. Unfortunately, many bankruptcy trustees want to extract as much money as possible from preference defendants while putting the minimum amount of thought into the individual case. As such, it is common for a trustee's analysis at this early stage of the litigation to be confined to a single argument; namely, that for the 90 day payments to be "ordinary" as between the parties, they must fall within an arbitrary and excessively narrow range either side of the historical average (for example, plus or minus five days). Thus, if the payments the creditor received from the debtor during the historical period were made an average of 30 days after invoice date, the trustee might take the position that the 90 day payments must fall within a range of 25 to 35 days after invoice date to be "ordinary" (and protected), while payments falling outside that range are not ordinary (and may be recovered by the trustee.)

The problem with this approach is that it is usually far removed from the reality of customary credit transactions that the ordinary course of business defense is meant to protect. Most trade creditors have fluid relationships with their customers, and it is rare for payments to be made within a range as narrow as 5 days either side of the historical average. While it might be true that a particular debtor historically made payments to a creditor an average of 30 days after invoice date, it could also be true that only a small fraction of those payments fell within a range of 25 to 35 days after invoice date. For example, the payments may have been scattered between 15 and 50 days after invoice date, with the majority concentrated outside the 25 to 35 day range (yet still lending themselves to a 30 day average). This can mean that bankruptcy trustees effectively end up arguing that for 90 day payments to be "ordinary," they must have been timed in a manner that was not even ordinary during the historical period.

The lack of logic behind this favorite approach of bankruptcy trustees has always been clear. However, there is an unfortunate dearth of case-law addressing it. As such, creditors should welcome the recently published decision of the bankruptcy court for the Eastern District of Pennsylvania in In re Philadelphia Newspapers, LLC, 468 B.R. 712 (Bankr. E.D. Pa. 2012). There, the bankruptcy trustee argued in his legal brief that "the payment history reflects that historically…the Debtor, on average, made payment to the Defendant approximately 50-days after the issuance of the invoice. *** In the interest of fairness, the Trustee asserts that a reasonable 'range' for purposes of establishing parameters for what

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Friedman's Court Decision on Subsequent New Value and Its Implications to Trade Vendors

On November 30, 2011, Judge Christopher S. Sontchi of the United States Bankruptcy Court for the District of Delaware, issued a decision on a Motion for Summary Judgment in the Friedman's Inc. v. Roth Staffing Companies LP (In re Friedman's Inc.) case which has led to contentious debate by bankruptcy professionals as to its implications for the future. The issue in Friedman's of greatest import to trade vendors is a determination of when the analysis of the subsequent new value defense to a claim of preferential transfer becomes fixed. Judge Sontchi, in reliance upon In re New York City Shoes, Inc., 880 F.2d 679 (3d Cir. 1989), correctly fixed the preference analysis as of the date a bankruptcy petition is filed by a debtor(s).

I. Background

Fredman's Inc. ("Friedman's") sells mid-level jewelry products. On January 22, 2008 (the "Petition Date"), some of Friedman's creditors banded together and forced Friedman's into an involuntary chapter 7 case. Friedman's subsequently converted the case to a voluntary chapter 11 filing. Roth Staffing Companies LP ("Roth") provided Friedman's with temporary staffing services both prior to and after the bankruptcy case was initiated. During the 90 days prior to the filing of the Bankruptcy petition (the "Preference Period), Roth received payment from Friedman's for temporary staffing services in the amount of $81,997.57 (the "Preferential Transfers"). After receiving the Preferential Transfers, but before the Petition Date, Roth provided additional temporary staffing services to Friedman's in the total amount of $100,660.88. Friedman's did not pay Roth for the additional staffing services provided prior to the Petition Date.

As one of its first day motions, Friedman's sought authorization from the Court to pay certain of its critical vendors. This included a request to pay Roth for the uncompensated temporary staffing services it provided pre-petition, as not paying for these services would cause irreparable harm to the bankruptcy estate. The Bankruptcy Court authorized post-petition payment of Roth's pre-petition invoices as a critical vendor. Thereafter, Friedman's remitted payment to Roth in the amount of $72,412.71 as a critical vendor payment.

On or about February 27, 2009, Friedman's filed an adversary action against Roth seeking return of the $81,997.57 it paid Roth during the Preference Period as an avoidable preference under Section 547 of the Bankruptcy Code. Roth argued that it was entitled to a subsequent new value defense in the amount of $100,660.88 for the uncompensated for temporary staffing services it provided to Friedman's pre-petition under 11 U.S.C. § 547(c)(4) reducing Roth's net preference exposure to zero. When presented with Roth's subsequent new value defense, Friedman's filed a Motion for Partial Summary Judgment arguing that its critical vendor payment reduced Roth's subsequent new value defense amount from $100,660.88 to $28,248.17, leaving net preference exposure in the amount of $53,749.40.

II. Court's Decision

The Court decided this case on the briefs submitted by the parties, determining that no oral argument on the issues was necessary. Judge Sontchi denied Friedman's Partial Motion for Summary Judgment. The Court relied upon the holding of New York City Shoes stating the three (3) elements of the subsequent new value defense, "the subsequent new value defense under section 547(c)(4) has three elements: (1) the creditor must have received a transfer that is otherwise voidable as a preference under section 547(b); (2) after receiving the preferential transfer, the preferred creditor must advance 'new value' to the debtor on an unsecured basis; and (3) the debtor must not have fully compensated the creditor for the 'new value' as of the date that it filed the bankruptcy petition." Friedman's at *4, quoting New York City Shoes (emphasis in original). Using this third element, Judge Sontchi held

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OF GREATEST IMPORT TO TRADE VENDORS IS A DETERMINATION OF WHEN THE ANALYSIS OF THE SUBSEQUENT NEW VALUE DEFENSE TO A CLAIM OF PREFERENTIAL TRANSFER BECOMES FIXED

Peter M. Sweeney, Esq.

