IN THE UNITED STATES BANKRUPTCY COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

IN RE: In Proceedings
Under Chapter 11

B.S.W. CORPORATION

Case No. 01-31116

Debtor(s).

B.S.W. CORPORATION

Plaintiff(s),

Adversary No. 02-3147

v.

O' NEAL STEEL, INC.

Defendant(s).

O P I N I O N

The issue before the Court in this case is whether a series of transfers between the debtor (Plaintiff) and the defendant, O'Neal Steel, Inc., are subject to avoidance as preferential transfers pursuant to 11 U.S.C. § 549(b).

On March 26, 2002, the plaintiff filed its voluntary petition under Chapter 11 with this Court. Prior to the filing, the parties to this proceeding had engaged in a number of sales transactions dating back to February 1999,[1] whereby the defendant, a steel processing center, would supply the plaintiff with steel and then send the plaintiff an invoice for payment. In the ninety day period immediately proceeding the filing of the

[1]The actual business relationship between the parties began on March 3, 1998. See Defendant's Brief at p. 2. However, for purposes of this hearing, the parties have focused on transactions occurring within the two year period immediately preceding the filing of the bankruptcy petition.

petition (the "preference period"[2]), the defendant sent the plaintiff 38 invoices totaling $96,222.43, which were paid by the plaintiff during the preference period. See Joint Stipulated Facts ¶¶ 3-4. The plaintiff has filed the instant complaint to avoid these transactions as preferences.

The defendant admits that the transfers in question constitute preferences within the meaning of 11 U.S.C. § 547(b).[3] See Transcript at p. 9. However, the defendant maintains that the transfers fall within the purview of the "ordinary course of business" exception contained in § 547(c)(2)[4] and, therefore, are not subject to avoidance. Alternatively, the defendant argues that the transactions are shielded from avoidance because they constitute "contemporaneous exchanges for new value" as prescribed by § 547(c)(1).

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[2]The parties have stipulated that the preference period began on December 26, 2000 and ended on March 26, 2001. See Joint Stipulated Facts ¶ 2.

[3]Section 547(b) states:

> Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property—
>
> (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 filing of the petition;
>
> * * *
>
> (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).

[4]Section 547(c) (2) creates an exception for transfers made within the "ordinary course of business." An otherwise avoidable transfer will not be avoided if the transfer was in payment of a debt incurred in the ordinary course of business between the parties, and if the payment was made in the ordinary course of business between the parties and "according to ordinary business terms." See 11 U.S.C. § 547(c)(2)

Ordinary Course of Business Exception

The defendant asserts that the transfers in question fall within the "ordinary course of business" exception to § 547(b) and, therefore, are not subject to avoidance. Section 547(c)(2) of the Bankruptcy Code states:

> c. The trustee may not avoid under this section a transfer—
> (2) to the extent 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.

11 U.S.C. § 547(c)(2).

This section is intended to insulate recurring, customary credit transactions between parties which are incurred in the ordinary course of business. WJM, Inc. v. Massachusetts Dept. of Public Welfare, 840 F.2d 996, 1011 (1st Cir. 1988). The Seventh Circuit Court of Appeals has interpreted this section to "[require] the creditor [to] prove, by a preponderance of the evidence, that the transaction was ordinary as between the parties, see 11 U.S.C. § 547(c)(2)(A)-(B), and ordinary in the industry examined as a whole, see 11 U.S.C. § 547(c)(2)(C)." Matter of Midway Airlines, Inc., 69 F.3d 792, 797 (7th Cir. 1995).

The first portion of the test for determining what constitutes ordinary business practices as between the parties is subjective in nature. As Judge Meyers, a fellow Bankruptcy Judge for the Southern District of Illinois, explained in Locke Home Products, Inc. v. Roadway Package System, Adv. 92-3041 (Dec. 21, 1992):

> In determining whether the payments made by the debtor to [the defendant] were made in the ordinary course of business, 'there is no precise legal test which can be applied; rather, [the] court must engage in a peculiarly factual analysis.' Ordinary course of business is determined from the way the parties actually conducted their business affairs, and not by merely looking to

> contractual terms neither party actually followed.

