

# DELAWARE DISTRICT COURT AFFIRMS CREDITOR WIN

## on Objective Ordinary Course of Business Preference Defense

TRADE CREDITORS DEFENDING PREFERENCE CLAIMS RECENTLY GOT SOME GOOD NEWS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF DELAWARE. IN *CENTER CITY HEALTHCARE, LLC V. MEDLINE INDUSTRIES, INC.*, THE DISTRICT COURT AFFIRMED THE BANKRUPTCY COURT'S GRANT OF SUMMARY JUDGMENT IN FAVOR OF THE CREDITOR-DEFENDANT (MEDLINE), AND GAVE SOME IMPORTANT SUPPORT FOR THE "OBJECTIVE," INDUSTRY-BASED ORDINARY COURSE OF BUSINESS (OCB) DEFENSE IN THE PROCESS.

The opinion is particularly significant because the District Court squarely endorsed Medline's use of Risk Management Association (RMA) data as reliable, admissible evidence for proving industry-standard payment practices and made clear that a straightforward "days-to-pay" analysis based on industry data, by itself, is sufficient to satisfy the objective OCB defense. The decision also upheld the Bankruptcy Court's ruling that collection pressure does not automatically negate an industry-based OCB defense. For trade creditors that routinely find themselves on the receiving end of preference demand letters and complaints, the *Center City* opinion reinforces multiple aspects of the preference defense toolkit.

### 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 the following:

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; and
5. That enables the creditor to receive more than it would in a hypothetical Chapter 7 bankruptcy case.

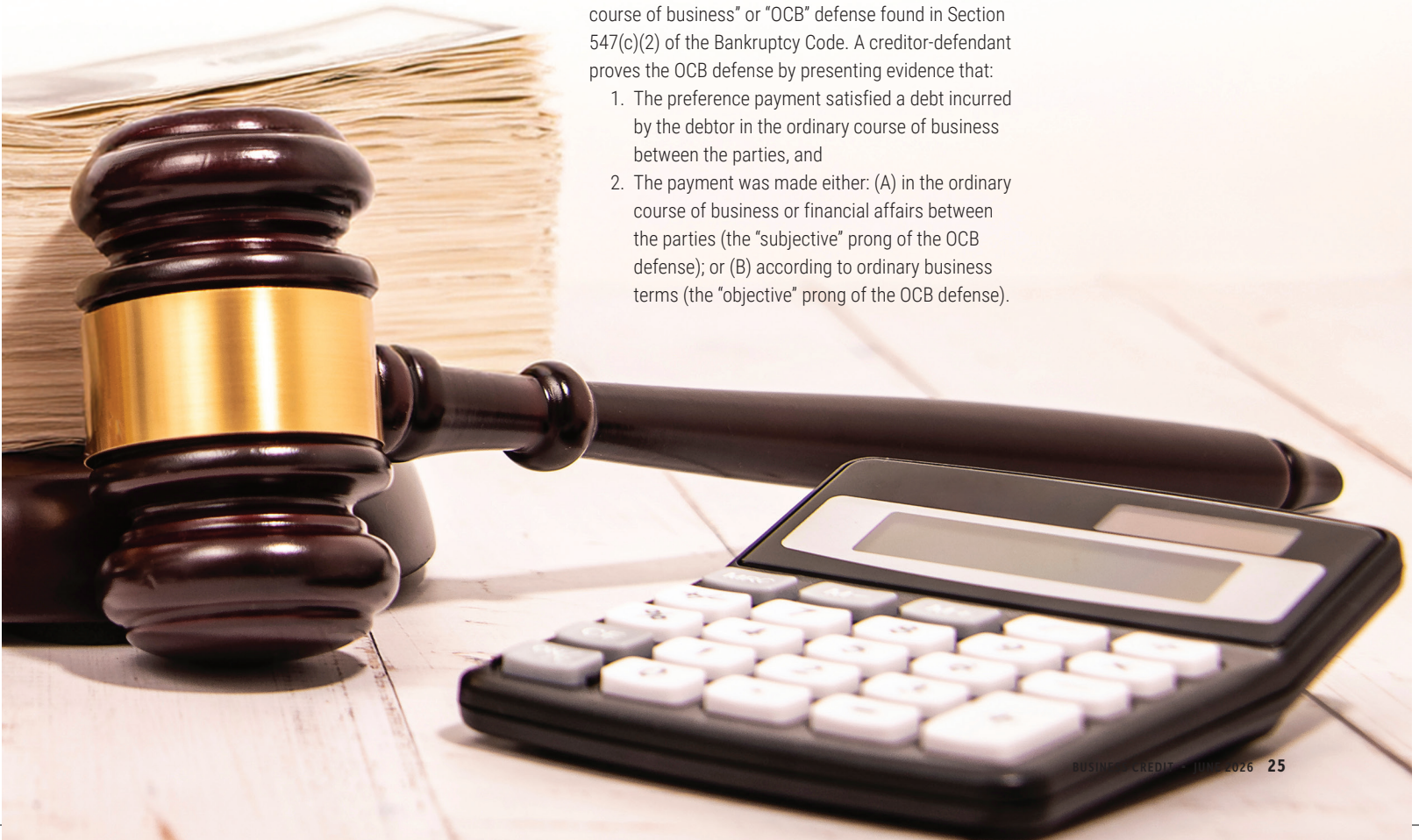
The legislative purpose of the preference statute is to treat creditors fairly by giving a bankruptcy trustee or other estate fiduciary the ability to recover prepetition payments made to "preferred" creditors so that the recovered proceeds can be distributed equally among all similarly classified creditors. But to the creditor that is the target of a preference claim, the process is anything but fair. This is particularly true given the unfortunate reality that in many cases, preference claims are used to pay secured claims and/or the administrative costs of the bankruptcy case rather than claims held by unsecured creditors.

