

UNITED STATES BANKRUPTCY APPELLATE PANEL
OF THE FIRST CIRCUIT

In re:	*	
	*	
HEALTHCO INTERNATIONAL, INC.	*	BAP No. 96-026
Debtor	*	
-----	*	
	*	
WILLIAM A. BRANDT, JR., TRUSTEE	*	Case No. 93-41604JFQ
Appellant	*	ADV. No. 95-4151
	*	
v.	*	
	*	
REPCO PRINTERS & LITHOGRAPHICS, INC.	*	
Appellee	*	
-----	*	

APPEAL FROM THE UNITED STATES BANKRUPTCY COURT
DISTRICT OF MASSACHUSETTS

(Hon. James F. Queenan, United States Bankruptcy Judge)

BEFORE

VOTOLATO, LAMOUTTE, and deJESUS
U.S. Bankruptcy Judges

Daniel C. Cohn, Esq., Attorney for Appellant
Duane L. Coleman, Esq., Attorney for Appellee

May 2, 1997

PER CURIAM.

The trustee of the Chapter 7 Debtor, Healthco International, Inc., ("Healthco") appeals from an order of the Bankruptcy Court of the District of Massachusetts dismissing his 11 U.S.C. § 547 complaint to recover an allegedly preferential transfer. The Bankruptcy Court had ruled that "the transfer in question (\$235,558)¹ to Repco Printers & Lithographics, Inc., ("Repco") was a payment in the ordinary course of business and therefore not preferential." Pursuant to 28 U.S.C. § 158(b), the parties have elected to have this appeal heard by the Bankruptcy Appellate Panel, so jurisdiction is not an issue. For the reasons stated below, the decision of the Bankruptcy Court is reversed.

I
BACKGROUND

On June 9, 1993, Healthco filed a petition under Chapter 11 of the Bankruptcy Code, and on September 1, 1993, the case was converted to Chapter 7. On October 29, 1993, after an election pursuant to 11 U.S.C. § 702(b), William A. Brandt, Jr. was appointed Chapter 7 trustee, and on June 8, 1995, he filed the

¹ The parties agree that \$31,977.38 of this payment was for new value provided to the Debtor by Repco subsequent to the alleged preference, and therefore is not recoverable.

instant complaint against Repco to recover a payment made within ninety days preceding Healthco's bankruptcy filing.

FACTS²

Repco, the Defendant/Appellee, is a commercial printer doing business in St. Louis, Missouri, and in August 1992, Fred J. Zaegel, Repco's president, was contacted by James Mills to handle Healthco's printing needs. Mills and Zaegel had previously worked together through other companies with which Mills was affiliated. From August 1992 through June 1993, Repco did all of Healthco's commercial printing, ranging from business cards to its extensive quarterly catalogs displaying Healthco's line of dental supplies and equipment.

Repco's invoices call for payment within ten days of receipt; however, none of Repco's customers paid according to the invoice terms. Typically, they would pay approximately sixty days after the date of invoice and that is the history of this account during the pre-preference period. The parties agree that due to the highly competitive nature of the printing business, a sixty day payment practice is standard in the industry.

² The following uncontested facts are derived from the pretrial stipulation and exhibits. See Record on Appeal, pp. 212-538.

Repco's collection techniques may be described as "low key," and typically are employed only when its operating cash flow is really down. Said practice, when initiated, would be implemented as follows: Repco would review its accounts receivable to determine which invoices were approaching sixty days, and those customers would be called to remind them that a group of invoices were approximately sixty days old and "are now payable." Usually, the first phone call resulted in payment. During the ten month relationship with Healthco, Zaegel called Healthco's treasurer, Arthur Souza, on four occasions to remind him that a group of Repco's invoices were approaching sixty days, and Souza usually sent the payment shortly after the phone call.

In late March 1993, Zaegel attempted, unsuccessfully, to call Souza to remind him that numerous invoices had reached sixty days old. During that time period, Healthco's payments were more delayed than in the past, "particularly considering the amounts involved." (See Record at 228, p. 47, line 13.) After several failed attempts to reach Souza, Zaegel took the unusual step of going directly to Healthco's Chief Financial Officer, James Moyle, to discuss the outstanding invoices. This was the first time Repco was ever in direct contact with Moyle regarding delinquent payment, and it is stipulated that Zaegel did not "pressure" Moyle, but used the same unobtrusive techniques utilized with Mr. Souza on previous

occasions. After his discussion with Zaegel, Moyle asked Souza what Repco was owed, and inquired "what was the fastest way to get Repco paid." Less than two weeks later, Repco received a wire transfer from Healthco in the amount of \$235,558.64. This payment, for the first time in the business history of these two entities, covered all outstanding invoices, leaving a zero balance. (See Record, at 230.) This was also the first time in the parties' dealings that Healthco paid by wire transfer. (See Record, at 229.) In this single payment Healthco satisfied 68 Repco invoices that ranged in age from 0 to 200 days old. (See Record, at 332-334.) During the pre-preference period, Healthco made 18 payments to Repco, paying 118 invoices ranging from 9 to 180 days old. (See Record, at 328-331.)

