oy, with the increase in bankruptcy filings starting in the middle of 2007 and accelerating in 2008 and 2009, preferences are not going away, and continue to be a source of aggravation for trade creditors. Many pundits predicted that the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”) would limit small preference actions for recovery of less than $10,000 ($10,950 in bankruptcy cases filed on and after April 1, 2007) because they must be commenced only in the creditor’s home jurisdiction, which is not necessarily the debtor’s home bankruptcy court. This change was supposed to make trustees think twice before pursuing small preference claims because of the risk that they might lose their home bankruptcy court advantage and be forced to litigate in a far less friendly court where the creditor is located.

Unfortunately, this protection might not be available to preference defendants after all because of the way the bankruptcy venue statute is drafted. The United States Bankruptcy Court for the Western District of Michigan, in In re Rosenberger, recently ruled that the venue limitation does not apply to small preference actions. What should we make of this decision? Is the Court improp-erly disregarding the applicability of BAPCPA’s venue limitation to small preference actions? Or did Congress simply mess up in drafting the venue limitation for small preference actions to make the Rosenberger decision inevitable?

Well folks, the news on the preference case law front is not all bad! The United States Bankruptcy Court for the Western District of Arkansas, in In re Meyer’s Bakeries, Inc., dismissed the trustee’s preference action, following a trial where the trade creditor/preference defendant proved the applicability of the Section 547(c)(2) ordinary course of business defense. This decision is interesting because the Court analyzed both the subjective, ordinary between the debtor and creditor, and objective, ordinary business terms/industry, prongs of the ordinary course of business defense.

So folks, let’s explore some interesting case law and statutory interpretation!

The Elements of a Preference Claim
Under Section 547(b) of the Bankruptcy Code, a trustee can recover a preference by satisfying all of the following:

(a) The debtor transferred its property, such as making a payment, to or for the benefit of a creditor (Section 547(b)(1)).

(b) The transfer was made on account of antecedent or existing indebtedness that the debtor owed the creditor (Section 547(b)(2));

(c) The transfer was made when the debtor was insolvent (Section 547(b)(3)). A balance sheet definition of insolvency, liabilities exceeding assets, is used. The statute also makes it easier for a trustee to prove a preference by creating a presumption of the debtor’s insolvency within the 90-day preference period; and

When a debtor or trustee satisfies all of the preference requirements, the burden shifts to the preference defendant to reduce or eliminate preference exposure.
(d) The transfer was made within 90 days of the debtor’s bankruptcy filing, in the case of transfers to non-insider creditors, and within one year of bankruptcy for transfers to insiders of the debtor, such as the debtor’s officers, directors, controlling shareholders and affiliated companies (Section 547(b)(4)); and

(e) The transfer enabled the creditor to receive more than the creditor would have recovered in a Chapter 7 liquidation of the debtor (Section 547(b)(5)). This requirement is always satisfied unless the debtor’s unsecured creditors receive full payment of their claims.

The Ordinary Course of Business Defense to Preference Claims

When a debtor or trustee satisfies all of the preference requirements, the burden shifts to the preference defendant to reduce or eliminate preference exposure by satisfying one or more of the preference defenses contained in Section 547(c) of the Bankruptcy Code. These defenses are intended to encourage creditors to continue doing business with, and extending credit to, financially distressed customers.

The Section 547(c)(2) ordinary course of business defense is one of the more frequently invoked preference defenses. The BAPCPA amended the ordinary course defense to make it easier to prove. The pre-BAPCPA version of Section 547(c)(2) applies to bankruptcy cases filed prior to the BAPCPA’s October 17, 2005 effective date. That is the applicable law in Meyer’s Bakeries, which was commenced prior to October 17, 2005. A transfer (A) in payment of indebtedness incurred by a debtor in the ordinary course of business or financial affairs of the debtor and the creditor; (B) made in the ordinary course of business or financial affairs of the debtor and the creditor; and (C) made according to ordinary business terms satisfies the pre-BAPCPA ordinary course defense. The first requirement, the incurrence of debt in the ordinary course of business of the debtor and creditor, is straightforward and frequently satisfied by the creditor’s extension of trade credit to the debtor. The second requirement, payment in the ordinary course of business of the debtor and creditor, is subjective in nature, requiring proof of some consistency between the alleged preference payment and the debtor’s and creditor’s payment history and other aspects of the parties’ relationship. The third requirement, payment according to ordinary business terms, is objective, requiring proof of consistency between the alleged preference and the payment practices and range of terms in the creditor’s industry, the debtor’s industry, or some subset of either or both.