### THE OCB AND SUBSEQUENT NEW VALUE DEFENSES

There are multiple affirmative defenses that creditors can wield to reduce or eliminate preference exposure. These defenses are intended to encourage creditors to (or, reward creditors that) continue doing business with, and extending credit to, financially distressed companies heading toward a future 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 presenting evidence 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).

THE LEGISLATIVE PURPOSE OF THE PREFERENCE STATUTE IS TO TREAT CREDITORS FAIRLY.



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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, the subjective OCB defense could be lost if the trustee proves that the creditor had exerted "collection pressure" on the debtor during the preference period, since that pressure—and not the parties' regular, past practices—arguably induced the debtor to make the alleged preference payments.

Creditors prove the objective OCB defense by presenting evidence that the alleged preference payments were consistent with the payment practices and terms consistent with "general norms within the creditor's industry," and "which prevail in healthy, not moribund, creditor-debtor relationships." This is "not an exacting standard," and the evidentiary burden on the defendant is "not formidable." The creditor need not "prove the existence of some single, uniform set of industry-wide credit terms." Rather, the objective prong of the OCB defense protects transfers that fall somewhere within "the range of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage," and "only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary."

Another frequently asserted preference defense is the subsequent new value defense set forth in Section 547(c)(4). According to Section 547(c)(4), a trustee cannot claw back a preference payment where, after receiving the payment, the creditor gave "new value" (such as by extending credit) to or for the benefit of the debtor and (a) such new value was not secured by an otherwise unavoidable security interest and (b) on account of such new value, the debtor did not make an otherwise unavoidable transfer to or for the benefit of the creditor. The new value defense reduces a creditor's preference liability dollar for dollar by the amount of credit extended to a debtor after the creditor's receipt of an alleged preference payment.

### BACKGROUND REGARDING THE CENTER CITY DECISION

The *Center City* decision arose out of the Chapter 11 bankruptcy filings of Center City Healthcare, LLC and certain affiliates, which operated Hahnemann University Hospital and St. Christopher's Hospital for Children in Philadelphia. After filing Chapter 11, the Debtors subsequently brought an adversary proceeding against Medline, a medical supplies provider, seeking to avoid and recover the Debtors' payments totaling \$4,393,024.56 made to Medline during the 90-day preference period.

Medline moved for summary judgment, asserting two defenses:

- First—\$1,297,376.50 of the transfers were protected by the objective OCB defense, supported by an expert analysis comparing the days from invoice date to payment date (i.e., "days-to-pay") for the alleged preference payments to RMA data for the relevant industry; and
- Second—The remaining \$3,095,648.06 was protected by the subsequent new value defense.

In response, the Debtors argued that RMA data was inadmissible hearsay. The Debtors also argued that a days-to-pay analysis alone was insufficient given Medline's extraordinary collection activity during the 90-day preference period.

On Aug. 27, 2024, the Bankruptcy Court granted summary judgment in favor of Medline. The Bankruptcy Court held that the RMA data was admissible and sufficient to prove the objective OCB defense and that "any evidence of [Medline's] collection activity, even if extraordinary or unusual, is not relevant to the objective ordinary course of business defense." The Debtors appealed to the District Court, challenging the Bankruptcy Court's holding that the objective OCB defense applied, contesting the admissibility of the RMA data and also relying on the collection pressure Medline had exerted on the Debtors.