Friedman's Court Decision on Subsequent New Value and Its Implications to Trade Vendors

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that the filing of the bankruptcy petition fixed the preference analysis. Any action taken by a debtor post-petition would not affect the analysis or a trade vendor's available defenses. In this case, Friedman's post-petition critical vendor payment to Roth would not change Roth's subsequent new value defense due to its provision of $100,660.88 in temporary staffing services for which it was not paid prior to the petition being filed. Under Judge Sontchi's decision, Roth has a complete defense to Friedman's adversary action for avoidance of preferential transfers.

III. Current Procedural Process and Future Implications

Shortly after Judge Sontchi issued its decision, on December 12, 2011, Friedman's lodged its appeal with the United States District Court for the District of Delaware (the "Appeal"). Pursuant to local District Court procedures, the Appeal must go through a mandatory mediation process, which is the current procedural standing of the case. Assuming the parties cannot reach settlement through the mediation process, then the parties would need to submit briefs to the District Court, have possible oral argument, and wait for the decision of the District Court. Either party would then have the right to appeal the decision of the District Court to the Third Circuit Court of Appeal. Mandatory mediation, briefing and possible oral argument would be repeated at this level. Ultimately, either party could appeal this matter to the United States Supreme Court.

Decisions in jurisdictions outside of the Third Circuit that have decided this issue in direct contradiction of Judge Sontchi's holding in the Friedman's decision. Settling the split amongst the various jurisdictions by the U.S. Supreme Court would be of great assistance to trade creditors. Having a final definitive process to perform subsequent new value analysis will make decision making and planning easier for trade vendors when interacting with a customer who is sinking into bankruptcy or deciding whether to become a critical vendor for a customer that has already filed for bankruptcy.

Under the Friedman's decision and similar cases, a trade vendor will not need to concern itself with whether becoming a critical vendor will affect its preference defenses. Critical vendors usually receive the benefit of having their pre-petition invoices cured, partially or in-full, in return for continuing to supply goods or services to a debtor post-petition on the same or substantially similar terms the vendor provided pre-petition. The decision to become a critical vendor has to be made quickly and usually without consideration for whether a debtor, possibly two (2) years in the future, may initiate an action against the trade vendor for return of alleged preferential transfers. If Friedman's is ultimately overturned through the appeals process, then critical vendors will lose this valuable subsequent new value defense by accepting post-petition payment of its pre-petition invoices. Given the size of some preferential transfers, this could result in having to pay back significant dollars to a debtor's estate instead of having no net preference exposure. In the case of Roth, the difference amounts to approximately $54,000.00, but to other vendors the risk could be in the hundreds of thousands of dollars. Not only does having the petition date act as a bright line division between pre-petition and post-petition actions better comport with the stated purposes of the Bankruptcy Code's preference provisions as stated by Judge Sontchi in his decision, but trade vendors will be able to both support their customers by being critical vendors and also protect themselves by preserving their defenses from any future claims for avoidance of preferential transfers.

Blakeley & Blakeley, LLP, as the lead attorneys for Roth at the bankruptcy level and during the appeal process, are at the forefront of this fight to protect trade creditors' rights.

A Creditor's Attorney's Fees May Be Paid By The Estate Through A Chapter 11 Plan

Ronald A. Clifford, Esq.

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neys' fees through the plan.

The *Adelphia* Court did, however, limit the awarding of attorneys' fees to those fees which were reasonable. The Court required that all of the attorneys at issue file a fee application, which application would be reviewed by the entire creditor body for comment, and ultimately ruled upon for reasonableness by the Court.

At first glance, this ruling seems to be somewhat limited. A settlement that provides for the payment of a parties' attorneys' fees is something a Bankruptcy Court certainly has the authority to consider under Section 105 of the Bankruptcy Code, which Section allows the Bankruptcy Court to enter orders that further the cause of Chapter 11. That agreement could be entered into and approved prior to the plan being filed.

The real issue here is the amount of the attorneys' fees requested. It is true that it seems odd that a creditor could employ an attorney for their own purposes, and then have the entire creditor body be responsible for those fees as if those fees were 503(b)-like services that benefited the estate. But unless a creditor or the US Trustee raises an issue with these provisions for attorneys' fees payments, they go unnoticed. The key takeaway from this case for trade vendors is recognizing that: (1) It is possible to have one's attorneys' fees paid for by the debtor in a Chapter 11 case, even when those services do not directly benefit the estate in any tangible way; and (2) a driver in the Bankruptcy Court's analysis as to whether it should approve payment of the fees will depend on the reasonableness of the action taken by the creditor's attorney. As long as creditors are acting reasonable in participating in a Chapter 11 case through an attorney, there may be a pocket for payment for the expenses of that attorney, through the bankruptcy estate.

"THE REAL ISSUE HERE IS THE AMOUNT OF THE ATTORNEYS' FEES REQUESTED"

California's New Mechanic's Lien Statute: The Basics

Johnny White, Esq.

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question is: what changes does the law make that are of relevance from day to day as a matter of practice? And there are certainly a couple of things. The first is that the law prescribes new conditional and unconditional waiver and release forms. Civil Code, §§ 8132-8138. A waiver and release of statutory lien rights in exchange for a progress payment or a final payment is "null, void, and unenforceable unless it is substantially [in the new] form." Accordingly, it is imperative to update your release forms. You should be able to locate the language of the new form online, but if you are having difficulty doing so, or are uncertain about whether you have it right, feel free to contact this office.

