UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re	:	Chapter 11
QUAD SYSTEMS CORPORATION	:	
Debtor	:	Bankruptcy No. 00-35667F
QUAD SYSTEMS CORPORATION	:	
Plaintiff	:	
v.	:	
H&R INDUSTRIES, INC.	:	
Defendant	:	Adversary No. 02-0972

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MEMORANDUM

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By BRUCE FOX, Chief Bankruptcy Judge:

In the above-captioned adversary proceeding, the debtor in possession, Quad Systems Corporation ("Quad"), seeks to avoid and recover preferential payments it made to the defendant, H&R Industries, Inc. ("H&R"), pursuant to 11 U.S.C. §§ 547 and 550.[1] The defendant concedes that the payments at issue were

[1]Sections 547 and 550 refer to the power of a trustee to avoid a preferential transfer and assess liability against the transferee. By virtue of section 1107(a), a chapter 11 debtor in possession has all the rights and powers of a trustee. See, e.g., In re University Medical Center, 973 F.2d 1065, 1075 n.12 (3d Cir. 1992); In re Sandy Ridge Oil Co., Inc., 807 F.2d 1332, 1334 (7th Cir. 1986). Thus, a debtor in possession may seek to avoid preferential
(continued...)

preferential, but argues that these transfers are unavoidable under either the ordinary course of business exception found in 11 U.S.C. § 547(c)(2) or the new value exception of 11 U.S.C. § 547(c)(4).

For the reasons stated below, I conclude that § 547(c)(4) does not apply in this case. I also conclude that the defendant has not met its burden of proving all three elements of § 547(c)(2), and accordingly the transfers it received from the debtor are avoidable under § 547(b) and its liability must be assessed under section 550.

Although trial was scheduled, the parties elected to offer all evidence by way of stipulation. The following facts and documents were agreed to by the parties, either at trial or in their "Agreed Statement of Facts."

I.

On or about June 23, 2000, Quad entered into a "blanket purchase contract" (Purchase Order No. 39594) for the "purchase and sale of 25 units (called base housings to contain electronic operating systems) into which [Quad] would install its proprietary electronic parts." Statement of Facts ¶ 2 and Exhibit A-1. The units were to be delivered on differing dates from August 15, 2000 to June 30, 2001.

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[1](...continued)
transfers. In re Maxway Corp., 27 F.3d 980, 983 (4th Cir. 1994) ("The operation of § 1107(a) thus provides standing to debtors in possession to seek the avoidance of preferential transfers even though § 547 explicitly refers only to trustees"); see also Matter of Gulf City Seafoods, Inc., 296 F.3d 363 (5th Cir. 2002); In re Coastal Group Inc., 13 F.3d 81 (3d Cir. 1994).

Id. Quad supplied the defendant with castings from which the bases were manufactured. Id. ¶ 2.

Subsequently, on September 13, 2000, the purchase order was changed to accelerate the due dates. Id. ¶ 3 and Exhibit A-2.

H&R began shipping the units on August 21, 2000, and provided the following invoices to Quad:

Invoice No.	Ship Date	Invoice Amount
22607	8/21/00	$10,229.70
22645	8/23/00	4,647.00
22766	9/08/00	1,653.00
22783	9/12/00	4,796.08
22798	9/13/00	4,755.41
22805	9/15/00	4,778.87
22806	9/15/00	4,778.87
22884	10/02/00	4,778.87
22885	10/02/00	4,778.87
22927	10/05/00	4,778.87
22932	10/09/00	4,778.87
22959	10/12/00	4,778.87

Id. ¶¶ 4 and 15 (Exhibits B and E). The terms of each invoice issued to Quad following delivery of each shipment was "net thirty days." Id. ¶ 13 and Exhibit D.

Upon receipt of Quad's order, H&R purchased and received the components it would need to assemble the product. For each unit ordered, approximately $3,000.00 in components were purchased. H&R ordered and received the component parts before the first shipment to Quad was made, although some of the component parts were actually incorporated into the product before payment from Quad was received.

