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The Antitrust Laws as a Vendor's Response to a Customer's Terms Pushback Strategy

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When assessing a customer's ability to pay on terms, the credit team relies on a number of sources, including a complex scoring model, financial, bank and trade references, internet searches and social media. Despite the increasingly thorough and detailed credit evaluation process, since the credit crunch of 2008, vendors across the country have seen their customers disregard the credit team's evaluation and unilaterally extend these terms to better fit their working capital and cash flow needs. According to Sageworks' 2013 Private Company Report, private U.S. companies reported a 7.4 day increase in their average accounts-receivable days (37.9 days—45.3 days) in the last year alone. With this term pushback strategy (TPS) being employed by financially-sound and financially-strained customers alike, the "new normal" for the credit team appears to be customers dictating credit terms to vendors. While pushing back on terms presents customers a less-expensive financing option and improves their working capital (as well as a best practice according to the customer's finance team), the TPS negatively affects a vendor's DSO and cash flow. How can vendors keep the customers within terms in the face of a customer's TPS? Can the federal antitrust law, the Robinson-Patman Act (RPA), be used as leverage against a TPS?

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United States Court of Appeals for the Third Circuit Holds that Postpetition Payments by Debtor do not Reduce Vendor's New Value Preference Defense

Bradley D. Blakeley, Esq.

In a precedential decision important for critical vendors and section 503(b)(9) claimants, the Court of Appeals in *In re Friedman's Liquidating Trust v. Roth Staffing Companies LP*, 738 F.3d 547 (3d Cir. 2013) has held that "where 'an otherwise unavoidable transfer' is made after the filing of a bankruptcy petition, it does not affect the new value defense." The Friedman's case, defended by my firm **Blakeley & Blakeley LLP** in the bankruptcy court, as well as the appeals to the district court and court of appeals, is the first and only decision by a United States court of appeals on the issue of whether new value is impacted by post-petition payments. The Court of Appeals' 34-page opinion provides a thorough examination of the issue of when new value should be measured – on the petition date - and provides vendors with a clear path to protect their new value defense when faced

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Special points of interest:

- Antitrust Laws
- Postpetition payments
- Section 503(b)(9)
- Supply Contracts
- Structured Dismissals
- Ordinary course of business

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Section 503(b)(9) Claimants May Need to Take an Extra Step in Asserting Their Claims

Ronald A. Clifford, Esq.

By now, most trade vendors and credit professionals are comfortable with Section 503(b)(9) of the Bankruptcy Code and the benefits 503(b)(9) provides to its holders. Since 2005, trade vendors that deliver goods to a customer within the 20 days of that customer filing for bankruptcy, in the ordinary course of business, are entitled to an administrative expense priority claim. Administrative expense priority claims are elevated in priority of payment under the Bankruptcy Code's distribution scheme. Essentially, absent consent of the holder of the 503(b)(9) claim to the contrary, 503(b)(9) claims must be paid in full, in cash, on the effective date of any chapter 11 plan, and are entitled to payment prior to non-priority unsecured claims in any other bankruptcy exit scenario. It makes sense that any trade vendor entitled to a 503(b)(9) claim take the steps required to have the claim officially recognized in the case.

As a starting point, in many of the larger cases filed in New York, Delaware and California, much of the heavy lifting is done for the trade vendor holding a 503(b)(9) claim. Due to the administrative costs associated with allowing numerous 503(b)(9) claims in larger cases, it has become common practice in those cases for the courts to enter orders establishing the steps that 503(b)(9) claimants must take to firmly establish their claims. These 503(b)(9) procedures, as they are often called, usually require the filing of a proof of claim form that is specially created by the debtor and approved by the court, which proof of claim must be filed by a date certain. Absent objection to the proof of claim, the 503(b)(9) claim is allowed under the 503(b)(9) procedures, and the holder of that 503(b)(9) claim does not need to do anything further to establish the claim.

The issue then becomes the establishment of a 503(b)(9) claim when there are no 503(b)(9) procedures in place. To analyze how a 503(b)(9) claim is established in the case when there are no procedures entered by the court to the contrary, Section 503(b)(9) itself is a good place to begin. Section 503(a) states that "[a]n entity may timely file a request for payment of an administrative expense ..." 503(b) goes on to state that "[a]fter notice and a hearing, there shall be allowed administrative expenses…" Read together, many practitioners have instructed clients that under 503, to assert a 503(b)(9) claim a trade vendor must file a motion requesting allowance. Since the 503(b)(9) claim is an administrative expense claim, as with all other administrative expense claims, the filing of a proof of claim is insufficient in having a 503(b)(9) claim allowed. Allowance is obtained through motion practice. One could be so brave as to say that this is still the counsel most trade vendors would receive on the issue of allowance of a 503(b)(9) claim.

One must take into account, however, a court ruling out of the Eastern District of Virginia. The court in the *In re Circuit City Stores, Inc.*[1] case took a more elaborate approach to this topic on the road to its dealing with a more involved topic. Although the crux of this case is temporary disallowance of a 503(b)(9) claim using 502(d) of the Bankruptcy Code due to an unreturned preferential payment, the *Circuit City* court goes through an analysis in how a 503(b)(9) claim is allowed, at least in the Eastern District of Virginia. The *Circuit City* court states that the 503(b)(9) claim is unlike virtually every other administrative expense claim in that it is a claim that accrues pre-petition. In fact, this is true. These claims are for goods delivered to the debtor within the 20 days preceding the petition date. Since 503(b)(9) claims are pre-petition claims, held the *Circuit City* court, 503(b)(9) claims must take a 3 pronged approach towards allowance.

As a first step, the *Circuit City* court requires that a normal proof of claim be filed by the bar date. This means that the 503(b)(9) claimant must file an Official Form B10 proof of claim with the court, or as instructed by any order entered in the case regarding the same, by a date fixed by the court. The *Circuit City*

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1. 426 B.R. 560 (E.D. VA 2010).

Creating "Preference -Proof" Supply Contracts for Unsecured Trade Creditors Selling Commodities and Similar Goods

Some of the biggest trade creditors in the largest bankruptcies in recent years (such as *Quebecor* and *NewPage*) have been suppliers of raw materials and similar goods. Many of those suppliers faced massive preference liability in connection with payments they received during the 90 days before the bankruptcy filings. This article considers whether, in future cases, such creditors could immunize themselves from preference liability by entering into contracts that can be classified as "forward contracts" under the Bankruptcy Code.[1]

A. 11 U.S.C. § 546(e) and the "Forward Contracts" Exemption from Preference Liability

Section 546(e) of the Bankruptcy Code protects certain payments made under "forward contracts" from recovery in preference actions. Most people think of a "forward contract" as a contract for the purchase or sale of a fixed quantity of commodities at a fixed price on some specified future date, usually through a commodity exchange like the Chicago Mercantile Exchange. However, the Bankruptcy Code has its own definition. Arguably, that definition covers all sorts of "ordinary" trade relationships. Thus, many creditors selling commodities or similar goods may be able to remodel their supply relationships by entering into "forward contracts" that could protect them from preference liability when their customers file bankruptcy.