The BAPCPA version of Section 547(c)(2), which applies to bankruptcy cases filed on and after October 17, 2005, retains the requirement that the indebtedness paid by the alleged preference was incurred in the ordinary course of business or financial affairs of the debtor and creditor. However, Section 547(c)(2) is now easier to prove because a creditor defending a preference action can prove either the subjective or objective portion of the defense, depending on which is supported by the facts of the case. For example, a creditor’s tightening of credit terms (such as from net 30 to net 7 days) would have made it virtually impossible to satisfy the pre-BAPCPA version of the Section 547(c)(2) ordinary course of business
defense, because of the creditor’s inability to satisfy the subjective element of the defense. However, tightened terms that fall within the broad range of terms in the relevant industry might now satisfy the objective part of the defense and, therefore, allow the creditor to escape preference exposure.

**In re Rosenberger**
The debtor, Bob William Rosenberger, filed a Chapter 7 case in the United States Bankruptcy Court for the Western District of Michigan on November 9, 2006. On November 5, 2007, the Chapter 7 trustee for the Debtor’s bankruptcy estate filed a lawsuit against Bank of America N.A. (the “Bank”). The trustee sought to avoid and recover the debtor’s payment of $5,576.31 to the Bank as a preference. The Bank moved to dismiss the trustee’s preference complaint based upon improper venue.

The Bank argued that the Delaware United States District Court, not the bankruptcy court where the debtor’s case is pending (the “debtor’s home court”), was the proper venue for the preference action because the trustee had sought recovery of a small preference claim for less than $10,950. Any such small preference action had to be brought in the district court where the Bank resides, which the Bank contended was in Delaware, the location of the Bank’s main office.

**The Bankruptcy Code’s Venue Provision**
The Bankruptcy Code’s venue provisions are contained in 28 U.S.C. §1409. Section 1409(a) states that the debtor’s home court is the proper venue for proceedings that: (a) arise under the Bankruptcy Code; (b) arise in a case under the Bankruptcy Code; and (c) relate to a case under the Bankruptcy Code.

Section 1409(b) identifies those matters over which the debtor’s home court does not have proper venue. These include proceedings arising in or related to a pending bankruptcy case where the trustee seeks to recover a money judgment of, or property worth less than, $10,000 ($10,950 in cases filed on or after April 1, 2007). According to Section 1409(b), these small claims can be brought in only the creditor’s home court; specifically the district court for the district in which the creditor “resides,” which may not necessarily be the debtor’s home court.

The issue in the Rosenberger case is whether Section 1409(b)’s venue limitation applies to small preference actions. The bankruptcy court had to analyze whether a preference action “arises in or relates to” a bankruptcy case, as required by Section 1409(b), or whether Section 1409(b) also applies to proceedings “arising under the Bankruptcy Code,” despite the fact that Section 1409(b) omits such proceedings.

The trustee argued that Section 1409(b)’s venue limit does not apply to small preference actions because preference actions arise under the Bankruptcy Code, and Section 1409(b) does not apply to these types of proceedings. The Bank countered that Section 1409(b)’s venue limitation should also apply to small preference actions because that is what Congress had intended. As a fallback, the Bank argued that the trustee’s small preference action “arises in” a bankruptcy case and, therefore, is within the scope of Section 1409(b)’s venue limit.

Well, who is correct here? Does Section 1409(b)’s venue limitation provision apply to small preference actions, where the amount sought is less than $10,000 ($10,950 in cases filed on and after April 1, 2007), to require their litigation in the creditor’s home court rather than the debtor’s home court? Or is Section 1409(b)’s venue limitation not applicable to small preference actions because they are omitted from the category of proceedings subject to this provision?

**Section 1409(b)’s Venue Limitation Does Not Apply to Small Preference Actions**
The bankruptcy court denied the Bank’s motion to dismiss the preference action for improper venue. The court held that Section 1409(b)’s venue limitation does not apply to small preference actions. The court relied on the language of Section 1409. First, Section 1409(a) states that the debtor’s home court is the proper venue for proceedings arising under the Bankruptcy Code, arising in a case under the Bankruptcy Code or related to a case under the Bankruptcy Code. However, Section 1409(b)’s venue limitation applies only in proceedings arising in or related to a case under the Bankruptcy Code where the amount at issue is below a specified threshold amount of $10,000 ($10,950 in cases filed on and after April 1, 2007).