The second change relates to notices. The new law makes an effort to standardize the form and manner of any notice given under the statute, setting forth minimum requirements for their contents, and standard methods of service. Fortunately, the new law also includes language to the effect that a notice is sufficient if it will "substantially inform the person given notice of the information required." This language will hopefully mitigate some of the harsh consequences of minor defects in notices that could have been fatal under the old law. Nonetheless, it is important to ensure that your preliminary notice and other forms are current, contain all of the information required by Civil Code, § 8102, the form language set forth in Civil Code, § 8202(a)(3), and your practice for serving them is up to date. For example, first class mail is no longer a valid means of serving a preliminary notice.

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California's New Mechanic's Lien Statute: The Basics

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Miscellaneous Changes

In no particular order, the new law also makes the following, noteworthy changes: (1) Solving the problem for subcontractors of identifying the construction lender when serving a preliminary notice, the new law requires the general contractor and the owner to make that information available; (2) General contractors are now also required to serve preliminary notices on construction lenders prior to filing a lien; (3) The process of expunging a lien has been expedited, and the penalties for failing to remove an invalid lien are potentially greater; (4) the rules relating to when a project is deemed complete have changed, among them an owner is now entitled to record its notice of completion up to 15 days after the date of completion of work; and (5) the amount of a mechanic's lien release bond has been reduced to 125% of the lien amount (formerly 150%).

Conclusion

While the changes to the law are primarily cosmetic, and should not be overly disruptive to the industry, there are nonetheless significant amendments that require immediate attention. This article touches on a few, but in the immediate aftermath of the change, you should second guess yourself, and consult the new (and hopefully more readable) law for guidance before taking any actions.

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Putting Ordinary Back into the Ordinary Course of Business Defense

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summary judgment. In response, Defendant filed a reply and its own cross-motion for summary judgment, supported by the affidavit of Brian Green who is an officer and principal of Defendant. Upon consideration of the record as a whole, the Court resolves the matter as follows.

First, the Court finds that Transfers are preferential transfers within the meaning of *section 547(b)*, stating: (1) The Transfers were of an interest of the Debtor in property, made to and for the benefit of Defendant, a creditor of the Debtor, on account of an antecedent debt, the debt owed to Defendant by the Debtor for the temporary employee services previously provided, (2) *Section 547(f)* states that "[f]or the purposes of [*Section 547*], the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition," (3) Defendant is an unsecured creditor in this case, and all creditors will not receive a 100% payout. As such, Defendant received more than it would have received in a hypothetical Chapter 7.

Second, Analyzing Defendant's subjective ordinary course of business defense, the Court finds the payment history between Debtors and Defendant from June 5, 2007 through May 7, 2008 (the "Pre-Preference Period") demonstrates that 90% of payments made by Debtors to Defendant were made within 30-60 days of invoicing. The remaining 10% of the Pre-Preference Period payments were made in less than 30 days.

Plaintiff does not dispute the timing of the payments during the Preference Period in relation to the Pre-Preference Period. Rather, Plaintiff argues that the ordinary course of business defense does not apply because payments to Defendant increased sharply during the Preference Period. Specifically, Plaintiff argues that in instances of multiple invoices being paid by multiple checks on the same day, the total amount paid on those days was starkly higher than the average payment in past practices. As such, Plaintiff

Putting Ordinary Back into the Ordinary Course of Business Defense

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argues that these increased payments are not within the ordinary course of business between the Debtor and Defendant.

Defendant argues that the payment history demonstrates many instances where multiple invoices were paid by Debtor by separate check on the same day and as such, this practice is not outside of the ordinary course of business between the Debtor and Defendant. Defendant argues that the invoices are based solely on the services provided to meet Debtor's need for temporary employees. Therefore, Defendant argues that the increase in the amount of the invoices does not disqualify the ordinary course of business defense.

Included in the second factor to be analyzed under the subjective ordinary course defense is whether the amount of the transfers differ from past practices. Upon the Court's review of the undisputed payment history, it is clear that there were several instances of multiple invoices being paid by Debtor on the same day. The Court finds that during the Pre-Preference Period, there were nineteen such examples of multiple invoices being paid on the same day. In fact, there were only twelve instances during the Pre-Preference Period where only one invoice was paid on that day, though such solitary payments were often separated from other solitary payments by a few days, rarely more than a week. The payments were always made by check. Each check was always in payment of a single invoice. This Court therefore concludes that payment of multiple invoices on the same day was not outside the ordinary course of business between Debtors and Defendant.

Plaintiff also argues that the amount of the payments during the Preference Period increased starkly from the payments during the Pre-Preference Period, especially when the payments of a single day are tallied. However, the Court's review of the payment history compels a different determination on the facts. While true that the amount of the payments made during the Preference Period did increase, this is part and parcel of Debtor's increased use of Defendant's services. Logically, Debtor's increased use of Defendant's services would yield higher invoices from Defendant. The first invoice in the payment history above $20,000.00 was dated January 15, 2008, months before the Preference Period, and was paid by Debtors on or about February 27, 2008. The majority of the invoices sent thereafter, until the last invoice paid by Debtors, were above $20,000.00. Prior to January 15, 2008, there were no invoices above $20,000.00; though the October 16, 2007 invoice was for $16,403.20, one of two October 30, 2007 invoices was for $18,042.06 and one of two November 20, 2007 invoices was for $18,900.86. Based on the foregoing, the Court finds that the Transfers were within the subjective ordinary course of business.