Beginning November 8, 2000 to December 4, 2000, Quad made payments to H&R totaling $49,975.54. Id. at Exhibit B. The following is a list of the payments made, the invoices to which each corresponded, and the number of days past invoice that each payment was made:

Check No.	InvoiceNo./Date	Date Paid	Days Past Invoice
166794	22645 (08/23/00)	11/08/00	77
166916	22607 (08/21/00)	11/15/00	86
	22766 (09/08/00)	11/15/00	68
167070	22783 (09/12/00)	11/22/00	71
	22798 (09/13/00)	11/22/00	70
	22805 (09/15/00)	11/22/00	68
	22806 (09/15/00)	11/22/00	68
167392	22884 (10/02/00)	12/04/00	63
	22885 (10/02/00)	12/04/00	63
	22927 (10/05/00)	12/04/00	60

Id. at Exhibits B and F.[2] Thus, the invoice payments at issue in this proceeding were made by Quad between 60 and 86 days after each shipment date.[3]

Quad systems filed for chapter 11 bankruptcy relief on December 18, 2000. Id. ¶ 1. Accordingly, the ninety-day preference period commenced on September 19, 2000.

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[2]In Exhibit F, styled a "Cash Receipts Journal" for Quad, the defendant included a hand-written column wherein it provided its calculation of the number of days past invoice that each payment was made by Quad. After comparing these figures with the information found in Exhibit B, a listing of all invoices and payments, it appears that some of the calculations in Exhibit F are slightly inaccurate, so I have recalculated the days past invoice in the above table.

[3]In their Statement of Facts, the parties contend that the invoice payments were made "between 60 and 75 days." Statement of Facts ¶ 6. However, as demonstrated by the above table, the actual range was from 60 to 86 days.

After the debtor filed its bankruptcy petition, the defendant continued to provide services under the purchase order and issue invoices. These invoices were paid from January 26, 2001 through March 23, 2001 on a "cash on delivery" basis. Id. ¶ 16 and Exhibit F. In addition, two invoices – Nos. 22932 and 22959, dated October 9, 2000 and October 12, 2000, respectively – in the amount of $4,778.87 each remain unpaid. Id. ¶ 15 and Exhibit E. A partial payment of $3,168.05 was made by the trustee. Id. ¶ 15.

The parties have stipulated that Quad had thirty-nine other vendors, "all of whom were paid by [Quad] in the same time sequence as [H&R] was paid." Id. ¶ 9. Thus, for these other creditors, "the average days between invoice date and check issuance date was 60 to 75 days." Id.

During the calendar year 2000, H&R's sales totaled $7,242,161.00. Id. ¶ 11. 81% of its business was paid by five customers with weighted average invoice payments between 50 and 71 days. Id. ¶ 11 and Exhibit C. In addition, these five customers actually paid their invoices in the range of 42 and 96 days, and none of the defendant's customers paid in accordance with the 30-day invoice term in the year 2002. Id. ¶ 14. The defendant had a similar payment experience throughout the year 2000. Id.

The parties stipulated that Quad "was not pressured or threatened in any manner by [H&R]" to make the payments when and in the manner it did. Id. ¶ 12.

Finally, the parties stipulated as follows:

> Morton Perchick, Vice-President of Kuliche [sic] & Soffa Industries would testify that he has been associated with his employer for 33 years in various financial and quality control capacities. At present he is Executive Vice President. Kuliche [sic] & Soffa is in the electronics manufacturing business selling a product known as wire bonding machines. He and Kulicke & Soffa are familiar with the business of QUAD Systems. Kulicke & Soffa operates in a similar manufacturing business. Kulicke & Soffa deals with over 100 vendors and paid vendor invoices between 37 and 95 days in 2000.

Id. ¶ 10.

II.

Before analyzing the legal issues involved, I note that the concept of an avoidable preferential transfer represents a longstanding congressional determination that creditors should not be permitted, either intentionally or unintentionally, to recover more from the debtor than other creditors with similar claims by virtue of transfers made in their favor just prior to the debtor's bankruptcy filing. At the time the preferential transfer is made, there may be nothing improper about it under state law. See Matter of Nelson Co., 959 F.2d 1260, 1266 (3d Cir. 1992). However, once the bankruptcy petition is filed, a trustee or debtor in possession may avoid or set aside the transfer as preferential pursuant to 11 U.S.C. § 547 and recover the amount transferred by virtue of section 550.