During the ninety day preference period, there were several payments by wire transfer, mostly to professionals assisting in Healthco's turn-around effort. Only three wire transfers were to nonprofessional creditors, including the questioned payment to Repco. Of those three payments, two have been returned to the Trustee as preferential. (See Record, at 338-349.)

II DISCUSSION

This dispute was submitted to the bankruptcy court on a stipulated record which included thirteen exhibits, and on July 17,

1996, the court issued an opinion and an order which states, in its entirety, that:

A trial was scheduled in this matter for May 1, 1996. However, the parties filed a motion to submit the matter on stipulated facts and exhibits, which was granted on April 30, 1996.

In consideration of said facts and exhibits, the complaint is dismissed by virtue of the ordinary course of business defense. A separate order will issue.

Opinion, July 17, 1996, *Record* at 534-35. The Order issued on the same date states: "The court having today issued a separate opinion in this matter, in accordance therewith, it is ORDERED that the complaint is dismissed." Order, July 17, 1996, *Record* at 536.

STANDARD OF REVIEW

Because no factual dispute exists in the instant case, the bankruptcy court's rulings are reviewed *de novo*. See *U.S. v. Yoffe*, 775 F.2d 447, 451 (1st Cir. 1985); *Auburn Police Union v. Carpenter*, 8 F.3d 886, 892-93 (1st Cir. 1993), *cert. denied*, 511 U.S. 1069 (1994); *Brewer v. Madigan*, 945 F.2d 449, 452 (1st Cir. 1991).

DISCUSSION

The parties do not disagree as to the requisite elements of a preference under Section 547(b).³ Rather, the sole issue at bench

³ This Section provides:

(b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property--

is whether the \$235,558.64 wire transfer to Repco was a payment made in the ordinary course of business pursuant to 11 U.S.C. 547(c)(2), and therefore not subject to recovery by the Chapter 7 trustee. Section 547(c)(2) states that:

(c) The trustee may not avoid under this section a transfer--

...

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

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

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

(C) made according to ordinary business terms.

-
- (1) to or for the benefit of a creditor;
 - (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
 - (3) made while the debtor was insolvent;
 - (4) made--
 - (A) on or within 90 days before the date of the filing of the petition;
 - or
 - (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
 - (5) that enables such creditor to receive more than such creditor would receive if--
 - (A) the case were a case under chapter 7 of this title;
 - (B) the transfer had not been made; and
 - (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. 547(b).

11 U.S.C. 547(c)(2). This exception to the trustee's ability to recover preferential payments was created "to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy." H.R. Rep. No. 595, 95th Cong., 1st Sess. 373 (1977), reprinted in 1978 U.S.C.C.A.N 5787, 5963, 6329; see also *First Software Corp. v. Curtis Mfg. Co. (In re First Software Corp.)*, 81 B.R. 211, 212 (Bankr. D. Mass. 1988).

The Section 541(c)(1) and (2) exceptions further the goal of enabling debtors to rehabilitate themselves by insulating normal business transactions from the trustee's avoidance power. Without these exceptions creditors would be reluctant to conduct business with a struggling enterprise for fear that any payments made by the debtor could later be avoided.

O'Neill v. Nestle Libbys P.R., Inc., 729 F.2d 35, 37 (1st Cir. 1984). The creditor has the burden to establish the ordinary course of business defense, by a preponderance of the evidence. 11 U.S.C. § 547(g); See *WJM, Inc. v. Massachusetts Dept. of Public Welfare*, 840 F.2d 996, 1010 (1st Cir. 1988); *Garb v. Atlandia Imports, Inc. (In re Narragansett Clothing Co.)*, 146 B.R. 609, 611 (Bankr. D.R.I. 1992); *First Software Corp.*, 81 B.R. at 212.

Although the Bankruptcy Code does not define "ordinary course of business," the term has been interpreted and circumscribed by the case law. To come within the ordinary course of business

exception, the creditor must show: (1) that the debt was incurred in the ordinary course of business between the debtor and the particular creditor; (2) that the payment from the debtor to the creditor was ordinary in relation to past practices between the debtor and the particular creditor; and (3) that the payment was ordinary according to prevailing business standards. *Mordy v. Chemcarb, Inc. (In re Food Catering & Housing, Inc.)*, 971 F.2d 396, 398 (9th Cir. 1992); see also *WJM, Inc.*, 840 F.2d at 1010-11; *Narragansett Clothing*, 146 B.R. at 611; *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1031-33 (7th Cir. 1993); *Logan v. Basic Dist. Corp. (In re Fred Hawes Org., Inc.)*, 957 F.2d 239, 243-45 (6th Cir. 1992). To establish the ordinary course defense it is necessary to prove each element. *WJM, Inc.*, 840 F.2d at 1011. "[T]he Code's failure to define the term makes each determination a peculiarly factual one," *First Software Corp.*, 81 B.R. at 213, and "[t]he factors the Court should consider to determine whether a transferee has established the requirements of Section 547(c)(2) include: 1) the prior course of dealing between the parties; 2) the amount of the payments; 3) the timing of the payments; and 4) the circumstances surrounding the payments." *Id*; see also *Fred Hawes*, 957 F.3d at 244.