The court noted that preference and other avoidance actions have been consistently treated as proceedings that “arise under the Bankruptcy Code.” As such, they are not subject to Section 1409(b)’s venue limitation because it applies only to proceedings arising in or related to a case under the Bankruptcy Code and not to proceedings arising under the Bankruptcy Code. A proceeding that involves a substantive bankruptcy right and has no existence outside of the Bankruptcy Code is one that arises under the Bankruptcy Code. The court concluded that preference and other avoidance claims are unique bankruptcy type claims that arise under the Bankruptcy Code and are, therefore, outside Section 1409(b)’s scope.

The court also concluded that Congress had deliberately omitted proceedings arising under the Bankruptcy Code from Section 1409(b)’s venue limitation provision. This reflected Congress’s intention that only bankruptcy courts can hear and determine substantive bankruptcy type claims, such as preference and other avoidance claims.

The court followed earlier court holdings, including pre-BAPCPA decisions, that had denied preference defendants’ motions to dismiss small preference actions commenced in the debtor’s home court based on improper venue. These include the United States Bankruptcy Court for the Northern District of Ohio’s 1987 decision in *In re Van Huffel Tube Corp.*, the United States Bankruptcy Court for the Northern District of New York’s 1996 decision in *In re Guilmette* and the recent United States Bankruptcy Court for the District of New Mex-
ico’s 2007 unreported decision in In re Nashmy. These courts, like the Rosenberger court, held that Section 1409(b)’s venue limitation provision omits and, therefore, does not apply to, small preference actions, because they “arise under the Bankruptcy Code.” Therefore, according to these holdings, the debtor’s home court remains the proper venue even for small preference and other avoidance actions!

However, the Ninth Circuit Bankruptcy Appellate Panel, in its 1993 decision in In re Little Lake Industries, Inc., and the North Dakota bankruptcy court, in its 1985 decision in In re Greiner, ruled that Section 1409(b)’s venue limitation provision applies to small preference actions. The Little Lake Industries court specifically ruled that preference claims “arise in” bankruptcy cases and are, therefore, covered by Section 1409(b). The court even declared that all proceedings arising under the Bankruptcy Code also arise in bankruptcy cases for purposes of Section 1409(b)’s venue limitation provision.

Interestingly, the Rosenberger court also held that the debtor’s home court had venue over the preference action against the Bank, because the Bank “resided” in that jurisdiction. The court relied on another venue provision, 28 U.S.C. §1391(c), which states that a corporation “resides” in any judicial district in which it is subject to personal jurisdiction at the time of the commencement of the lawsuit. A corporation is subject to personal jurisdiction in any district where the corporation regularly conducts business. The Bank was unquestionably subject to the personal jurisdiction of courts in the jurisdiction of the debtor’s home court, the Western District of Michigan, because the Bank had regularly conducted business there. As such, the Bank resided, and venue was proper, in the debtor’s home court.

The Meyer’s Bakeries Case
Defendant, Interstate Packaging Group, Inc. ("Interstate"), was a distributor of packaging materials and equipment. Interstate had sold packaging materials to the debtor, Meyer’s Bakeries, Inc. ("Meyer’s Bakeries") from 1985 until 1992 or 1993 and then again from 2003 until 2005. Meyer’s Bakeries’ purchases from Interstate included printed poly bags, stretch film, tapes, a type of film to cover an energy bar and polythene bags.

On February 6, 2005, prior to BAPCPA's effective date, Meyer’s Bakeries filed Chapter 11 with the United States Bankruptcy Court for the Western District of Arkansas. The 90-day preference period in the Meyer’s Bakeries case ran from November 8, 2004 through February 6, 2005. During the preference period, Meyer’s Bakeries made eight payments totaling $58,296.63 (the “alleged preferential payments”) to Interstate.

Prior to the preference period, from December 1, 2003 through November 7, 2004, Meyer’s Bakeries paid 38 invoices owing to Interstate on average 70.2 days after invoice date. During the preference period, Meyer’s Bakeries paid 16 invoices owing to Interstate on average 71.5 days after invoice date. Interstate has also otherwise consistently conducted business with Meyer’s Bakeries both prior to and during the preference period.