Section 546(e) provides, in relevant part, as follows:

> [T]he trustee may not avoid a transfer that is a… <u>settlement payment</u>, as defined in section 101…of [the Bankruptcy Code] …or that is a transfer made by or to (or for the benefit of) a… forward contract merchant…in connection with a… <u>forward contract</u>, that is made before the commencement of the case, except under section 548(a)(1)(A) of [the Bankruptcy Code][.]

The underlined terms are central to the issue of whether a creditor may be able to bring itself within the protection of § 546(e). From the perspective of "ordinary" trade creditors, the breadth of those definitions received a favorable analysis in *In re MBS Mgmt. Servs.*, 690 F.3d 352 (5th Cir. 2012) ("*MBS*").

B. *In Re MBS Management Services* and the Expansion of § 546(e) to Cover "Ordinary" Commodity Supply Contracts

The *MBS* case began in bankruptcy court in New Orleans. After a trial, the judgment of the bankruptcy court was upheld by the district court and ultimately the Fifth Circuit Court of Appeals. Decisions of the Fifth Circuit are binding on bankruptcy courts in Texas, Louisiana, and Mississippi, but they are persuasive authority for bankruptcy courts nationwide.

The terms of the energy supply contract at issue in *MBS* are noteworthy because many trade creditors could adopt similar contract terms without materially altering their trade relationships. With respect to quantity, the contract required the creditor to "supply the full requirements" of electricity to the debtor, and the debtor was required to "receive and take its full electric requirements" from the creditor. *In re MBS Mgmt. Servs.*, 432 B.R. 570, 572 (Bankr. E.D. La. 2010). The price was calculated by multiplying the total amount of electricity used by a fixed price of $0.119 per kilowatt hour. The duration was twenty-four months. *Id.*

After *MBS* filed bankruptcy, the trustee sought to recover payments the creditor received during the 90 days before the bankruptcy filing in a preference action. In response, the creditor argued that the payments were protected under § 546(e). Summarizing the statute's requirements, the bankruptcy court observed that § 546(e) prohibits recovery of: (1) settlement payments; (2) made to a forward

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David Mannion, Esq.

1. THIS ARTICLE IS FOR INFORMATIONAL PURPOSES ONLY AND SHOULD NOT BE CONSTRUED AS LEGAL ADVICE WHICH HAS TO BE ADDRESSED TO PARTICULAR FACTS AND CIRCUMSTANCES INVOLVED IN ANY GIVEN SITUATION. TO THE EXTENT THIS ARTICLE MAY CONTAIN SUGGESTIONS, THEY WILL REQUIRE MODIFICATION TO SUIT A PARTICULAR TRANSACTION, JURISDICTION, OR SITUATION, AND CONSULTATION WITH AN ATTORNEY IS NECESSARY.

Delaware Views from the Bench — Structured Dismissals

Peter M. Sweeney, Esq.

"MANY BANKRUPTCIES ARE NOW USING STRUCTURED DISMISSALS AS THE DEBTOR'S EXIT STRATEGY"

On November 25, 2013, I attended the American Bankruptcy Institute's ("ABI") annual Delaware Views from the Bench and Bar Conference (the "Conference"). This year the speaker panels at the Conference discussed such topics as conducting bankruptcy appellate litigation, certain plan confirmation issues, the "Hot Topics" of 363 Sales, and issues involving Structured Dismissals. The focus of this article is on the topic of the various issues surrounding structured dismissals discussed at the Conference and found in the Conference's educational materials. In the current economic climate, many bankruptcies are now using structured dismissals as the debtor's exit strategy instead of confirming a liquidating plan or conversion of the case to a Chapter 7 liquidation.

Section 1112(b) of the Bankruptcy Code states, in pertinent part, that "the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, if the movant establishes cause." In a standard dismissal scenario, the debtor is dismissed out of bankruptcy and creditors are returned to the status quo that existed prior to the debtor filing for bankruptcy. If a debtor was in receivership prior to the bankruptcy, the receivership would be reinstated. Avoided transfers and avoided liens would also be reinstated and any property would revert to the debtors' ownership. Creditors would then be able to exercise all of their state law remedies against the debtor. A "Structured Dismissal" includes other provisions that would normally be found in a chapter 11 liquidating plan. These types of provisions include, but are not limited to, (i) procedures for reconciling and paying claims; (ii) allowing for recoveries to unsecured creditors; (ii) releases and exculpations for the debtors and other parties; and (iv) the bankruptcy court's retention of jurisdiction over certain items. Further, a structured dismissal order will normally preserve all prior orders of the Bankruptcy court, including, but not limited to, any 363 Sale Order instead of reverting to the pre-petition *status quo*.

Typically, Structured Dismissals are used by debtors after sale of all or substantially all of their assets under Section 363 of the Bankruptcy Code. After such a sale, if the debtor is left in one of three fact patterns, the debtor would then typically pursue a structured dismissal as its exit strategy from bankruptcy. First, if the proceeds from the 363 Sale were such that the estate is administratively insolvent or unable to fund a plan process, then the debtor may pursue the structured dismissal option. Second, a structured dismissal might be employed if the 363 Sale proceeds would allow for only a very small distribution to the class of unsecured creditors and conducting the plan process would significantly reduce or even risk eliminating any sale proceeds available for such a distribution. Third, a structured dismissal may also be pursued by a debtor when some of its assets remain to be administered after a 363 Sale process and an out-of-court workout has been agreed to by the creditors of the debtor or the creditors committee. The main factual basis the debtor needs to establish for the Court is that there are no meaningful assets remaining in the Debtor's bankruptcy estate for a meaningful distribution to creditors.

The proponents of utilizing Structured Dismissals as an exit strategy out of bankruptcy make compelling arguments for its use. Structured Dismissal proponents argue that utilizing this exit strategy preserve estate assets for distribution. First, a structured dismissal avoids the lengthy and costly plan confirmation process. Second, pursuing a structured dismissal eliminates the delay and costs associated with converting the case to Chapter 7 and paying the Chapter 7 Trustee and his or her professionals to get up to speed to administer the debtor's estate. Further, it eliminates the uncertainties of the Chapter 7 liquidation process. Third, a structured dismissal would streamline the claims resolution process through establishing the claims resolution procedures in the same mo-

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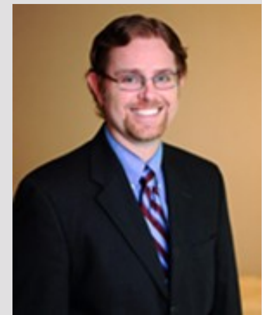
Utilizing the "Ordinary Course Of Business" Defense to Protect One-Off Transactions from Preference Exposure


Matthew W. Grimshaw, Esq.

Most vendors understand that the payments they receive during the 90 days before a debtor files bankruptcy can be recovered by the debtor's bankruptcy trustee in a preference action under 11 U.S.C. §547(b). When faced with a preference action, vendors often consider raising an "ordinary course of business." Because of the proof required, vendors occasionally believe that the defense only protects payments from long-standing customers. In reality, the defense is designed to protect a broad range of transactions, including first-time or one-off purchases.