In the instant case the parties stipulate that "[t]he invoices paid with the alleged preference were for printing services and

product incurred in the ordinary course of Healthco's business," thereby satisfying the first element under Section 547(c)(2)(A). (Record, at 215, ¶17.) Repco argues that the second part of Section 547(c)(2)(B) is also satisfied, i.e., that during the pre-preference period, a clear course of dealing developed between the parties, showing that Healthco paid Repco's invoices, on average, 62.3 days after the invoice date. The invoices paid by Healthco via the wire transfer were aged, on average, 59.5 days. Finally, Repco argues that it has satisfied the third element of the ordinary course of business defense under Section 547(c)(2)(C) because, according to the Stipulated Facts,⁴ Healthco's average payment of 59.5 days during the preference period compares favorably with the industry standard of sixty days.

In support, Repco cites *Branch v. Ropes & Gray (In re Bank of New England Corp.)*, 161 B.R. 557 (Bankr. D. Mass 1993), where the debtor made ten payments to its lawyers, totaling \$614,889.08, during the preference period. The court compared the way the debtor paid the Ropes & Gray invoices during the pre-preference period and found that the 54.7 day average during the preference period did not significantly differ from the 38.4 day pre-preference average. The court noted that during the preference period

⁴ See Record at 213, ¶ 6.

the debtor remained consistent with its general goal of paying Ropes & Gray invoices within 30-60 days. *Id.* at 560-61. It appears from the Bankruptcy Court opinion that the only factor considered by the court in *Branch* was the "average" time of the payments. As the trustee correctly points out in this case, however, there are a number of factors, in addition to average time, that are also relevant, and indeed necessary to consider, to do a meaningful analysis in these cases.

If timing/averaging could be considered in isolation, Repco's argument would be more persuasive, but looking beyond just mathematical "averages," and by examining the payments individually, a significant difference in payment behavior between the pre-preference and the preference period is revealed. Prior to the transfer in question, almost ninety percent of Repco's invoices were paid between 30 to 90 days, while only fifty-one percent of the invoices paid by the wire transfer fell within 30 to 90 days. Also of significance, according to Mr. Zaegel, shortly prior to the transfer Healthco was "more delinquent than it had been in the past." (See Record, at 228, ¶ 47, line 13.) Indeed, the extremes in the dates of the payments in this case skew "averages" to the point that they are irrelevant and misleading.

When one combines the timing of the questioned payment with all of the other relevant factors, we are unable to agree with the

Bankruptcy Judge's conclusion that the wire transfer was "ordinary," vis-a-vis the prior conduct of the parties. In addition, we are mindful of these additional factors: (1) this was by far the largest payment made by Healthco to Repco during their ten month relationship. The only other payment that comes close, in magnitude, to the questioned transfer was one totaling \$172,690.72, on December 28, 1992. All other payments were in amounts less than 26% of the payment in question; (2) this was the first time in the parties' business history that invoices were paid by wire transfer rather than by check; (3) this was the first time in the parties' history that Repco's president dealt directly with Healthco's Chief Financial Officer James Moyle regarding payment; (4) this was the first time in the parties' history that Healthco paid the entire outstanding balance due Repco.⁵

Although not specifically articulated in his opinion, it is implicit therein that the Bankruptcy Judge felt that the similarity in average age of the invoices paid by Healthco during the preference period was dispositive of the issue. Such a conclusion

⁵ Repco disputes this contention on the ground that it was providing pre-press services on Healthco's quarterly catalog at the time of the transfer; however, it is clear that Healthco could not pay for services that Repco was in the process of performing and had not yet even billed to Healthco. In light of Repco's hypersensitivity on this issue, it would be more accurate to say that this is the first time Healthco paid all *known, outstanding* invoices due Repco.

overlooks many of the stipulated facts, as well as the other factors enunciated in *First Software Corp. supra*. Based on the totality of the undisputed circumstances, we feel constrained to find and conclude that the payment in question was not made in the ordinary course of business between Healthco and Repco.⁶ Accordingly, we rule that the \$235,558⁷ payment is preferential, and subject to recovery by the Trustee under Section 547.

⁶ In footnote 7 of its brief Repco argues in the alternative that the Court, while ruling that the wire transfer is a preference, could also find by examining the individual invoice dates that a portion of the payment was not preferential, thereby splitting the payment as to preference and non-preference parts. In support of this argument, Repco cites *In re Miner Indus., Inc.*, 119 B.R. 6, 9 (Bankr. D.R.I. 1990). In *Miner* the only factor at issue was the timing of the alleged preference. The Court stated that "[t]he record also shows Narragansett did not prompt or induce the December 14, 1987 payment, but that it was received by regular mail, and was made, as usual, by an uncertified business check." *Id.* The many additional factors present in this case take Healthco's payment outside of the ordinary course, and because of that, *Miner* is not applicable here.

⁷ Less \$31,977.38 stipulated by the parties to be new value.