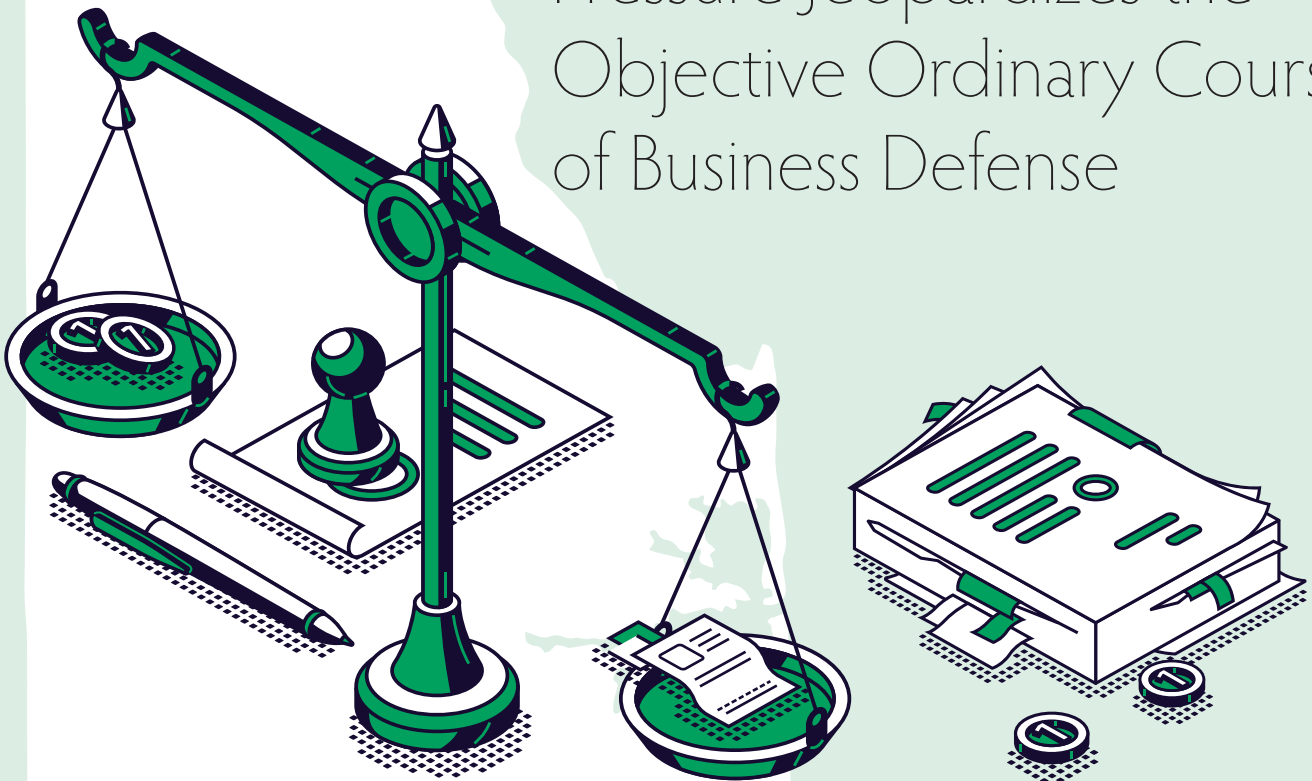
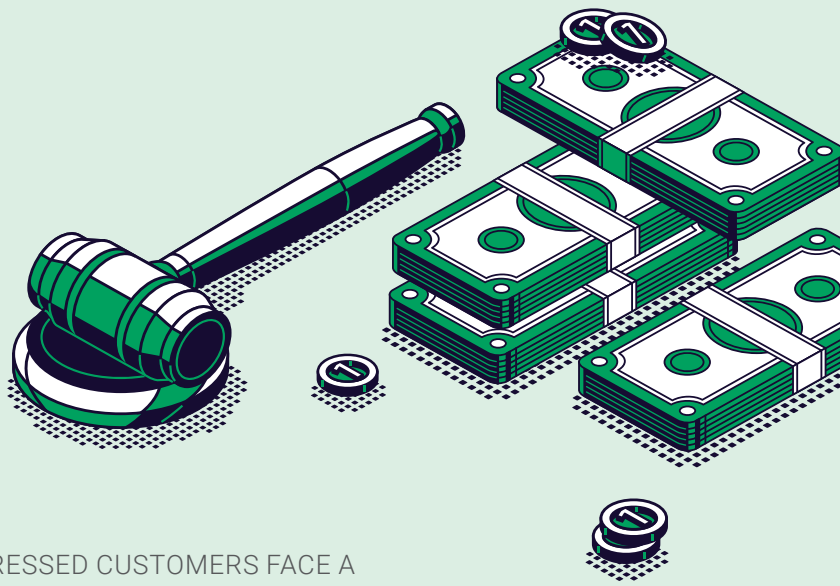