A creditor asserting an ordinary course of business defense can prevail by showing that the payment (1) resulted from a debt incurred by the debtor in the ordinary course of business of the debtor and the creditor and (2) was made in the ordinary course of business of the debtor and the creditor.[1] Typically, a creditor establishes this defense by showing that the characteristics of the payments that it received from the debtor during the 90 day preference period are substantially similar to the characteristics of the payment that it received from the debtor prior to the preference period. In other words, the creditor shows that the timing of the payments that it received from the debtor, the method of payment by the debtor, and the like did not change significantly when the historic period is compared with the preference period.

By definition, the ordinary course of business defense is comparative in nature. Therefore, utilizing it to protect first-time or one-off transactions can be challenging because there is no baseline for comparison. But it can be done. A recent decision from the Bankruptcy Appellate Panel for the Tenth Circuit (the "BAP") helps explain how.

In *Rushton v. SMC Electrical Products, Inc. (In re C.W. Mining Co.)*,[2] the chapter 7 trustee filed a preference action against SMC Electrical Products, Inc. ("SMC") seeking to recover payments that it received from C.W. Mining Co. ("C.W. Mining"). Shortly before an involuntary bankruptcy petition was filed against it, C.W. Mining entered into a contract with SMC. Under this contract, SMC agreed to sell, install, and service a "longwall" electrical system that would allow C.W. Mining to improve the way in which it mined for coal and increase its production by four or five times. The purchase of the "longwall" system was the first transaction between C.W. Mining and SMC.

As was typical with "longwall" system purchases at the time, C.W. Mining's contract required that it make progress payments to SMC. When one of these payments came due, SMC issued an invoice to C.W. Mining for approximately $805,000. Over the next 28 days, C.W. Mining made five separate payments to SMC on this invoice. It was these five payments that the chapter 7 trustee sought to recover.

SMC argued that the payments were protected by the ordinary course of business defense, and the BAP agreed. In reaching its decision, the BAP employed a two-step approach. First, the BAP examined whether the debt was "incurred" in the ordinary course of C.W. Mining's business. Second, the BAP examined whether the payments were "ordinary" between SMC and C.W. Mining.

With respect to whether the debt was "incurred" in the ordinary course of business of C.W. Mining's business, the BAP had no trouble concluding that it was. The trustee argued that the debt was not "incurred" in the ordinary course of C.W. Mining's business. Before purchasing the "longwall" system, C.W. Mining employed a "continuous" mining system. It had never owned or operated a "longwall" mining system. The debt was "incurred" for the express purpose of drastically altering C.W. Mining's methodology. Therefore, according to the trustee, this purchase represented an "extraordinary" transaction, not an "ordinary" one.

The BAP disagreed, insisting that the trustee's

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"THE DEFENSE IS DESIGNED TO PROTECT A BROAD RANGE OF TRANSACTIONS, INCLUDING FIRST-TIME OR ONE-OFF PURCHASES"

1. 11 U.S.C. §547(C)(2).
2. 500 B.R. 635 (B.A.P. 10TH CIR. 2013).

Scott E. Blakeley, Esq.

“IF TWO CUSTOMERS DO NOT DIRECTLY COMPETE, THEN THE VENDOR DOES NOT VIOLATE RPA BY OFFERING A CUSTOMER MORE FAVORABLE PRICING AND TERMS”

The Antitrust Laws as a Vendor’s Response to a Customer’s Terms Pushback Strategy

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The RPA amended Section 2 of the Clayton Act and, among other things, makes it illegal for vendors to extend more favorable prices and/or terms to one customer without extending comparable prices and terms to all similarly-situated customers. The RPA has historically been applied to small vendors who grant discriminatory prices and terms to customers in hopes of receiving orders over larger competitors. The RPA bars discriminatory pricing and extended terms (as well as vendor concessions such as credits, rebates, promotional allowances and early pay discounts) amongst like, competing customers. If two customers meet the following factors, they may fall under the purview of the RPA’s like-customer evaluation:

(1) The customer’s functional level (Wholesaler? Retailer?);

(2) The type of product the customer purchases (i.e. grade and quality);

(3) The quantity of that product the customer purchases; and

(4) The geographic region in which the customer does business (the respective customer’s sales territories must overlap).

However, if two customers do not directly compete, then the vendor does not violate RPA by offering a customer more favorable pricing and terms.

How may the vendor use the RPA so they themselves push back from the customer’s TPS? If another customer occupies the same like-class of RPA factors above, the vendor may use the RPA to push back on the customer’s TPS. The credit team may respond to the customer’s TPS with: “We would like to accommodate extended terms, but the RPA prevents us. You are classed with customers who are granted normal terms.” The credit team’s response to the customer’s TPS attempts to bridge the gap of the customer’s strategy to improve its cash flow to the detriment of the vendor’s DSO. The vendor may underscore to the customer that, under the RPA, allowing a customer to set extended terms (or other vendor concessions) is no different than the vendor setting extended terms as to compliance with the like-class rule. The vendor does not have a catch-all defense to the RPA that the customer is dictating the terms of sale and therefore should be excluded from compliance with the like-class rule. Rather, the focus of compliance with the RPA’s like - customer rule is whether the customer received discriminatory pricing or terms; the rule applies regardless of which party set the terms or prices. The extended terms are still the terms of the trade relationship and if they differ from the terms extended to another similarly-situated customer, the vendor has discriminated in favor of the customer setting terms.

It should be noted that RPA restrictions may not be invoked by all vendors in the face of a TPS. The RPA only covers commodities—not services. For the purposes of RPA, the following are not considered commodities: real property, brokerage services, newspaper advertising, cable television, long distance and cellular telephone service. Likewise, the RPA only covers actual purchases; it does not cover price quotes or offers to sell. The sales in question must cross state lines in order to fall under the purview of RPA. Export sales are also outside the scope of the RPA.

Consider a different setting with evaluating RPA’s like-customer rule and TPS: the customer requests extended terms based on the vendor’s competitor offering more favorable terms. The customer is attempting to use the vendor’s competitor’s extended terms offer to force the vendor to concede like terms, or lose the business. In this setting, the vendor may have no choice but to concede the extended terms if it wishes to keep that customer’s business. The drafters of the RPA crafted the meet the competition concession because vendors often offer favorable terms in response to a

The Antitrust Laws as a Vendor's Response to a Customer's Terms Pushback Strategy

Scott E. Blakeley, Esq.

customer's threat to change vendors in an effort to obtain more favorable pricing or terms (as set forth above). Thus, discriminatory prices and terms are lawful provided the vendor is acting to meet the lower price or extended terms of its competitor. According to the Supreme Court, the meeting the competition exception balances the protectionist aspects of the RPA with the pro-competitive purposes of antitrust laws.

If the customer pushes back on price or terms in response to one of the vendor's competitors offering lower prices or extended terms, the customer may nullify the vendor's RPA - based argument against extended terms. Having said that, the vendor is under no legal obligation to meet the competition and can decline to provide extended terms, but risk losing the customer to a competitor. The credit team's best practice when faced with a customer's meet the competition demand is to have the customer pledge that they have received more favorable terms or pricing from a competitor. The customer's pledge should disclose the competitor's product(s) being purchased and the terms being offered. If the customer has a better offer from a competitor, then the customer should be willing to make the competition pledge. If the customer refuses to do so, it may be a red flag that the customer does not, in fact, have a competitor's better offer. If so, the vendor may then use the like-customer rule and advise that the RPA does not permit discriminatory pricing or terms. The RPA provides that the vendor meet a good faith requirement to justify meeting the competition. If the customer is unwilling to make the competition pledge, yet still insists the vendor make price and terms concessions, then it may be a questioned whether the vendor meets the good faith requirement of meeting the competition concession. If, on the other hand, the customer does make the competition pledge and the vendor decides to meet its competitor's terms, then the credit team keeps the pledge in its credit file to support the newly-extended terms.