Congress envisioned two overriding policies which would be enhanced by the trustee's ability to avoid preferential transfers. First, similar creditors would be

treated equally in their receipt of distributions from the debtor's assets. Second, creditors would be discouraged from racing against each other to dismember the debtor, since an earlier recovery could later be set aside as preferential. H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 177-78 (1977).

The scope of a preferential transfer, as it is defined by section 547, embodies the balancing of a number of policy choices. See generally Thomas H. Jackson, Avoiding Powers in Bankruptcy, 36 Stan. L. Rev. 725 (1984). These are initially articulated by the provisions of section 547(b), which contain the essential elements of a preference as Congress chose to define it. Congress then recognized additional policy considerations by virtue of section 547(c). Certain transfers which might at first appear preferential, because they meet all the requirements of section 547(b), are nevertheless excepted from avoidability for various reasons.

While section 547 identifies those transfers which may be avoided, section 550 governs the trustee's power to recover transfers so avoided. 11 U.S.C. § 547(b) provides as follows:

> (b) 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 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 provision of this title.

11 U.S.C. § 550(a) provides in pertinent part that:

> [e]xcept as otherwise provided in this section, to the extent that a transfer is avoided under section . . . 547 . . . , the trustee may recover, for the benefit of the estate, the property transferred, or, if the court so orders, the value of such property, from -
>
> (1) the initial transferee of such transfer or the entity for whose benefit such transfer was made; or
>
> (2) any immediate or mediate transferee of such initial transferee.

In this proceeding, Quad filed its bankruptcy petition on December 18, 2000. The ninety day reach-back period established by subsection 547(b)(4)(A) began on September 19, 2000. Although the purchase order was signed and subsequently altered before the preference period began – June 23, 2000 and September 13, 2000, respectively – Quad made payments (i.e., transfers, see 11 U.S.C. § 101(54)) to H&R from November 8, 2000 to December 4, 2000. Thus,

all pre-bankruptcy payments made under this purchase order fall within the preference period.

H&R has stipulated that Quad has proven all the necessary elements of § 547(b) and that, therefore, the pre-bankruptcy payments it received from Quad were preferential. It maintains, however, that these transfers are all excepted from preference avoidance under either §§ 547(c)(2) or (4).

I thus turn to those two statutory preference defenses.

III.

Pursuant to the ordinary course of business exception, found in 11 U.S.C. § 547(c)(2):

> The trustee may not avoid under [section 547(b)] 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 transferee;
>>
>> (B) made in the ordinary course of business or financial affairs of the debtor and transferee; and
>>
>> (C) made according to ordinary business terms.

Accordingly, for this preference defense to apply, three elements must be established. See generally In re Allegheny Health, Education and Research

Foundation, 292 B.R. 68, 2003 WL 1921901, at *5 (Bankr. W.D. Pa. 2003); In re Sacred Heart Hospital of Norristown, 200 B.R. 114, 116 (Bankr. E.D. Pa. 1996). The "sparse" legislative history available for this subsection indicates that, "'[t]he purpose of the exception is to leave undisturbed normal financing 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.'" In re Molded Acoustical Products, Inc., 18 F.3d 217, 223 (3d Cir. 1994) (quoting S. Rep. No. 989, 95th Cong., 2d Sess. 88 (1978)); see also In re Vogel Van & Storage, Inc., 210 B.R. 27, 34 (N.D.N.Y. 1997), aff'd, 142 F.3d 571 (2d Cir. 1998); In re Parkline Corp., 185 B.R. 164, 168 (Bankr. D.N.J. 1994). As further explained by one commentator, "[Section 547(c)(2)] is intended to protect recurring, customary creditor transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor's transferee." 5 Collier on Bankruptcy ¶ 547.04[2], at 547-54 (L. King et al. eds., 15th ed. rev. 2003); see also In re Vogel Van & Storage, Inc., 210 B.R. at 34.

Based upon the statutory language, to except the transfers from avoidance as a preference under § 547(c)(2), the defendant must show that (1) the debt was incurred in the ordinary course of business of both the debtor and the creditor; (2) the transfer was made in the ordinary course of business of the debtor and the creditor; and (3) the transfer was made according to ordinary business terms. The defendant bears the burden of proving each element by a preponderance of the evidence. 11 U.S.C. § 547(g); Matter of Midway Airlines, Inc., 69 F.3d 792, 797 (7th

Cir. 1995); In re Allegheny Health, Education and Research Foundation, 2003 WL 1921901, at *5; In re L. Bee Furniture Co., Inc., 230 B.R. 185, 190 (Bankr. M.D. Fla. 1999); In re Sacred Heart Hospital of Norristown, 200 B.R. at 117.