Third, ruling on Defendant's objective ordinary course of business defense, the Court finds that Defendant has demonstrated by a preponderance of the evidence that the Transfers are properly unavoidable pursuant to *section 547(c)(2)(B)*. Defendant argues that the ordinary course of business defense applies because the Transfers were consistent with the industry standard in that it is customary for invoices to be paid by medium and large companies in the temporary employee service industry between 30 and 60 days of invoicing. Further, Defendant argues that Green's affidavit is sufficient proof of the industry custom because Green's statements were based on his personal knowledge from being in the industry for over 12 years and his interaction with multiple companies during that time. As such, Defendant argues that Green's statements were made with requisite specificity on the issue.

The industry standard may be established by the testimony of an officer or employee of the transferee if that testimony establishes the range of the prevailing practices within the industry. *Peltz v. Hartford Life Ins. Co. (In re Bridge Info. Sys., Inc.), 321 B.R. 247, 258 (Bankr. E.D. Mo. 2005)* (citing *Jones v. United Sav. and Loan Ass'n (In re U.S.A. Inns of Eureka*

"THIS COURT THEREFORE CONCLUDES THAT PAYMENT OF MULTIPLE INVOICES ON THE SAME DAY WAS NOT OUTSIDE THE ORDINARY COURSE OF BUSINESS"

Bradley D. Blakeley, Esq.

Putting Ordinary Back into the Ordinary Course of Business Defense

Springs, Arkansas, Inc.), 9 F.3d 680, 685 (8th Cir. 1993)(where transferee's agent's testimony that late payment from distressed clients was the industry norm was sufficient to establish the industry norm pursuant to *Section 547(c)(2)*)).

Plaintiff does not dispute the veracity of Green's statements but rather asserts that Green's statements are not based on personal knowledge and are not sufficiently specific. The Court disagrees finding that Green has affirmatively stated that it is the industry norm based on his 12 years of experience dealing with multiple companies, and that those multiple companies, of which he has personal knowledge, pay their temporary employee service invoices between 30 and 60 days after invoicing. Green's testimony is credible and his assertions are accepted for their veracity as the industry norm.

Given the Court's conclusion that Defendant has established its ordinary course of business defense, the Court did not address the new value defense. The Court's ruling on the ordinary course of business defense gives creditors strong ammunition when they have consistency between the pre-preference and preference periods in: (1) the amounts of the invoices and transfers, (2) number of invoices paid by transfers, (3) form of transfers, and timing of transfers.

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Lessons Learned from "Zombie Restaurants": A Cause of Indigestion for a Creditor

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these so-called "zombies" barely bring in enough revenue to cover base level expenses, many of them cling to life. These failing restaurants have continuously cut prices in order to attract customers, and healthy restaurants have been forced to do the same in order to remain competitive. Analysts state that this excess of producers is part of the economy in the food industry, which allows "zombie restaurants" to stay open as long as they can cover basic costs. Much of the financial trouble in the food industry stems from this oversaturation of suppliers, which has lead to an imbalance in supply and demand in the restaurant industry.

Friendly's Ice Cream Corp. and Real Mex Restaurants Inc. filed for Chapter 11 within days of each other, citing a sluggish economy, high rent costs, slow consumer spending and high costs for commodities. Real Mex Restaurants is the largest full service Mexican restaurant chain with locations in 17 states. Friendly's operates a chain of about 500 family-style restaurants in 15 states. Both Friendly's and Real Mex are portfolio companies of the private equity firm Sun Capital Partners. Sbarro, Inc. filed for Chapter 11 in April of 2011. It is a leading Italian quick service restaurant concept and the largest shopping mall-focused restaurant concept in the world with locations in 42 countries. A food manufacturer, Orval Kent Food Company recently filed Chapter 11. Orval Kent is the leading provider of prepared foods to the retail and food service industries. Orval Kent was also held as a portfolio company by a private equity firm.

How do these recent Chapter 11 filings impact vendors' credit decisions with national and regional restaurant chains and food distributors? How are vendors' prepetition claims being treated in these Chapter 11's? What of opportunities for the vendor to continue selling postpetition? What red flags should the vendor look for to identify food distributor and restaurant chain insolvency risk?

The Corporate Debtor's Favorite Chapter 11 Filing Location: Delaware

Friendly's, Real Mex and Orval Kent all filed

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Chapter 11 in the district of Delaware, although their principal places of business are elsewhere. Real Mex's principal place of business is California, Friendly's is Massachusetts, and Orval Kent's is Illinois. However, each of the companies is incorporated in Delaware, which provides venue to file Chapter 11 in Delaware. The U.S. Congress is considering legislation that amends the Bankruptcy Code and localizes Chapter 11's by limiting a company's ability to file outside of the state where they have their primary operations, such as Delaware and New York. For now, creditors must continue to take the "Delaware train" to deal with their prepetition and postpetition claims with customers filing in this venue.

The Chapter 11 Debtor's Balance Sheet

Whether the debtor is a public or privately held business, a customer that files Chapter 11 must disclose its assets and liabilities at the time of the bankruptcy filing or, in the opening weeks of the filing. The schedules can assist a creditor in evaluating the prospects for a range of distribution, which may guide them should the creditor be approached by a claim's buyer. The schedules may also assist the creditor with evaluating postpetition credit risk should it elect to sell on terms. The schedules and statement of financial affairs also discloses whether the customer is part of a family of companies that has filed Chapter 11.