### THE DISTRICT COURT'S HOLDING

The District Court affirmed the Bankruptcy Court's decision on each of the issues before it.

First, the District Court held that a defendant can prove the objective OCB defense based entirely on a days-to-pay analysis. Medline's expert compared the number of days it took the Debtors to pay Medline's invoices to the range of days-to-pay reflected in RMA data for 13 companies in Medline's industry, the "Medical, Dental, and Hospital Equipment and Supplies Merchant Wholesalers" industry classification, finding that the industry range was 28 to 76 days, and that \$1,297,376.50 of the transfers fell within that range. The District Court found this analysis to be well-supported and consistent with precedent, citing *In re AES Thames* (Bankruptcy Court, Delaware) and *In re ASPC Corp.* (Bankruptcy Court, S.D. Ohio) as examples of other decisions that have relied on RMA-generated days-to-pay analyses to establish the objective ordinariness of transactions.

The District Court also devoted significant attention to the admissibility and reliability of RMA data, affirming the Bankruptcy Court's findings on both points. On reliability, the Court observed that multiple courts have recognized RMA data as reliable and appropriate for establishing industry norms. The Court rejected the Debtors' argument that RMA's own disclaimer—characterizing its data as "general guidelines and not

as absolute industry norms”—undermined its reliability, noting that the same RMA materials tout the data as “the industry standard for comparison financial data” and that the Third Circuit does not require proof of “some single, uniform set of industry-wide credit terms.” On admissibility, the Court agreed with the Bankruptcy Court that RMA data qualifies as a “Market Report[] and Similar Commercial Publication[]” under Federal Rule of Evidence 803(17), supported by uncontroverted evidence that industry professionals routinely rely on RMA data to determine market credit terms.

The District Court also rejected the Debtors’ argument that Medline’s pre-petition collection efforts—including demanding a parent guaranty, requiring wire payments and modifying payment and delivery terms—disqualify Medline from relying on the objective OCB defense. The Court observed that the Debtors offered no evidence that Medline’s conduct was “so idiosyncratic as to fall outside the broad range” of industry norms. The Debtors “essentially argue[d] that where, as here, there was any collection activity at all, the transfers that followed necessarily fall outside of ordinary business terms.” The Court rejected this argument as inconsistent with the principle that the industry standard is defined as a “range of terms” and that the standard is “not an exacting” one.

Notably, the District Court addressed the Debtors’ reliance on *In re Fred’s Inc.*, a January 2025 decision from the Delaware bankruptcy court that discussed the *Center City* bankruptcy court decision. In *Fred’s*, the creditor had attempted to prove that it was common in its industry for suppliers to tighten credit terms once a customer faces financial difficulty—an effort to redefine “ordinary business terms” in light of the debtor’s distress. The *Fred’s* court rejected this approach, consistent with the Third Circuit’s holding in *In re Molded Acoustical Products* that ordinary business terms are those prevailing in “healthy” creditor-debtor relationships. The District Court agreed, emphasizing that Medline, unlike the creditor in *Fred’s*, properly established the industry norm by putting forward RMA data based on healthy creditor-debtor relationships—not by trying to justify its own collection practices as industry-standard.

The District Court also affirmed the Bankruptcy Court’s grant of summary judgment on the subsequent new value defense. Medline demonstrated that during the preference period, it had supplied the Debtors with new goods totaling \$4,064,050.97—more than sufficient to cover the \$3,095,648.06 in transfers not protected by the objective OCB defense. Even accepting the Debtors’ various objections to the new value calculation, the Bankruptcy Court concluded—and the District Court agreed—that the new value provided was still sufficient to eliminate all remaining preference liability.<sup>1</sup>

## CONCLUSION

The *Center City* Bankruptcy and District Court decisions collectively provide a significant win for trade creditors. They provide meaningful support for straightforward days-to-pay analyses based on RMA data, without the need for additional evidence regarding collection practices or other industry metrics. Just as importantly, they reinforce the principle that pre-petition collection activity, standing alone, does not defeat an objective OCB defense where the actual payment timing falls within the range of industry norms. For trade creditors that aggressively manage their receivables and enforce their credit terms, the *Center City* opinion offers reassurance that doing so will not automatically expose them to preference liability. Regardless, creditors should always be mindful of the potential implications that their collection efforts may have on the availability of the OCB defense if their distressed customer ultimately files for bankruptcy protection. **BC**

1. *The District Court’s opinion was initially appealed by the Debtors, however that appeal has since been withdrawn.*



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