In the instant dispute, the plaintiff has stipulated that the debt - i.e., Quad's contractual obligation to pay for the product shipped by H&R - was incurred in the ordinary course of the parties' respective businesses, thus establishing the element found in section 547(c)(2)(A). Therefore, I need only consider whether H&R has met its burden to demonstrate, by a preponderance of the evidence, "that the transaction was ordinary as between the parties . . . and ordinary in the industry examined as a whole." Matter of Midway Airlines, Inc., 69 F.3d at 797 (citations omitted); see 11 U.S.C. § 547(c)(2)(B)-(C).

A.

First, I must determine whether or not Quad's prepetition payments to H&R during the preference period were made in the ordinary course of the parties' respective businesses. The defendant maintains that this element has been proven because, although the payments were not made in accordance with the terms of the purchase order, they were still made in the ordinary course of the parties' dealings: Quad was accustom to paying its creditors late and the H&R routinely accepted late payments from its customers.

The plaintiff, however, argues that this statutory element has not been demonstrated because any comparison with the parties' third-party business transactions is irrelevant. Rather, Quad contends that H&R was required to show that the transfers at issue were made in accordance with the defendant's pre-preference period business relations with Quad. Since H&R cannot provide evidence of such business transactions (as will be discussed below, to the extent such pre-preference transfers occurred, they occurred many years ago), Quad maintains that one may consider only the payment terms of the agreement between Quad and H&R – viz., if the transfers were not made in accordance with the payment terms stated in the invoices, then they were per se not made in the ordinary course of the parties' business dealings under section 547(c)(2)(B).

"In determining whether the second requirement of Section 547(c)(2) is satisfied, the focus of the inquiry is subjective, i.e., were the payments made in the ordinary course of dealings between the parties." In re R.M.L., Inc., 195 B.R. 602, 613 (Bankr. M.D. Pa. 1996) (internal quotations omitted); see also In re Vogel Van & Storage, Inc., 210 B.R. at 34; In re Ed Jefferson Contracting, Inc., 224 B.R. 740, 745 (Bankr. E.D. Mo. 1998). However, there is no precise test for determining what was "ordinary" between the parties, and the court must necessarily engage in a "peculiarly factual analysis," In re Ed Jefferson Contracting, Inc., 224 B.R. at 745; see also In re Vogel Van & Storage, Inc., 210 B.R. at 34; In re R.M.L., Inc., 195 B.R. at 613, that considers such factors as:

> (1) the length of time the parties have engaged in the type of dealing at issue, (2) whether the subject transfer was in an amount more than usually paid, (3) whether the payments were tendered in a manner different from previous payments, (4) whether there appears any unusual action by either the debtor or creditor to collect or pay on the debt, and (5) whether the creditor did anything to gain an advantage (such as gain additional security) in light of the debtor's deteriorating financial condition.

In re Allegheny Health, Education and Research Foundation, 2003 WL 1921901, at *5 (internal quotations omitted); see also In re Parkline Corp., 185 B.R. at 169.

Therefore, in evaluating the ordinary course of dealings between the parties, courts will usually examine "whether the transactions between the debtor and the creditor both before and during the ninety-day [preference] period were consistent." In re Allegheny Health, Education and Research Foundation, 2003 WL 1921901, at *6 (quoting 5 Collier on Bankruptcy, supra, ¶ 547.04[2][a][ii][B], at 547-58); see also Ed Jefferson Contracting, Inc., 224 B.R. at 745. This typically requires the defendant to establish a "baseline of dealing" by demonstrating what the practices were between the parties before the preference period began running. Then, the preference period transfers will be compared against this "baseline of dealing" to see if they are consistent. See In re Allegheny Health, Education and Research Foundation, 2003 WL 1921901, at *5; In re R.M.L., Inc., 195 B.R. at 613; 5 Collier on Bankruptcy, supra, ¶ 547.04[2][a][ii][B], at 547-58.