Real Mex

Real Mex listed debts of $3.2 billion, of which $2.8 billion is secured. Assets are valued at $434 million. Real Mex filed with 16 related companies: Acapulco Mark Corp., Acapulco Restaurant of Downey, Acapulco Restaurant of Moreno Valley, Acapulco Restaurant of Ventura, Acapulco Restaurant of Westwood, Acapulco Restaurants, ALA Design, Chevys Restaurants, CKR Acquisition Corp., El Paso Cantina, El Torito Franchising Company, El Torito Restaurants, Murray Pacific, Real Mex Foods, RM Restaurant Holding Corp., and TARV. These cases are jointly administered under Real Mex Restaurants.

Friendly's

Friendly's listed debts of $401 million, of which $341 million is secured. Assets are valued at $144 million. Friendly's filed with four related companies: Friendly's Restaurant Franchise, Friendly's Realty I, Friendly's Realty II, and Friendly's Realty III. These cases are jointly administered under Friendly Ice Cream Corporation.

Sbarro

Sbarro listed debts of Sbarro $461 million, of which $207 million is secured. Assets are valued at $51 million. Sbarro filed with 27 related companies: Carmela's of Kirkman Operating, Carmela's of Kirman, Carmela's, Corest Management, Demefac Leasing Corp., Larkfield Equipment Corp., Las Vegas Convention Center, Sbarro American Properties, Sbarro America, Sbarro Blue Bell Express, Sbarro Commack, Sbarro Express, Sbarro Holdings, Sbarro New Hyde Park, Sbarro of Las Vegas, Sbarro of Longwood, Sbarro of Virginia, Sbarro Pennsylvania, Sbarro Properties, Sbarro Venture, Sbarro's of Texas, Umberto at the Source, Umberto Deer Park, Umberto Hauppauge, Umberto Hicksville, Umberto Huntington and Umberto White Plains. These cases are jointly administered under Sbarro, Inc.

Orval Kent

Orval Kent listed debts of $740 million, of which $490 million is secured. Assets are valued at $261 million. Orval Kent filed with nine related companies: Chef Solutions Holdings, CS Distribution Holdings, CS Distributors of Ohio, CS Prepared Food Holdings, Chef Solutions, Orval Kent Holdings, Orval Kent Intermediate Holdings, Orval Kent Parent, and Orval Kent Food Company of Linares. These cases are jointly administered under Chef Solutions Holdings.

Keeping the Debtor's Doors Open: Use of Cash and Debtor in Possession Financing

In the opening days of the chapter 11 filing,

"THE SCHEDULES CAN ASSIST A CREDITOR IN EVALUATING THE PROSPECTS FOR A RANGE OF DISTRIBUTION"

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VENDORS DON'T HAVE TO WAIT FOR PAYMENT UNTIL A PLAN OF REORGANIZATION OR LIQUIDATION IS CONFIRMED

the customer must have access to cash to meet its operating expenses, whether through cash flow or financing. The customer must obtain a bankruptcy court order authorizing use of cash or financing. To use the cash collateral, the debtor must adequately protect the secured creditor's interest. If the customer needs financing to fund its postpetition operations, the customer may file a motion with the bankruptcy court requesting the DIP financing.

Real Mex

Real Mex received DIP financing up to $49 million to fund ongoing operations.

Friendly's

Prior to their bankruptcy filing, Friendly's negotiated a $71.3 million postpetition financing package with their existing secured creditors. The DIP facility was used to meet operating expenses so as to prepare the sale of the business. Just as Real Mex, the DIP facility would provide the funding necessary to allow the debtors to maintain the ordinary course of business, thereby preserving the value for the creditors.

Sbarro

Sbarro was authorized to borrow money pursuant to the DIP Credit Agreement up to $35 million from Cantor Fitzgerald Securities.

Orval Kent

Orval Kent arranged two DIP facilities, with one from Wells up to $28 million, and another with Reser's, who provided financing of $10 million.

The Most Recent Prepetition Invoices ('Freshest') are Entitled to Payment Per Invoice Terms, Provided Post Petition Trade Credit is Extended

Prior to the Bankruptcy Reform Act of 2005, vendors selling goods on credit to an insolvent customer that files Chapter 11 would find the value of the unpaid invoices at risk, even those goods shipped just days before the Chapter 11. A vendor would have a multi-step prove up before the bankruptcy court to reclaim the goods recently shipped and the customer received prepetition. However, the evidentiary burden of the old reclamation code section imposed on creditors was so high that they seldom improved their prospect for payment.

The Bankruptcy Reform Act of 2005 provides that vendors are entitled a priority claim for those goods received by the debtor within 20 days of the Chapter 11 filing. The adoption of this provision, has created a new constituent at the bargaining table - the Section 503(b)(9) claimants. However, the Bankruptcy Code does not specify when payment must be made, other than confirmation of the plan.

Real Mex

Real Mex and Friendly's recognized the significance of 503(b)(9) claims as to their exit from Chapter 11, and each filed motions with the bankruptcy court in the first days of the Chapter 11 addressing unique treatment of vendors asserting 503(b)(9) claims.

The bankruptcy court authorized Real Mex to pay those vendors holding 503(b)(9) claims according to the prepetition invoice terms, provided the vendor commits to provide the debtor comparable credit terms as provided prepetition. The good news is that vendors don't have to wait for payment until a plan of reorganization or liquidation is confirmed, which could be a year or longer.

Real Mex's motion is voluntary. If the vendor holding the 503(b)(9) claim does not want to sell on terms postpetition, the vendor is not required to participate in the motion. This means that the purpose of the 503(b)(9) motion is to ensure Real Mex inexpensive financing, which trade credit provides. For the vendor, the credit evaluation is determining the risk of non payment with any postpetition credit sale.