Meet the Competition Pledge

Dear [*Vendor (your company)*],

This letter confirms that [*Competitor*] has offered us a sales arrangement which includes the following terms:

Product/Service involved:_______________

Terms of payment:____________________

Date of offer:__________________________

Quantity of product/service involved:

____

This information is provided to allow [*Vendor*] to meet the offer of [*Competitor*].

Sincerely,

[*Customer*]

Thanks to Credit Today Downloads; www.CreditToday.net

Scott Blakeley is a principal with Blakeley & Blakeley LLP, where he practices creditors' rights and bankruptcy. Scott's full article, *Customer Payment-Term-Pushback Strategy (Formal and One Offs): How Customers (Solvent and Otherwise) are Unilaterally Extending Credit Terms and the Credit Team's Response* , will be featured in the upcoming CRF's Credit and Financial Management Review. Also, Scott and Bob Schultz of Quote-to-Cash presented a webcast on this subject; the handout and powerpoint are available upon request (seb@blakeleyllp.com). Special thanks to CreditToday.net for providing the attached Meet the Competition template.

Bradley D. Blakeley, Esq.

United States Court of Appeals for the Third Circuit Holds that Postpetition Payments by Debtor do not Reduce Vendor's New Value Preference Defense

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with the threat in a chapter 11 case that they will lose such a defense if such new value is paid postpetition by the debtor.

Background

Roth Staffing Companies LP ("Roth Staffing") provided Friedman's Inc. ("Friedman's") temporary staffing services both prior to and after Friedman's filed for bankruptcy. In the 90 days prior to its bankruptcy filing (the "Preference Period"), Friedman's paid Roth Staffing $81,997.57 for temporary staffing services (the "Preferential Transfers"). After receiving the Preferential Transfers, but before the petition date, Roth Staffing provided additional temporary staffing services to Friedman's totaling $100,660.88. Friedman's did not pay Roth Staffing for these additional staffing services before it filed for bankruptcy.

In one of its first-day motions, Friedman's sought authority to pay its employees and independent contractors' pre-petition wages, compensation, and related benefits. The motion identified Roth Staffing as a critical vendor and requested authorization to pay Roth Staffing for the uncompensated, additional staffing services. Friedman's represented to the Bankruptcy court, inter alia, that if its employees and vendors were not compensated at least in part for the services that had been provided, there would likely be "an epidemic of Employee departures" and/or a "deterioration in morale." It argued that this would "substantially and adversely impact [its] businesses and result in immediate and irreparable harm to the creditors and estates" and that special treatment was necessary as a result. The bankruptcy court authorized the post-petition payment of Roth Staffing's pre-petition invoices and Friedman's paid $72,412.71 of the $100,660.88 it owed Roth Staffing (the "Critical Vendor Payment").

Friedman's filed an adversary action against Roth Staffing seeking to avoid and recover the Preferential Transfers. We argued on behalf of Roth Staffing that it was entitled to a complete subsequent new value defense under 11 U.S.C. § 547(c)(4) because Roth Staffing provided $100,660.88 of additional services after the Preferential Transfers that remained unpaid as of the petition date. Notwithstanding Friedman's cry that Roth Staffing was entitled to special treatment under the wage motion, Friedman's disagreed with the assessment, arguing that its Critical Vendor Payment reduced Roth Staffing's subsequent new value defense amount from $100,660.88 to $28,248.17, leaving $53,749.40 of net preference exposure.

Friedman's Liquidating Trust ("FLT") took over as the successor in interest to Friedman's and filed a motion for partial summary judgment. B&B asserted a complete new value defense on behalf of Roth Staffing. The bankruptcy court denied FLT's motion, holding that the filing of the bankruptcy petition fixes the preference analysis, and any action taken by a debtor post-petition neither affects the preference analysis nor reduces a trade vendor's available defenses.

> "FILING OF THE BANKRUPTCY PETITION FIXES THE PREFERENCE ANALYSIS"

FLT appealed the decision to the United States District Court for the District of Delaware, but the District Court affirmed the bankruptcy court's ruling also finding that new value is measured on the petition date. FLT also appealed that decision, which brought the case to the Third Circuit Court of Appeals.

The Friedman's Decision in Favor of the Vendor's Preference Defense

In its detailed analysis, the Court of Appeals considered B&B's argument of "contextual indicators" in the Bankruptcy Code, including:

- The fact that section 547 is titled "Preferences," suggesting that it concerns those transactions made during the Preference Period (i.e. 90 days before the bankruptcy filing);

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- The hypothetical liquidation test, which must be performed as of the petition date;
- The statute of limitations, which begins to run on the petition date;
- The improvement-in-position test, which includes the phrase" as of the date of the filing of the petition"; and
- The logical conclusion that if post-petition payments can affect the preference analysis, vendors must be entitled to assert new value defenses for post-petition extensions of new value, the latter of which has been rejected by numerous courts.

In essence, B&B asserted that many aspects of bankruptcy law, and preferences in particular, are based on the petition date. When section 547(c)(4)(B) is viewed in this proper context, its most plausible and natural interpretation is that it refers to pre-petition transfers.

The Court of Appeals also thoughtfully analyzed the policies behind section 547, including:

- Encouraging trade creditors to continue dealing with troubled businesses, such as critical vendors; and
- Equal distribution among similarly situated vendors, such as section 503(b)(9) claimants.

Ultimately, the Court of Appeals held that, contrary to the appellant's arguments, a vendor is not "double dipping" when it asserts a subsequent new value defense for pre-petition invoices paid by post-petition transfers. The vendor still replenished the debtor's estate during the preference period, and therefore aided the debtor in avoiding bankruptcy.

The Court of Appeals also rejected the Appellant's argument that policy behind section 547 requires all vendors must be treated equally. Instead, reasoned the court, "the Bankruptcy Code… carves out special treatment for creditors or claims of certain kinds." As examples, the Court of Appeals cited to critical vendors and section 503(b)(9) claimants, both of which can be given special treatment under the Bankruptcy Code.

It is important to note that the Third Circuit has previously allowed one important exception to the *Friedman's* position that the section 547 analysis should ignore post-petition facts. The Third Circuit, in *Kimmelman v. Port Authority of New York and New Jersey (In re Kiwi Air)*, held that where a debtor or trustee assumes an executory contract or unexpired lease under which a creditor may have received preferential payments, such assumption is a complete defense to the recovery of prepetition payments. There, section 365(b) of the Bankruptcy Code requires the debtor or trustee to cure defaults as a condition to assumption and therefore, such payments would have been made post-petition as part of the contract or lease assumption. Although the Appellant here used *Kiwi Air* to argue that the court must take into account all material post-petition events. However, the Court of Appeals disregarded this apparent conflict and noted that the facts and circumstances were unique to the *Kiwi Air* case.