Id., at 3, quoting In re Fulghum Const. Corp., 872 F.2d 739, 743 (6th Cir. 1989).

It is certainly within the ordinary course of business for a company that specializes in steel fabrication to order supplies from a metal service center on credit, thus satisfying § 547(c)(2)(A). Therefore, the Court must determine whether the transfers in question were made in the ordinary course of business as between the parties and whether they were made pursuant to ordinary business terms.

In determining whether a transfer was made in the ordinary course of business as between the parties, courts generally compare the parties' pre-preference transactions with those occurring during the preference period, focusing on five (5) factors:

(1) the length of time the parties were doing business together;
(2) whether the amount or form of payments differed from past practices;
(3) whether the creditor engaged in any unusual collection activity;
(4) the circumstances under which the payments were made; and
(5) the timing of the payments

See In re H.L. Hansen Lumber Co. Of Galesburg, Inc., 270 B.R. 273, 277 (Bankr. C.D. Ill. 2001).

The significant issues in the case presently before this Court involve the length and extent of the parties' business association. The parties agree that, for purposes of this litigation, the first invoice sent by the defendant to the plaintiff was dated February 23, 1999. See, Joint Stipulated Facts, Exhibit #2. From February 23, 1999 through April 19, 1999, the defendant sent the plaintiff 38 invoices. However, after April 19, 1999, the plaintiff made no further purchases from the defendant until December 21, 2000. At that time, the defendant requested updated credit information and references from the plaintiff, which the plaintiff provided. Following the submission of this credit application, the defendant made sales to the plaintiff until February 22, 2001, shortly after which time the plaintiff filed its bankruptcy petition.

The evidence indicates that prior to the preference period, the plaintiff paid the defendant anywhere from 25 to 320 days late, with the average payment being 78 days late. See, Joint Stipulated Facts, Exhibit #6. However, during the preference period, the payments ranged anywhere from 0 to 38 days late, with the average payment being 12 days late. Id., Exhibit #5. Clearly, the plaintiff paid the defendant much faster during the preference period than during the two year period preceding the filing of the bankruptcy petition. However, the defendant argues that this Court should not consider the pre-preference period transfers in determining the ordinary course of dealings as between the parties. Instead, it maintains that because of the 20 month gap in ordering during 1999-2000, a new relationship was established between the parties beginning in December 2000, and therefore, all prior transactions are irrelevant.

While there is authority for the proposition that a court may look exclusively at the preference period to determine the parties' course of dealing, these situations appear to be limited to instances where the parties' only dealings occurred during the preference period. See Warsco v. Household Bank F.S.B., 272 B.R. 246, 251 (Bankr. N.D. Ind. 2002); In re Russell Cave Co., Inc., 259 B.R. 879, 883-84 (Bankr. E.D. Ky. 2001); In re Midway Airlines, Inc., 180 B.R. 1009, 1015 (Bankr. N.D. Ill. 1995). Where, however, there is a prior history of dealing between the parties, it is entirely appropriate for the Court to examine that relationship. As was explained in In re Morren Meat and Poultry Company, Inc., 92 B.R. 737, 740 (W.D. Mich. 1988):

> [T]he course of dealing between the parties themselves is indeed a factor to consider and . . . § (B) [of § 547] contemplates an evaluation of the parties prior subjective dealings, *when such exist*.

Id. (emphasis added).

In the instant case, the Court does not find that the prior transactions between the parties were so removed in time from each other as to constitute separate courses of dealing. While there was an extensive period of time during which the plaintiff ordered no products from the defendant, this lack of ordering activity does not mean that the parties had terminated their relationship. According to the unrefuted testimony of Joe

Parise, the former owner and CEO of the plaintiff, the plaintiff was purchasing its steel during the "gap" period from Action Steel, one of the defendant's competitors. However, the defendant's sales representatives visited the plaintiff on several occasions during this period and provided the plaintiff with pricing information. See Transcript at pp. 42-45. The Court finds that these actions evidence a continuing relationship between the parties and, therefore, the pre-preference period transactions should be considered.