Friendly's

Friendly's 503(b)(9) motion is comparable to

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Real Mex.

Sbarro

Sbarro established a deadline for vendors to file 503(b)(9) claims and also employed a notice and claims agent, Epiq Bankruptcy Solution.

Orval Kent

Orval Kent established a deadline for vendors to file 503(b)(9) claims, but no mechanism for early payment of these claims. Vendors may file motions for 503(b)(9) payment. The challenge for the vendor is that the bankruptcy courts generally do not permit immediate payment of the 503(b)(9) claim in the early stages of the chapter 11. The legal standard the court generally employs in evaluating whether to order early payment of the 503(b)(9) claim is the financial hardship on the vendor if payment is not shortly forthcoming.

The vendor may consider the Real Mex and Friendly's example where the debtor may agree to early pay of the 503(b)(9) claim in exchange for postpetition credit extensions. This means that the trade relationship moves from an invoice by invoice trade relationship to a postpetition supply contract on credit terms comparable to those provided prepetition. The duration of the postpetition supply contract is commonly marked by the confirmation of the plan of reorganization or liquidation. The vendor's evaluation of opting in for the early payment of the claim is measuring the postpetition credit risk that accompanies the supply contract, balanced with the profit from the forthcoming credit sales.

Both Old and New (Fresh) Invoices Paid Early in Exchange for Post Petition Trade Credit: Critical Vendor Considered

On occasion, a vendor may find that the product or service they provided to the customer prepetition is deemed essential to the Chapter 11 debtor and key to the debtor's continued operations. The uniqueness of the product or service may give the indispensible vendor leverage in negotiating post-bankruptcy sales. In this situation the debtor may request that the bankruptcy court allow it to immediately pay the vendor's prepetition claim in the opening days of the Chapter 11, in exchange for the vendor selling to the debtor post-bankruptcy on comparable credit terms for the duration of the Chapter 11.

Real Mex

Real Mex obtained court authorization to treat its alcohol beverage vendors as critical to its operations and paid immediately on their prepetition debt. Real Mex stated that the alcohol vendors would be given special treatment because under state law these vendors must be paid within 30 days. No others vendors were given this special treatment. Given this, a vendor must look to third parties to get paid prior to confirmation of a plan.

Friendly's

Friendly's did not file a critical vendor motion. This means that, like Real Mex, vendors holding older prepetition invoices do not have a source of early payment from the debtor on their pre-503(b)(9) invoices, other than to a claim's buyer.

Sbarro

Sbarro received authorization to pay the prepetition claims of Critical Vendors who agree to continue to supply goods or services Postpetition on acceptable terms and conditions. The payments are not to exceed $5.2 million.

Orval Kent

The bankruptcy court authorized the debtor to pay $1 million to vendors the debtor deems as essential to ongoing operations. In exchange, the vendors must provide post petition trade terms on terms comparable to that provided prepetition.

Suppliers of Fresh Fruits and Vegetables and Suppliers of Livestock and Poultry Entitled to Special Treatment: PACA and PSA Claims

Suppliers of perishable fruits and vegetables are given extraordinary protections under the

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Perishable Agricultural Commodities Act (PACA). PACA impresses a floating trust in favor of the unpaid suppliers of perishable agricultural products. The trust is even senior to the customer's lender that holds a blanket lien. Likewise, the Packers and Stockyard Act (PSA) provides protections to unpaid sellers of livestock and poultry and all products, receivables or proceeds related to livestock and poultry.

Real Mex

The bankruptcy court authorizes the debtor to pay PACA and PSA claims in the ordinary course of business.

Friendly's

Same treatment for PACA claims as in Real Mex.

Sbarro

Sbarro authorized to pay all valid PACA claims in the ordinary course of business.

Orval Kent

Orval Kent authorized to pay PACA claims, but may not exceed $3.7 million.

Exit Strategy: Selling All the Assets

The exit strategy trend of Chapter 11 customers is to sell all of their assets, usually in the opening weeks of the Chapter 11, as opposed to proposing a plan that pays creditors a quarterly dividend based on operating cash flow. The sale of assets strategy is a multistep process. First, the debtor hopes to lock in a stalking horse bidder that sets the floor for a minimum price for the debtor's assets. The debtor commonly sets a bidding procedures motion to provide for overbids of the stalking horse offer, and the terms that an over-bidder must meet. The sale motion provides for an auction process where the bidder that makes the highest and best bid is selected as buyer of the debtor's assets. Such is the case with Real Mex, Friendly's and Orval Kent. The Bankruptcy Code allows for the sale of substantially all of the assets of the debtor, upon approval of the bankruptcy court. Generally, a major asset sale eliminates the need for a plan that provides for the debtor's reorganization; rather, a liquidation plan will be filed.

Distribution to Unsecured Creditors Through a Sale of Assets

Under the asset purchase agreement, the stalking horse bid is often set at the amount of the debtor's secured debt. If a stalking horse bid is below the amount of the secured debt, the secured creditor must consent to the sale at that price. Assuming that the stalking horse bid is set at the amount of the secured debt, unless there is robust auction of the debtor's assets that results in a significant overbid of the stalking horse bid, there will not be a meaningful distribution to unsecured creditors through the sale process. The bankruptcy court may authorize a sale in which unsecured creditors will not receive a distribution through sale proceeds.

Real Mex

The bankruptcy court approved a sale of all assets of the debtor, with an auction scheduled for January 26, 2012.