All of Interstate’s invoices contained the pre-printed term of “net 30 days.” However, Interstate’s customers generally did
Interstate had also frequently permitted its more profitable customers, like Meyer’s Bakeries, to take longer to pay their invoices. Meyer’s Bakeries had typically paid Interstate’s invoices within 60 to 80 days of invoice date. Meyer’s Bakeries had also frequently used a single check to pay multiple invoices owing to Interstate.

On March 23, 2006, Meyer’s Bakeries’ Chapter 11 case was converted to Chapter 7 and a Chapter 7 trustee was appointed. On July 18, 2007, the trustee filed a lawsuit against Interstate to recover the alleged preferential payments. Interstate answered the complaint, raising, among other defenses, the Section 547(c)(2) ordinary course of business defense. Since Meyer’s Bakeries had filed its Chapter 11 prior to BAPCPA’s effective date, Interstate had to satisfy the pre-BAPCPA version of the ordinary course of business defense. That required Interstate to prove, among other things, both the subjective, ordinary between the parties, and objective, ordinary business terms/industry, prongs of the ordinary course defense.

The bankruptcy court ended up dismissing the preference complaint because Interstate had satisfied the ordinary course of business defense.

The preference action actually went to trial. The bankruptcy court ended up dismissing the preference complaint because Interstate had satisfied the ordinary course of business defense.

The court concluded that the alleged preferential payments were made in the ordinary course of business of Meyer’s Bakeries and Interstate. The court noted that the subjective portion of the ordinary course defense required Interstate to prove some consistency between the alleged referential payments and Meyer’s Bakeries’ prior payments to Interstate. The fact that the alleged preferential payments were made outside of invoice or contract terms did not necessarily preclude Interstate from proving the subjective requirement.

Interstate proved that Meyer’s Bakeries had typically paid Interstate’s invoices outside of terms and that the alleged preferential payments were consistent with Interstate’s and Meyer’s Bakeries’ pre-preference period course of dealing. For instance, prior to the preference period, Meyer’s Bakeries paid Interstate’s invoices on average 70.2 days after invoice date. This was consistent with the average of 71.5 days it took Meyer’s Bakeries to pay Interstate’s invoices during the preference period. The court also relied on Interstate’s president’s testimony that, prior to the preference period, Meyer’s Bakeries had typically paid Interstate’s invoices within a 60-80 day range and not based on net 30 day terms. The court also disregarded the Trustee’s witness’ testimony that the amount of Interstate’s invoices that Meyer’s Bakeries had paid with a single check had nearly tripled during the preference period. The court felt this change was not so significant as to alter its conclusion that the alleged preferential payments were consistent with Meyer’s Bakeries’ pre-preference payments to Interstate, particularly where the Trustee could not prove that Interstate had pressured Meyer’s Bakeries to make the payments.

Since the Meyer’s Bakeries bankruptcy was filed prior to the BAPCPA’s effective date, Interstate also had to prove the objective prong of the ordinary course of business defense, that the alleged preferential payments were made according to ordinary business terms. The court ruled that Interstate also satisfied the ordinary business terms/industry portion of the ordinary course defense. The court accepted the testimony of Interstate’s president that the alleged preferential payments were not unusual in Interstate’s industry, the packaging industry. Specifically, Interstate’s president testified that customers in the packaging industry had typically paid multiple invoices with a single check and sellers allowed more profitable customers to take longer to pay their invoices. The court was also swayed by the testimony of the industry expert produced by Interstate, who had worked for eight or nine different packaging companies. This witness had similarly testified that customers in the packaging industry had rarely paid invoices within 30 days. Rather, the practice in the industry was for customers to pay within a range of 50-80 days after receipt of invoices, and for sellers to base payment terms on the size of their customer and permit larger customers to take longer to pay invoices and pay several invoices with one check.

Conclusion
You’ve got to love the law. Aw shucks, maybe this writer is getting too sentimental! However, when you see well-reasoned decisions, like the Rosenberger court’s decision rejecting the applicability of BAPCPA’s venue limitation to small preference claims, you realize how important it is for Congress to write clear legislation. One easy fix, adding “proceedings arising under the Bankruptcy Code” to Section 1409(b)’s venue limitation provision would assure its applicability to small preference actions.

At least we have the recent Meyer’s Bakeries court decision dismissing a preference complaint based on a trade creditor’s successful invocation of the ordinary course of business defense. A win for the trade in one out of two preference cases sounds pretty darn good! ●

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