# DELAWARE BANKRUPTCY COURTS' CONFLICTING RULINGS



on Whether Collection  
Pressure Jeopardizes the  
Objective Ordinary Course  
of Business Defense





CREDITORS DEALING WITH FINANCIALLY DISTRESSED CUSTOMERS FACE A DIFFICULT CONUNDRUM. CREDITORS MAY SEEK TO PROTECT AGAINST THE RISK OF NONPAYMENT BY TIGHTENING PAYMENT TERMS, REDUCING CREDIT LIMITS, WITHHOLDING SHIPMENTS OR EVEN SENDING SIMPLE FOLLOW UPS REQUESTING PAYMENT OF OUTSTANDING INVOICES. HOWEVER, THOSE VERY SAME ACTIONS THAT PROMPT A CUSTOMER TO PAY OUTSTANDING INVOICES MAY JEOPARDIZE A CREDITOR'S "ORDINARY COURSE OF BUSINESS" DEFENSE IN THE EVENT THE CUSTOMER FILES BANKRUPTCY AND A LAWSUIT IS COMMENCED TO RECOVER "PREFERENCE" PAYMENTS MADE TO THE CREDITOR WITHIN THE 90 DAYS OF THE BANKRUPTCY FILING.

Courts have generally held that a creditor's prepetition collection pressure negates its defense to preference liability based on the subjective prong of the ordinary course of business defense (that is, where the defense relies on the ordinary practices between the creditor and the debtor). But what if the ordinary course of business defense is based on industry terms? In an opinion issued in January 2025 in *FI Liquidating Trust v. C.H. Robinson Company, Inc.*, the United States Bankruptcy Court for the District of Delaware (the preeminent district for large, commercial chapter 11 filings) held that a creditor did not prove the industry-based "objective" ordinary course of business defense because the alleged preference payments were induced by the creditor's collection pressure. This decision appears to conflict with a decision by a different Delaware bankruptcy judge issued just five months earlier, in the *Center City* bankruptcy case. In that case, the court held that collection pressure is irrelevant to the objective ordinary course of business defense.

The court's decision in *FI Liquidating Trust v. C.H. Robinson Company, Inc.* just goes to show that the outcome of preference litigation is difficult to predict, particularly where the ordinary course of business defense is at issue. Similar facts and similar legal arguments can lead to different outcomes, even in the same court! While a bird in the hand is worth two in the bush when seeking to collect from a financially

distressed customer, creditors should be mindful that heightened collection efforts may adversely impact the ordinary course of business preference defense.

### WHAT IS A PREFERENCE?

A debtor or trustee in bankruptcy can seek to recover payments made to creditors before the bankruptcy filing as a "preference" by proving there was:

1. A transfer of property of the debtor's estate (such as a debtor's payment);
2. To or for the benefit of a creditor;
3. On account of an antecedent debt (such as an outstanding invoice);
4. On or within the 90 days before the bankruptcy filing (i.e., the "preference period"); and
5. That enabled the creditor to receive more than it would in a hypothetical chapter 7 bankruptcy case.

The legislative purpose of the preference statute is to treat creditors fairly, by giving a bankruptcy trustee or other estate fiduciary the ability to recover prepetition payments to "preferred" creditors so that the recovered proceeds can be distributed to all similarly-classified creditors (in theory, at least). But the process is anything but fair to the creditor that is the target of a preference claim. This is particularly true where preference recoveries are used to pay higher priority administrative expenses that accrued during the bankruptcy case rather than funding distributions to unsecured creditors.