As indicated above, the plaintiff, on average, paid the defendant 78 days late during the pre-preference period. However, in the 90 days immediately preceding the bankruptcy filing, the payments were much more timely, with the average payment being only 12 days late. A review of the plaintiff's pre-preference payment history indicates that the soonest it ever paid an invoice was 25 days late, with the majority of the payments being more than 50 days late. See Joint Stipulated Facts, Exhibit #5. Clearly a comparison between the timing of the payments during the two periods indicates that the plaintiff paid the defendant much more quickly during the preference period than in prior instances. This conclusion is buttressed by the testimony of Mr. Parise, who testified that in order to obtain the steel needed for his operation, it was necessary to pay the defendant faster than the plaintiff's other creditors.[5] For these reasons, the Court finds that the payments in

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[5]At trial, Mr. Parise testified as follows:

> Q: And then within the preference period, the greatest number of days late, as you mentioned was 38. Can you explain why B.S.W. Corporation paid O'Neal Steel so much faster during the preference period?
>
> A: Well, in order to continue to have the credit available to us, we had to do that, and in order to continue to get pricing for work in progress, when you submitted requests for pricing, you would be asked about these invoices or what about the previous purchase or sales that we have made to you.

Q: Did you pay all of your creditors as fast as you paid O'Neal Steel during the preference period?

A: No, we didn't.

this case were not made within the ordinary course of the parties' business and, therefore, the defendant's defense under § 547(c)(2) must fail.[6]

Contemporaneous Exchange for New Value Defense

In addition to raising an ordinary course of business defense pursuant to § 547(c)(2), the defendant argues, alternatively, that the transactions fall within the "contemporaneous exchange for new value" exception contained in 11 U.S.C. § 547(c)(1). Section 547(c)(1) protects an otherwise avoidable transfer "to the extent that such transfer was–

> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
> (B) in fact a substantially contemporaneous exchange.

11 U.S.C. § 547(c)(1). Transfers that fall within this exception are not deemed preferential because they encourage creditors to continue to do business with financially troubled debtors and because in such situations, other creditors are not adversely affected if the estate receives new value. In re Jones, 130 F.3d 323, 326, (8th Cir. 1997). As Judge Meyers explained in In re Messamore), 250 B.R. 913, 919 (Bankr. S.D. Ill. 2000):

> In enacting the 'contemporaneous exchange' defense of § 547(c)(1), Congress recognized that if a creditor provides new value in exchange for a preferential transfer, the estate has not been diminished, and, therefore, the creditor is entitled to protection to the extent of the new value provided.

Q: Why did you pick O'Neal Steel to pay faster than all the other creditors you had at the time?

A: Because I needed the steel.

See Transcript at pp. 47-8.

[6]Having determined that the payments were not made within the ordinary course of the parties' business, the court need not address whether the payments were made pursuant to ordinary business terms as required by 11 U.S.C. § 547(c)(2)(C).

In order to be successful under this defense, the defendant has the burden of proving by a preponderance of the evidence not only that a substantially contemporaneous exchange occurred but, more importantly, that the parties intended the transaction to be a contemporaneous exchange for new value. As the Seventh Circuit Court of Appeals has noted, "[t]he critical inquiry in determining whether there has been a contemporaneous exchange for new value is whether the parties intended such an exchange." Matter of Prescott, 805 F.2d 719, 727 (7th Cir. 1986) (emphasis added).

In the instant case, the defendant has offered no evidence as to the parties' intent when the transfers in question were made. Further, the defendant has not set forth the "new value" received by the plaintiff with any specificity. Therefore, this Court finds that the defendant has failed to sustain its burden of proof and its defense under § 547(c)(1) must also fail.

Conclusion

The plaintiff having sustained its burden of proof under § 547(b), and, the defendant having failed to prove an affirmative defense, the Court finds that payments in question constitute avoidable preferential transfers. Judgment shall enter on plaintiff's complaint in the amount of $96,222.43.

Counsel for the plaintiff shall serve a copy of this Opinion by mail to all interested parties who were not served electronically.

ENTERED: May 19, 2003

/s/ William V. Altenberger
UNITED STATES BANKRUPTCY JUDGE