Friendly's

Friendly's cancelled an auction for the sale of its assets when it did not receive offers to compete with the proposed purchase offer from its owner, Sun Capital. Sun Capital paid $75 million for the assets, of which $50 million was from a credit bid of its secured debt. $2.75 million is to be carved out for unsecured creditors and to cover the costs of closing the Chapter 11.

Sbarro

Sbarro chose not to auction off its assets, and instead offered a revised plan of organization. This plan gave the lenders partial ownership of the reorganized restaurant in exchange for a reduction in debt and an additional $35 million in capital. Unsecured creditors received no distribution in the revised plan.

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Orval Kent

Orval Kent sold its assets for $69.2 million to Reser's Fine Foods and Mistral Capital Management LLC. The offer covers, in addition to debt assumption, $35.9 million cash to pay off secured debt plus a $25.3 million credit bid.

Plan of Liquidation

After the sale of assets, the sale proceeds are usually distributed through a plan of liquidation. The plan of liquidation commonly provides for the creation of a liquidating trust. The trust comprises the sale proceeds and assignment of litigation claims, including preference claims. A liquidation trustee is employed to administer the assets, including pursuing preference claims against vendors.

Sale of Claims

Claims' buyers in many larger Chapter 11 cases offer to purchase a vendor's claim at a discount. The upside for the vendor in selling their claim is getting paid immediately, and avoiding the risk that the value of the claim may decrease as the Chapter 11 proceeds. The downside for the vendor is that they may have discounted the value of the claim too much.

It may be possible for the vendor to sell to a claim's buyer. The claims' buyers are often deep-pocketed funds that seek out vendors to sell their claims (open invoices at the time of the chapter 11 filing) at a discount. The claims' buyers base their claim pricing on a number of factors, which the claims' buyers usually don't disclose to the vendor. The claims' buyers buy the claims at a discount and hold the claim through distribution.

Opportunity for Continued Sales to the Buyer of Assets?

The buyer of the debtor's assets often seeks to continue trade relationships with key vendors of the debtor. A vendor often welcomes the buyer as a new customer as the buyer has a stronger balance sheet than the debtor, as it purchased only the debtor's assets not liabilities. If the vendor was selling under a supply contract to the debtor, the buyer of the assets may have elected to assume the supply contract. The buyer of the debtor's assets becomes the customer for the vendor. Assumption of the contract provides that the vendor is paid on its prepetition claim and is released from preference liability.

Vendors selling on an invoice basis will not have their prepetition claim directly paid by the buyer, other than a prorated distribution of the sale proceeds. The vendors in this type of trade relationship do not have a contract with the buyer of the assets for continued sale of goods or services. The sale's person's responsibility is to close the sale with the buyer, subject to the credit professional's credit evaluation.

The Preference Clawback: Vendors at Risk?

Vendors are wrestling with bankruptcy trustees and liquidating agents in record numbers over the bankruptcy preference. The bankruptcy preference requires a vendor to return payments received within the 90 days prior to the bankruptcy filing, subject to defenses such as the subsequent advance and ordinary course of business. The liquidating trustee has two years from the Chapter 11 filing to file preference actions. Real Mex, Friendly's, Sbarro, and Orval Kent have not made demands on vendors for any payments alleged to be preferential, although it is early in their Chapter 11's and liquidating trusts have not yet been created and the avoidance actions assigned to these trusts. In sale of asset cases, as we have here, preference actions will be brought against vendors to recover a part of the shortfall from the sale of assets.

Warning Signs of a Customer's Insolvency: Are You Selling to an Insolvent Restaurant Chain or Distributor?

Given Real Mex's, Friendly's, Sbarro's and Orval Kent's Chapter 11 filings, and concerns regarding other restaurant chains' insolvency risks, below are some red flags that may be key indicators of insolvency risk.

THE DOWNSIDE FOR THE VENDOR IS THAT THEY MAY HAVE DISCOUNTED THE VALUE OF THE CLAIM TOO MUCH

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Warning signs come in many forms and some are more obvious than others. As we review the past, it is easy to be a "Monday Morning Quarterback", but reviewing a matter after the bankruptcy can bring much insight that will prevent future losses. It is well worth the effort.

When considering the overall financial health of a customer, always start with a common sense macro point of view. As mentioned earlier, the restaurant industry has been hit hard by the economic downturn of the last three years. For most consumers, dining out is an optional expense, therefore, the restaurant industry is a likely casualty when the consumer's discretionary income is in question. With this downturn, even consumers who are not experiencing financial difficulty are cutting back on optional expenses. The sense of fear has been communicated universally to consumers nationwide.

WHEN CONSIDERING THE OVERALL FINANCIAL HEALTH OF A CUSTOMER, ALWAYS START WITH A COMMON SENSE MACRO POINT OF VIEW

Areas for Review: Market, Personnel and Financial

In general, warning signs can be inferred from market activities, such as the overall demand for the goods provided, stock and bond pricing, key customer losses and an increase in vendor activity, such as credit reference requests.

Personnel is another area that can provide clues as to negative changes in a business, such as the departure of select senior management, changes in communication patterns with vendors or even employee rumors and departures. Granted these changes are not always warning signs of problems, but they warrant closer scrutiny to be sure.

Returned checks and slowness of trade payments are traditional credit benchmarks that indicate possible financial deterioration and should always be a component of a credit review.

Even if a company is privately held, there may be public debt outstanding that requires the company to make financial information publically available. Such was the situation for Real Mex. Where financial data is available, the list of review items becomes much longer.

Negative trends in areas such as reduced cash, increased inventories, reduced EBITDA, decline in Interest Coverage are all good indicators to monitor. A change in Days Payable Outstanding, is frequently an indication of a customer attempting to increase vendor financed inventories. Correspondingly, reductions in lending availability or covenant violations all warrant close review.