## THE COURT'S DECISION IN *FI LIQUIDATING TRUST V. C.H. ROBINSON COMPANY, INC.* JUST GOES TO SHOW THAT THE OUTCOME OF PREFERENCE LITIGATION IS DIFFICULT TO PREDICT, PARTICULARLY WHERE THE ORDINARY COURSE OF BUSINESS DEFENSE IS AT ISSUE.

### WHAT IS THE ORDINARY COURSE OF BUSINESS DEFENSE?

There are multiple affirmative defenses that creditors can assert to reduce or eliminate preference exposure. These defenses are intended to encourage creditors to (or, reward creditors that) continue doing business with, and extend credit to, financially distressed companies heading toward a bankruptcy filing.

One of the most prominent defenses is the “ordinary course of business” or “OCB” defense found in section 547(c)(2) of the Bankruptcy Code. A creditor-defendant proves the OCB defense by showing that:

1. The preference payment satisfied a debt incurred by the debtor in the ordinary course of business between the parties, and
2. The payment was made either:
  - (A) in the ordinary course of business or financial affairs between the parties (the “**subjective**” prong of the OCB defense); **or**
  - (B) according to ordinary business terms (the “**objective**” prong of the OCB defense).

Creditors prove the **subjective** OCB defense by showing consistency in the timing and manner of the debtor's payments during, and before, the 90-day preference period. However, creditors that have applied unusual “collection pressure” to induce payment during the preference period risk losing their subjective OCB defense. Examples of collection pressure include:

- Restricting credit terms
- Imposing or enforcing credit limits
- Threatening to stop shipment
- Imposing credit holds
- A creditor's change in invoice method (electronic vs. paper)
- Change in:
  - Payment method (regular check to wire, ACH, etc.)
  - Delivery method (regular mail to Federal Express or hand delivery)

Creditors prove the **objective** OCB defense by presenting evidence that the alleged preference payments were consistent with the payment practices and terms in the creditor's industry, the debtor's industry or a subset of both industries (e.g., suppliers like the creditor selling to buyers like the debtor). Some courts have held that evidence of collection

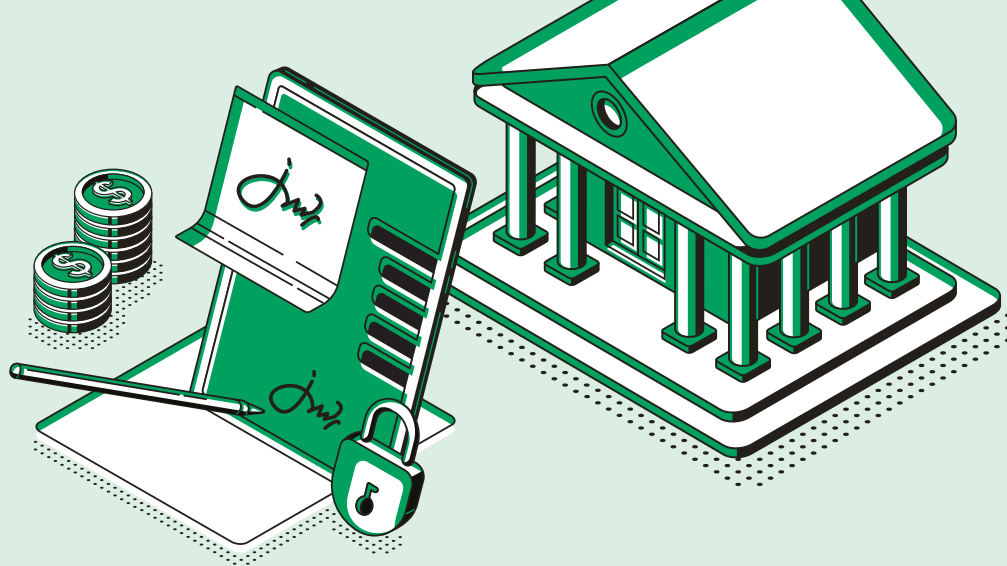
pressure does not negate the objective OCB defense, since the objective OCB defense is based on industry terms, and not the parties' practices. For example, in an opinion issued in August 2024 in the *Center City Healthcare, LLC* chapter 11 cases, the United States Bankruptcy Court for the District of Delaware held that collection activity, even if extraordinary or unusual, is simply not relevant to the objective OCB defense. And yet, just a few months later, a different Delaware bankruptcy judge ruled just the opposite in *FI Liquidating Trust v. C.H. Robinson Company, Inc.*