What the Friedman's Decision Means for the Vendor's Credit Sales to the Cash Constrained Customer

Though Roth Staffing received payment through a first-day motion, the Friedman's decision should apply with equal force to all vendors who receive payment of pre-petition invoices after a bankruptcy case is filed and later attempt to use those same invoices as part of a new value defense to a preference action. When the preference analysis is fixed by the petition date, critical vendors,

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"A VENDOR IS NOT "DOUBLE DIPPING" WHEN IT ASSERTS A SUBSEQUENT NEW VALUE DEFENSE FOR PRE-PETITION INVOICES PAID BY POST-PETITION TRANSFERS"

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503(b)(9) claimants, and PACA claimants can accept court-approved, post-petition transfers without increasing their preference exposure. As credit professionals are keenly aware, the ability to claim critical vendor or 503(b)(9) new value can make all the difference when calculating preference exposure.

Debtors also benefit under the Friedman's decision as they require access to cash and/or trade credit to continue their operations in a chapter 11 case. One of the most popular ways to secure trade credit is to pay certain creditors' claims early, in exchange for credit terms equal, or better than, those provided to the debtor pre-petition. Claimants (whether critical vendors, 503(b)(9), PACA, etc.) may have their pre-petition invoices cured, partially or in-full, in return for extending credit terms equal to, or better than, those extended to the debtor pre-petition. The decision to become a critical vendor has to be made quickly and usually without consideration for whether a debtor, possibly two years in the future, may initiate an action against the trade vendor for return of alleged preferential transfers. If vendors can accept early payment of their pre-petition claims while still preserving their preference defenses, they have more incentive to extend post-petition credit terms to debtors.

The Friedman's decision out of the Third Circuit directly contradicts decisions from lower courts in other jurisdictions, and Friedman's may yet appeal to the United States Supreme Court. At present, the decision is binding in the Third Circuit courts (which includes Delaware, New Jersey and Pennsylvania) and persuasive in all other circuit, district and bankruptcy courts.

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tion as the dismissal. Also, the procedures and parameters for effectuating claim dispute settlements with unsecured creditors would be set forth in the same motion without the costs associated with obtaining approval of a liquidating plan.

Roberta A. DeAngelis is the U.S. Trustee for Region 3, encompassing Delaware, New Jersey and Pennsylvania. Ms. DeAngelis presented the Office of the U.S. Trustee's point of view regarding Structured Dismissals at the Conference. The U.S. Trustee's Office has filed objections to structured dismissal motions on the basis that structured dismissals violate the provisions of the Bankruptcy Code. The basis for one such objection is that structured dismissals effect impermissible *sub rosa* plans without establishing the statutory requirements for plan approval and without the Court vetting whether the "plan" meets the fair and equitable standards required for plan approval. *Sub Rosa* bankruptcy plans are secret or covert plans of reorganization or liquidation or de facto plans of reorganization or liquidation that have not been subject to the requirements of Chapter 11 for the confirmation of such plans. Opponents to structured dismissals argue that they are *sub rosa* plans as the structured dismissal orders perform the functions of a plan of liquidation without going through the plan approval process.

The plan approval process requires that all creditors be provided with a disclosure statement describing the terms of a plan of liquidation. Further, the Bankruptcy Code requires that creditors of all impaired classes of creditors vote for the acceptance of such a plan. Structured dis-

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missal opponents argue that since no disclosure statement is provided, creditors cannot make an informed decision regarding whether to oppose the structured dismissal motion. Further, the Bankruptcy Code requirements for voting and acceptance of a plan are not met with a structured dismissal. Additionally, under the Absolute Priority Rule, junior classes of creditors are not paid unless the senior classes with a higher priority are first paid in full. Often, Structured Dismissals include a payment or "gift" to the general unsecured class when other more senior classes of creditors have not been paid in full. Therefore, opponents of structured dismissals argue that such structured dismissals are in violation of the Absolute Priority Rule. Proponents of structured dismissals reply that the "gift" to unsecured creditors is actually not part of a debtor's bankruptcy estate, but is carved out of the secured creditor's collateral.

Another basis for objection by the U.S. Trustee's Office is the inclusion of releases and exculpation provisions in the structured dismissal order. First, without a disclosure statement, the U.S. Trustee's Office argues that a creditor does not have enough information to evaluate the release and exculpation provisions. Second, without the plan approval process required by the Bankruptcy Code, a creditor would not have the leverage to negotiate the language of the releases to obtain improved treatment. Third, the U.S. Trustee's Office contests that no statutory basis exists to grant releases and exculpations outside of the plan negotiation and approval process.

Despite the U.S. Trustee's Office filing objections to structured dismissal motions, Courts have frequently approved structured dismissals over such objections, especially where all major creditors and/or the creditors committee have joined in supporting the structured dismissal of the case. In such cases, the Court is requiring that all creditors receive notice of the structured dismissal motion and are provided with the opportunity to file an objection thereto.

The Honorable Kevin J. Carey, U.S. Bankruptcy Judge from the District of Delaware sat on the panel for this section of the Conference. The Delaware Bankruptcy Court has entered several structured dismissal orders over the last several years. As of yet, no reported decisions have been issued by the Delaware Bankruptcy Court regarding structured dismissals. The Court referred to structured dismissals as the "least worst option" due to the factual scenarios in the cases presented. Many of the cases in which structured dismissals were approved did not have the assets to move the case through a plan approval process. The only way to preserve any distribution for unsecured creditors was to utilize the structured dismissal option. The Court emphasized at the Conference that structured dismissal orders were entered on a case by case basis and that none of the structured dismissal orders were precedential in nature. Further, one of the major factors in granting a debtor's motion for structured dismissal was the consensus of all the major stake holders, including the secured creditor(s) and the major unsecured creditors and/or the creditors committee.

Generally, unsecured creditors and creditor committees have been in favor of structured dismissals when the assets in a debtor's estate are minimal and cannot fund a plan process. In such cases, structured dismissals eliminate the costly plan process and the delay and costs of conversion to Chapter 7. Structured dismissals may be the only way to preserve any of the debtor's assets for distribution to the class of general unsecured creditors. Blakeley & Blakeley LLP has represented creditor committees and individual creditors in cases were structured dismissals were used as the debtor's exit strategy. If you are a creditor and have been presented with a structured dismissal motion, our office is available to work through all of the pertinent issues with your team.

"COURTS HAVE FREQUENTLY APPROVED STRUCTURED DISMISSALS OVER SUCH OBJECTIONS, ESPECIALLY WHERE ALL MAJOR CREDITORS AND/OR THE CREDITORS COMMITTEE HAVE JOINED IN SUPPORTING THE STRUCTURED DISMISSAL OF THE CASE"

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contract merchant; (3) on a forward contract. 432 B.R., at 573. These requirements are considered in Parts 1, 2, and 3 below. Since the definition of a "forward contract" incorporates several other statutory definitions, those additional definitions are considered in subparagraphs (i) to (iv) of Part 1.

(1). What Qualifies as a "Forward Contract" under Section 546(e)?