Where were the clues?

Looking back on the traditional checklist of warning signs, we can see that many were present before the filings of Friendly's, Real Mex, Sbarro and Orval Kent.

For example:

- Both Friendly's and Real Mex (Acapulco, Chevy's & El Torito) restaurants reported a slowdown in guest traffic, as well as reduced check totals with trends continuing negatively long before they filed for Bankruptcy protection. As a supplier, a review of shipment records may have confirmed the reduced requirements being shipped into the debtor's operations.

- For those that made financial information public, such as Real Mex, the lack of profitability was obvious. The lack of cash was acknowledged and discussed as early as May of 2011, within the context of being able to fund debt payments.

- Real Mex disclosed in their March 2011 fiscal statements that they were in violation of loan covenants with senior debt holders and the bank. The disclosure indicated that the company was in discussions on the matter. However, in the Real Mex situation, formal waivers were never officially executed.

- Within the context of officer changes, Orval Kent/Chef Solutions changed senior officers within the 18 months before the filing.

- Where financial information was not avail-

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able, trade payments provided some interesting insights. For example, reporting agencies showed deviations in how these businesses paid vendors versus the industry at large; however there was no significant deterioration in the few months preceding the filings.

Although not every warning sign was exhibited for each of these debtors, there were enough signs to warrant a close review and conversations with the debtor's management.

What Next?

Once the warning signs have been identified, the challenging art of balancing your company's desire for sales and aversion to losses becomes the most important task. Collaboration with the selling organization and a thorough understanding of the customer's operation are critical to creating an approach that may allow you to save the sale for your company, without incurring a loss.

Consider the alternatives – Will the customer purchase on Wire in Advance terms? Is a Standby Letter of Credit a possibility to support the credit line? Is there any collateral available to secure the relationship? Might a program of limiting sales to a 20 day balance be a possibility, so that if the customer files, the balance is a claim that is handled as a priority? Your assessment of the company's post-petition prospects are critical to this decision, as you may be required to extend post-petition credit in order to have the 503(b)(9) claim paid.

Real Mex, Friendly's, Sbarro and Orval Kent are not likely to be the last wave of national restaurant and food manufacturer Chapter 11's. Although finding a way through the maze of warning signs and remedies is very challenging, the reward can be great. Making the sale without losing the money, when facing a customer's insolvency, is the best possible outcome for the credit professional and your company.

The New York Times article reminds the vendor that certain restaurant chains may be insolvent and have the appearance to have the financial wherewithal to pay according to invoice. However, these chains may be the "walking dead" and may be unable to meet their obligations and default in the near term. The New York Times article is also a reminder that even profitable restaurant chains may find that their segment of market may be tough going with profits being siphoned from the Real Mex and Friendly's type of competitors.

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COLLABORATION WITH THE SELLING ORGANIZATION AND A THOROUGH UNDERSTANDING OF THE CUSTOMER'S OPERATION ARE CRITICAL

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Philadelphia Bankruptcy Judge Rejects Trustee's Unreasonably Narrow Range in Evaluating Ordinary Course of Business Defense

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payments were made within the ordinary course of business would be payments made between 40 and 60 days after the issuance of the invoice. This range provides a ten day cushion on both sides of the historical average[.]" 468 B.R., at 717-718. However, disapproving this range as "too narrow," the court noted that "[d]uring the Historical Period…only 33%...of the payments, were made in the 40 to 60 day range used by the Trustee." 468 B.R., at 724. Instead, in order to accommodate the reality of the parties' historical business dealings, the court adopted a broader range of 30 to 70 days from invoice date for the purpose of evaluating the ordinariness of the 90 day payments. Id.

Philadelphia Newspapers holds true to the stated purpose of the ordinary course of business defense: to protect "recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the [creditor]." Nevertheless, few, if any, creditors will ever encounter a bankruptcy trustee who suggests that a 40 day range is appropriate when measuring the ordinariness of 90 day payments, even if the vast majority of payments in the historical period were, in fact, spread evenly throughout a 40 day range. Thus Philadelphia Newspapers is an important authority for creditors to have in their legal arsenal.

Similarly, in finding for the creditor-defendant in Tennessee Valley Steel Corp. v. Central Communs. & Elecs., Inc., 203 B.R. 949 (Bankr. E.D. Tenn. 1996), the court adopted a range of 56 days for the purpose of analyzing the payments at issue. There, the trustee argued that the 90 day payments were not ordinary because the payments during the historical period were made an average of 35.67 days from invoice date, whereas the payments in the 90 day period were made an average of 43 days from invoice date. 203 B.R., at 955. Rejecting this argument, the court noted that during the historical period "payments…were consistently scattered between [14] and [78] days." Id. Identifying the legal standard to be applied to such a fact pattern, the Court held that:

It appears to this court that… once the parameters of that which is ordinary to the course of the business or financial affairs of the Debtor and Defendant during the pre-preference period have been established, the fact that the Debtor's preference period payments may fluctuate within these parameters is inconsequential so long as the payments continue to be scattered within these parameters. *** The determinative factor is whether the preference period payments were scattered within these parameters. 203 B.R., at 955 (emphasis added).

Philadelphia Newspapers has yet to be taken up in any other published opinions. However, being less than four months old the decision is still in its infancy and it is to be hoped that more courts and creditors will come to rely on it when faced with the arbitrary and unreasonable ranges routinely adopted by bankruptcy trustees in measuring the ordinariness of 90 day payments.