### BACKGROUND ON *FI LIQUIDATING TRUST V. C.H. ROBINSON COMPANY, INC.*

The Debtors filed their chapter 11 cases on September 9, 2019. Before the filing, the Debtors and their lead logistics provider, C.H. Robinson (the Defendant), entered into an agreement that required the Debtors to pay the Defendant for its services within 30 days of the invoice date and imposed an initial credit limit of \$3 million. However, as the Debtors ran into financial distress, the Defendant began tightening terms and ramping up collection efforts, as follows:

- In June 2019, the Defendant reduced the credit limit to \$1.75 million in response to the Debtors' announcement of a “round of store closings.”
- In July 2019, the Defendant further reduced the Debtors' credit limit to \$1 million.
- On July 11, 2019, the Defendant emailed the Debtors asking if the Defendant could apply credits to the Debtors' oldest invoices to “help the current financial situation.” The Defendant also sent an e-mail stating the Debtors were on a “credit hold” and the Defendant would not deliver the Debtors' goods. The Debtors responded by paying \$800,000 to the Defendant the following day, of which \$300,000 was apparently on account of past-due invoices.
- On July 17, 2019, the Defendant emailed the Debtors to express concern that things were “taking a turn for the worse” and to confirm a reduction of credit terms from 30 days to “14 days to pay with a credit limit of \$1M.”

On September 8, 2021, the liquidating trustee (the Trustee), appointed under the Debtors' confirmed chapter 11 plan, filed a complaint against the Defendant to recover approximately \$3.5 million in payments to the Defendant during the preference period. After discovery, the Trustee moved for summary judgment. The Defendant opposed the trustee's motion, asserting, among other defenses,<sup>1</sup> that the objective OCB defense applied because it is “standard practice” within the transportation and logistics industry to adjust a customer's credit limit in



view of the “client’s credit profile, including its existing financial status and projections of future financial performance.” The Defendant argued that the objective OCB defense should apply so long as the pressure applied to the Debtors was commonplace within the Defendant’s industry.

## THE BANKRUPTCY COURT’S DECISION

The Court granted partial summary judgment in favor of the Trustee, holding that the objective OCB defense was lost due to the Defendant’s collection pressure during the preference period. The Court relied on decisions by the U.S. Courts of Appeals for the Third Circuit (in *Molded Acoustical Products, Inc.*) and Tenth Circuit (in *Meridith Hoffman Partners*) that imposed a “healthy debtor” standard in analyzing the OCB defense. That is, the relevant industry terms for the objective OCB defense must be based on dealings with *healthy* companies, not companies in financial distress. Although the Second, Eighth and Ninth Circuits have ruled differently, the Court reasoned that the Third Circuit’s approach (which is binding on the District of Delaware) “better accords with the underlying congressional purpose in adopting the ordinary course defense, which was to keep distressed companies out of bankruptcy by creating an incentive for vendors to continue extending credit.”

Interestingly, the Court stated that its ruling was not at odds with the Delaware bankruptcy court’s decision in *Center City*. The Court reasoned that in *Center City*, the bankruptcy court had emphasized that the plaintiff was wrong to rely on the defendant’s collection activity when the relevant issue was the course of dealing in the Defendant’s industry. The Court then opined that nothing in the *Center City* decision is inconsistent with Third Circuit’s holding in *Molded Acoustical Products* and that the objective ordinary course of business defense must be based on prevailing terms for healthy, and not financially distressed, debtors. Applying this “healthy debtor”

standard to its case, the Court held that the objective OCB defense was not available because there was nothing in the record to show that the Defendant’s collection pressure (e.g., restricting terms and threatening to discontinue services in the event of nonpayment) was consistent with how a vendor in the shipping and logistics industry would treat a financially healthy customer. **BC**

1. The Defendant also disputed the amount of the alleged preference transfers and the amount of subsequent new value available to reduce the Defendant’s liability. However, this article focuses solely on the issues relevant to the Defendant’s objective OCB defense.



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