Ten years before the *MBS* case, the issue of whether an "ordinary" commodity supply contract could be a "forward contract" (so as to be immune from preference liability under § 546(e)) was addressed by the Fifth Circuit in *In re Olympic Natural Gas*, 294 F.3d 737 (5th Cir. 2002). In *Olympic* "[t]he Trustee contend[ed] that the transactions at issue…were not 'forward contracts,' but rather ordinary commodity contracts, which are exempted from the definition of 'forward contract[.]'" 294 F.3d, at 740. "In essence, the Trustee claim[ed] that the Bankruptcy Code divides the 'world of commerce in commodities' into three parts: (1) futures, or on - exchange financial instruments; (2) forwards, or off-exchange financial instruments; and (3) ordinary commodity contracts (*i.e.* contracts for the commercial supply of goods with a future delivery date)." *Id.*

The creditor, "on the other hand, argue[d] that § 101(25) [of the Bankruptcy Code]…simply reinforces the established practice of distinguishing off-exchange forward contracts from on-exchange futures, or 'commodities' contracts, and that no third category of 'ordinary commodity contracts' exists." *Id.* The Fifth Circuit agreed and held that "the transactions here fall within the scope of § 101(25)'s definition of forward contract." *Id.*, at 740-741.

Section 101(25) of the Bankruptcy Code defines "forward contracts" as follows:

> The term 'forward contract' means--(A) <u>a contract (other than a commodity contract, as defined in section 761</u> [11 USCS § 761]) <u>for the purchase, sale, or transfer of a commodity, as defined in section 761(8)</u> of this title [11 USCS § 761(8)], or any similar good, article, service, right, or interest which is presently or in the future becomes <u>the subject of dealing in the forward contract trade</u>, or product or byproduct thereof, <u>with a maturity date more than two days after the date the contract is entered into</u>[.]

Each of the four underlined phrases is addressed below, with a brief consideration of whether "ordinary" commodity supply contracts could come within their coverage.

(i). Contracts "other than a commodity contract, as defined in section 761."

At the summary judgment stage in *MBS*, the bankruptcy court observed that the "Trustee avers that in order for a contract to be a 'forward contract' it must be subject to the rules or regulations of a contract market or board of trade," and that is how "commodity contracts" are defined in § 761. *In re MBS Mgmt. Servs.*, 430 B.R. 750, 754-755 (Bankr. E.D. La. 2010). Rejecting this argument, the court held that "[a] plain reading of [§ 101(25)] establishes otherwise." *Id.*, at 755. Likewise, since most "ordinary" commodity supply contracts are not subject to the rules of a board of trade, vendors selling commodities should have no problem meeting this requirement of § 101(25).

(ii). Contracts "for the purchase, sale, or transfer of a commodity, as defined in section 761(8)."

Turning to the definition of a "commodity," at the summary judgment stage the *MBS* trustee argued "that electricity is not a commodity, but a 'good[,]'" and that, "[a]s such, the Contract [was] not a commodity contract, but a sale or supply contract." 430 B.R., at 753. However, the bankruptcy court held that the "Trustee

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fails to explain why a sale of goods or a commercial agreement is not a commodity contract[.]" *Id*. Instead, the court observed that "§ 761(8) incorporates the definition of 'commodity' as that provided in the Commodity Exchange Act ('the Act')." *Id*. Section 1a of the Act defines a commodity as follows:

> The term 'commodity' means wheat, cotton, rice, oats, barley, rye, flaxseed, grain sorghums, mill feeds, butter, eggs, Solanum Tuberosum (Irish potatoes), wool, wool tops, fats and oils (including lard, tallow, cottonseed oil, peanut oil, soybean oil, and all other fats and oils), cottonseed meal, cottonseed, peanuts, soybeans, soybean meal, livestock, livestock products, and frozen concentrated orange juice, and all other goods and articles, except onions as provided in section 13-1 of this title, and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in.
> *7 U.S.C. § 1a(4)*.

Even though "electricity" is not expressly listed as a commodity in 7 U.S.C. § 1a(4), the bankruptcy court observed that "[j]urisprudence under the Act consistently treats electricity as a commodity[.]" *Id.* Similarly, given the breadth of the definition, many goods sold by ordinary trade creditors may qualify as a "commodity." Moreover, the definition of a "forward contract" in § 101(25) extends beyond just commodities to "any similar good, article, service, right, or interest," and even any "product or byproduct thereof." As such, even certain finished goods arguably come within this element of the definition of a "forward contract."

(iii). Contracts that "are the subject of dealing in the forward contract trade."

Although it appears in several statutory definitions relevant to § 546(e), the term "forward contract trade" is not itself defined in the Bankruptcy Code. However, it seems reasonable to assume that anyone qualifying as a "forward contract merchant" should be deemed to be a participant in the "forward contract trade." As discussed below, § 101(26) defines a "forward contract merchant" as "an entity the business of which consists in whole or *in part* of entering into forward contracts…" (emphasis added). Thus, it is submitted that a creditor who qualifies as a "forward contract merchant" (*see*, Part 2, below) should not be excluded from § 546(e) protection simply because participating in the "forward contract trade" is an ancillary part of their business.

Notably, the *MBS* bankruptcy trustee argued at the summary judgment stage that § 546(e) "was not designed to protect ordinary supply or sale contracts for future commodities to end users but contracts traded between merchants for hedging or financial risk diversion." 430 B.R., at *755*. However, as the bankruptcy court observed, "even supply contracts have hedging or risk management attributes. By setting the price for electrical power, end users protect themselves against large fluctuations in price and stabilize their cost of power." 432 B.R., at *576 -577*. "As a result, [the] Trustee…refine[d] his position to admit that while the Contract contains hedging attributes, because those were not [the debtor's] primary goal, it is not a forward contract." 432 B.R., at *577*. Dismissing this "primary goal" requirement, the court held that the "[t]rustee's position was squarely rejected" in *Olympic*, *supra*.

"DISMISSING THIS "PRIMARY GOAL" REQUIREMENT, THE COURT HELD THAT THE "[T]RUSTEE'S POSITION WAS SQUARELY REJECTED" IN *OLYMPIC*, *SUPRA*.

In *Olympic* the Fifth Circuit held that "we see no reason to…distinguish between 'financial' forward contracts, and 'ordinary purchase and sale' forward contracts, when the statutory language makes no such distinction." *Olympic,* 294 F.3d, at *742*. This refusal to impose limitations on § 546(e) that are not contained in § 546(e) itself is central to the thesis that "ordinary" suppliers of commodities and similar goods may be able to avail

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themselves of the statute's protection. It is a basic rule of statutory interpretation that statutes should be construed in accordance with their plain meaning. Thus, if an ordinary supply contract can come within the statutory definitions, it should be irrelevant that it differs from what is conventionally considered to be "forward contract."

Looking to the plain language of § 546(e), the *MBS* bankruptcy court also rejected the trustee's argument that "the Contract is not a forward contract because it is not for a set quantity of power but instead requires [the creditor] to supply all power needed by [the debtor]." 432 B.R., at 574. The court held that "[n]othing in the Bankruptcy Code requires that a forward contract provide for the purchase of the commodity at a set price or quantity." *Id.*

On appeal, the Fifth Circuit agreed noting that "[t]his court has previously engaged in close statutory analysis of forward contracts." *MBS*, 690 F.3d, at 355 (*citing Olympic*, 294 F.3d, at 740-41). "As in *Olympic*, we rely on the statutory language alone, and the Trustee's proffered requirements of specific quantity and delivery date must fail. Neither the definition of a forward contract, 11 U.S.C. § 101(25), nor the exemption from preference recovery, Section 546(e), contain such limitations." 690 F.3d, at 356.

Notably, and of particular importance to "ordinary" trade creditors selling commodities and similar goods, the Fifth Circuit in *MBS* held that "[t]he Trustee's arguments reflect concerns expressed in various cases that payments debtors make on 'ordinary supply contracts' should not be protected from preference litigation." *Id.* However, "these concerns are immaterial when laid against the statutory text" which, as the *Olympic* court observed, makes no distinction "between 'financial' forward contracts, and 'ordinary purchase and sale' forward contracts[.]" *Ibid.* (*quoting Olympic*, 294 F.3d at 742.)

(iv). Contracts "with a maturity date more than two days after the date the contract is entered into."

The requirement of § 101(25) that to qualify as a "forward contract" the contract must have a maturity date more than two days after it was entered into could also be satisfied in many "ordinary" trade relationships. This issue was undisputed in *MBS* but other cases have taken an expansive view of the requirement. *See e.g., In re Renew Energy LLC*, 463 B.R. 475 (Bankr. W.D. Wis. 2011).

In *Renew Energy* the bankruptcy court observed that although there was no statutory definition of the term "maturity date," "a common sense (and usage) definition…is the date that all other obligations under the contract have been performed, and nothing else need be done except tender payment." 463 B.R., at 480. "Common usage in the context of forward contracts suggests that it refers to the date on which delivery has occurred and payment to 'settle' is due." 463 B.R., at 480 -481. The court also held that "[t]he word 'mature,' used in § 101(25)(A), suggests a single date and meant the 'due date for commencement of performance,' but Congress did not intend to restrict the number of times a forward contract can mature." *Id.* (*citing*, *In re Mirant Corp.*, 310 B.R. 548, 564 & n.26 (Bankr. N.D. Tex. 2004)).

Considering the contracts before it, the *Renew Energy* court found that two of the contracts "clearly fall under the definition of a forward contract in § 101(25)" because they were negotiated in February 2008, the deliveries took place in September, and the allegedly preferential transfers made in payment of the deliveries took place in November. 463 B.R., at 480.

By contrast, the court held that a third contract did not meet this requirement because "[i]t was negotiated on October 28, 2008. The first delivery date…was October 28, 2008. The last delivery date was October 30, 2008. By October 30, all obligations…were satisfied, except issuing the invoice and collecting the

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payment. This was a simple commodity purchase contract. It did not mature more than two days after it was entered into. It fails under the statutory definition and is not a forward contract for the purposes of § 546(e)." *Ibid.*

(2). Who Qualifies as a "Forward Contract Merchant" under section 546(e)?

Turning to the issue of who qualifies as a "forward contract merchant," the bankruptcy court in *MBS* noted that the creditor "is in the business of buying and selling electrical power. It does not produce any of the power it markets. Therefore, the Court concludes that [the creditor] is a forward contract merchant." 432 B.R., at 574. On appeal, the District Court held that "[t]he Bankruptcy Court correctly concluded that [the creditor] is a forward contract merchant based on evidence that '[the creditor] is in the business of buying and selling electrical power,' and '[i]t does not produce any of the power it markets.'" *Lightfoot v. MXEnergy, Inc.*, 2011 U.S. Dist. LEXIS 54546, at *7 (E.D. La. 2011). It is unclear whether the courts in *MBS* would have concluded that the creditor was a forward contract merchant even if it had produced the electricity itself. However, the statutory definition of a "forward contract merchant" states, in relevant part, that:

> The term 'forward contract merchant' means…an entity the business of which consists in whole or in part of entering into forward contracts as or with merchants in a commodity… or any similar good, article [or] service…which is presently or in the future becomes the subject of dealing in the forward contract trade. *See*, 11 U.S.C. § 101(26).

Based on the plain language of the statute, it would seem that any vendor whose business consists even "in part" of entering into forward contracts "as or with" a merchant of a commodity "or any similar good, article [or] service" is a "forward contract merchant" under § 101(26). It should not matter whether the vendor is also a producer of the goods.

As the Fifth Circuit in *MBS* acknowledged (690 F.3d, at 356), various cases involving § 546(e) suggest that ordinary supply contracts do not qualify for the statute's protection. Indeed, even in *MBS* the Fifth Circuit found support for its decision in expert testimony to the effect that, among other things, "[f]orward contract merchants create or manage commodity markets by providing a place for industry participants to buy or sell a commodity in advance of its actual production[.]" 690 F.3d, at 357. Most ordinary suppliers of commodities do not "create or manage commodity markets." However, the statutory definition in § 101(26) contains no such requirement and it is submitted that this language in *MBS* was *dicta*. It is also submitted that an objective reading of the plain language of § 101(26), without regard to possibly conflicting industry parlance, could and should bring many "ordinary" suppliers of commodities within the statute's definition of a "forward contract merchant."

> "IT SHOULD NOT MATTER WHETHER THE VENDOR IS ALSO A PRODUCER OF THE GOODS"

(3). What Constitutes a "Settlement Payment" under Section 546(e)?

Turning to the issue of whether an allegedly preferential transfer is a "settlement payment" so as to be protected from recovery under § 546(e), § 101(51A) of the Bankruptcy Code provides that:

> The term 'settlement payment' means…a preliminary settlement payment, a partial settlement payment, an interim settlement payment, a settlement payment on account, a final settlement payment, a net settlement payment, or any other similar payment commonly used in the forward contract trade.

As courts have noted, by defining the term "settlement payment" with reference to various *types* of settlement payments, the definition is

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somewhat circular. However, giving a clue as to the sort of payments that may qualify, the Fifth Circuit in *Olympic* observed that "[b]ecause the parties conducted numerous transactions each month…the Contract provided for a single net payment to be made in settlement of each month's trading." 294 F.3d, at 739. Concluding that the payments at issue were "settlement payments" under § 101(51A), the *Olympic* Court held that "the definition of 'settlement payment' in § 101(51A) encompasses payments made in settlement of forward contract transactions…" 294 F.3d, at 742.

Similarly, in *Renew Energy* the bankruptcy court was of the opinion that "[w]hile the statute's tautology does not provide defining characteristics, it is reasonably clear that a 'settlement payment' follows the maturity of a forward contract and consists of the consideration to settle (or complete all obligations under) that contract." 463 B.R., at 480 (*citing*, *In re Enron Creditors Recovery Corp.*, 422 B.R. 423, 440-41 (S.D.N.Y. 2009)). According to the *Renew Energy* court, "[u]se of the phrase 'settlement payment' rather than simply 'payment' suggests that the obligation arose under a forward contract rather than a simple commodity purchase contract." *Id.* "Therefore, we must determine whether the contracts at issue are forward contracts before concluding that the payments fulfilling them qualify as settlement payments under § 546(e) and § 101(51A)." *Ibid.*

Thus, it seems that once a contract can be classified as a "forward contract" under § 101(25), then payments made under the contract will be deemed to be "settlement payments" under § 101(51A). Notably, as far as "ordinary" suppliers of commodities are concerned, the *Olympic* Court rejected the trustee's argument that "in order to be exempt from avoidance, a 'settlement payment' must be made on a financial derivative contract, and be cleared or settled through a centralized system." 294 F.3d, at 742. Moreover, although not addressed in the foregoing cases, § 546(e) protects not only "settlement payments" but also any "transfer." As such, it appears that a "transfer" of money under a forward contract might be protected under § 546(e) even though it is not a "settlement payment" under § 101(51A).

III. Conclusion.

The Tenth Circuit Court of Appeals has observed that "[s]ection 546 was first enacted…to 'promote customer confidence in commodity markets generally' *via* 'the protection of commodity market stability.'" *Kaiser Steel Corp. v. Charles Schwab & Co.*, 913 F.2d 846, 848-849 (10th Cir. 1990) (*quoting*, S. Rep. No. 989, 95th Cong., 2d Sess. 8 (1978), reprinted in 1978 U.S. Code Cong. & Admin. News 5787, 5794). There is a valid argument that when, for example, a massive paper manufacturer like *Quebecor* or *NewPage* files bankruptcy and a trustee seeks to recover what may amount to tens of millions of dollars in preference actions from suppliers of commodities or similar goods, that could force those suppliers to raise prices with the potential of triggering further bankruptcies by other manufacturers or the suppliers themselves, thereby causing a destabilizing ripple effect throughout the commodities market.

Nevertheless, courts are generally not supposed to consider legislative history when they interpret statutes unless the statutory language is ambiguous. Thus, if a creditor successfully argues that the language of § 546(e) is unambiguous and can bring itself within the relevant statutory definitions, they should be entitled to the statute's protection. *Cf.*, *Peterson v. Somers Dublin Ltd.*, 729 F.3d 741, 749 (7th Cir. 2013) (considering the § 546(e) exception and observing that "[s]tatutes often are written more broadly than their genesis suggests. *** '[I]t is our obligation to interpret the [Bankruptcy] Code clearly and predictably using well established principles of statutory construction.' We apply the text – which both Houses of Congress approved and the President signed

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– not themes from a history that was neither passed by a majority of either House nor signed into law.") (*quoting*, *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065, 2073, 182 L. Ed. 2d 967 (2012)).

Case-law concerning the availability § 546(e) as a defense to preference actions is sparse. In *MBS* (decided in 2010) the bankruptcy court observed that "[f]ew cases have addressed the provisions called into question by this case[.]" 430 B.R., at 756. And of the cases that *have* been decided, it has been observed that "little has been gleaned to formulate any decisive standard to determine which transactions fall within the exemption." *QSI Holdings, Inc. v. Alford*, 382 B.R. 731 (W.D. Mich. 2007) *aff'd*, 571 F.3d 545 (6th Cir. 2009), *cert. den.* 558 U.S. 1148 (2010). Thus, the availability of § 546(e) as a preference defense for "ordinary" unsecured trade creditors selling commodities and similar goods is unpredictable, especially outside the Fifth Circuit. Still, at a minimum, adjusting trade relationships by entering into supply contracts that could qualify as "forward contracts" may give creditors additional leverage in defending preference actions.

Section 503(b)(9) Claimants May Need to Take an Extra Step in Asserting Their Claims

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court was clear that this must be done before the motion for allowance is filed and heard. Second, the claim must be allowed under 502 of the Bankruptcy Code, which could be an issue depending on where the case is pending, as this section of the Bankruptcy Code deals with, in part, temporary disallowance due to the existence of a preferential transfer. Lastly, the creditor must file a motion to have the claim allowed under 503 as discussed earlier. Absent the prior filing of the proof of claim, says the *Circuit City* court, one loses the right to a 503(b)(9) claim.

The *Circuit City* case illustrates the ever burgeoning nature of 503(b)(9). What seemed to be a well-established process for obtaining allowance of a 503(b)(9) claim, through the filing of a motion requesting the same, has been expanded, at least in the Eastern District of Virginia. Simply filing a motion is insufficient without also filing a proof of claim prior to the filing of the motion.

> "SIMPLY FILING A MOTION IS INSUFFICIENT WITHOUT ALSO FILING A PROOF OF CLAIM PRIOR TO THE FILING OF THE MOTION."

For the trade vendor and credit professional, the lesson to be learned from the *Circuit City* case on this topic is that there is simply no need to delay the filing of a proof of claim in a bankruptcy case. Even if one believes they simply have a 503(b)(9) claim, at least one court has said that filing a proof of claim is required anyhow. So, to the extent there are not 503(b)(9) procedures, the *Circuit City* case instructs the trade vendor to file a proof of claim straight away, and then file a motion for allowance. Failure to file the proof of claim, even if one is listed on the schedules of the debtor, could result in a loss of the 503(b)(9) claim, and in the worst case, the entire claim.

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Utilizing the "Ordinary Course Of Business" Defense to Protect One-Off Transactions from Preference Exposure

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arguments demonstrated a misunderstanding of when a debt is "incurred" in the ordinary course of business. The inquiry does not focus on whether the debtor routinely engages in the type of transaction at issue. Rather, the inquiry focuses on whether the debt arose from a normal, arm's-length transaction. According to the BAP, C.W. Mining's primary business purpose was to mine coal, and the "longwall" purchase furthered that purpose. SMC showed that other companies in their industry engaged in similar transactions, and that the terms of the transaction between SMC and C.W. Mining comported with industry standards.

Similarly, the BAP concluded that the payments were made in the ordinary course of business between SMC and C.W. Mining. The trustee argued that the payments were not "ordinary" for numerous reasons. First, the parties had never done business together before the transaction at issue. Second, the five payments were made by three different entities, and each payment came from a different bank account. Third, the payments did not correspond to invoice amounts or to the progress payment schedule. Finally, the five payment payments were made just days before a $24 million dollar judgment was entered against C.W. Mining.

In deciding that the payments were "ordinary," the BAP considered four separate factors: (1) the amount of time involved in the preference period transaction, (2) whether the amount or form of payment differed from prior practices, (3) whether the creditor employed unusual collection activities, and (4) the circumstances surrounding the payment. The second and third factors were particularly important in the court's analysis. The undisputed facts showed that the amount and form of C.W. Mining's payments were substantially similar to the amount and form of the payments made by SMC's other customers. The payments were "progress payments" that comported with industry norms. SMC showed that its customers often made multiple payments on a single invoice. SMC also showed that it often received payments from entities affiliated with its customers. Further, SMC had neither solicited the payments nor undertaken any coercive collection efforts to obtain them.

Unfortunately, the BAP's decision is not a silver bullet that would allow vendors to protect every payment they receive from preference exposure. It does, however, highlight the breadth of the "ordinary course of business" defense and provide guidance to vendors attempting to use that defense to protect the payments they received in a first-time or one-off transaction. In such a situation, a vendor can defeat a bankruptcy trustee's preference claims by showing that the characteristics of the payments that it received from the debtor comport with the characteristics of payments commonly received from similarly situated parties in the vendor's industry.

"THE BAP'S DECISION IS NOT A SILVER BULLET THAT WOULD ALLOW VENDORS TO PROTECT EVERY PAYMENT THEY RECEIVE FROM PREFERENCE EXPOSURE