Nevertheless, courts have also recognized that "an isolated or first time transaction is not per se ineligible for protection from avoidance under section 547(c)(2)." E.g., In re Forman Enterprises, Inc., 293 B.R. 848, 857 (Bankr. W.D. Pa.

2003) (holding that, where there were no pre-preference period dealings between the parties, the transfer at issue will be considered "ordinary" between the parties, even though payment was not made within the thirty-day payment term provided on the invoice, because the evidence suggested that the parties had not discussed the payment terms before the shipment was made, but later negotiated acceptance of payment past thirty days); Warsco v. Household Bank F.S.B., 272 B.R. 246, 251 (Bankr. N.D. Ind. 2002) (holding that, where there were no pre-preference period dealings between the parties, the transfer at issue will be considered "ordinary" between the parties where they conformed to the payment terms of the underlying agreement). Therefore, even if the defendant had no pre-preference period dealings with the debtor – and accordingly cannot establish a "baseline of dealings" – the transfers may still be excepted from avoidance if the defendant can otherwise establish that they were made in the ordinary course of the parties' business dealings.

As explained by one court,

> the plain language of subsection 547(c)(2)(B) does not require the existence of pre-preference period relations between . . . [the debtor and the creditor] . . . . [T]he statute states: "affairs of the debtor and transferee," not "affairs between the debtor and the transferee." Accordingly, while subsection 547(c)(2)(B) contemplates an evaluation of the parties' [pre-preference period] subjective dealings . . . when such exist, such dealings are not a requirement for finding that the preference period payments were ordinary."

In re Peterson Distributing, Inc., 197 B.R. 919, 926 (D. Utah 1996) (internal citations and quotations omitted) (alterations and emphasis in original).

Here, H&R was unable to provide evidence of its pre-preference period dealings with Quad. According to Exhibit C of the Agreed Statement of Facts – a fax transmittal cover sheet from Mr. Scott Jacoby at H&R Industries, Inc. – H&R had prior business with Quad "many years ago," but H&R was unable to locate any record of those prior dealings to establish their previous payment history. As explained above, this lack of a pre-preference period payment history is not fatal to the defendant's case. The defendant must still prove, however, that the payments were made in the ordinary course of the plaintiff's and defendant's businesses.

Based upon the agreed-upon evidence, I find that the defendant has met this burden.

Despite the fact that courts generally take into account the payment terms of the underlying agreement between the parties, there is no inflexible rule that late payments cannot be ordinary. See In re Vogel Van & Storage, Inc., 210 B.R. at 35; In re R.M.L., Inc., 195 B.R. at 614. Rather, late payments can fall within the scope of section 547(c)(2)(B) where the defendant can demonstrate that such payments were ordinarily made and accepted by the parties. In re R.M.L., Inc., 195 B.R. at 614 ("[L]ate payments may be protected under the ordinary course of business exception if those payments are the ordinary practice of the debtor and the other two elements of § 547(c)(2) are proven"); In re Parkline Corp., 185 B.R. at 169; In re A.J. Lane & Co., Inc., 164. B.R. 409, 414 (Bankr. D. Mass. 1994) ("[L]ate payments are in the ordinary course of business of the debtor and creditor when the parties 'adopt' them as their normal practice"); cf. Cassidy Podell Lynch, Inc. v. SnyderGeneral

Corp., 944 F.2d 1131, 1147 (3d Cir. 1991) (discussing the concepts of waiver and modification found in Article 2 of the Uniform Commercial Code concerning payments made later than the terms of the invoice).

In this dispute, the evidence supports the defendant's contention that late payments were "ordinary" in the business dealings between itself and Quad, notwithstanding the fact that the payment terms of the underlying invoices were net thirty days. All of the payments made by Quad under the purchase order were late – each by at least thirty days. See Exhibit B. Moreover, the defendant accepted the late payments, never took any action against Quad for breach of contract, and continued to perform its obligations under the purchase order. The parties also stipulated that Quad "was not pressured or threatened in any manner" to make the payments it did – even when they were significantly late. This uncontroverted evidence suggests that late payments were the ordinary course of dealings between Quad and H&R.

However, I also recognize that it becomes difficult to evaluate the ordinariness of transfers when the preference-period transfers make up the entire business relationship between the parties. Under those circumstances, some courts have recognized that the defendant may satisfy § 547(c)(2)(B) by providing comparative evidence of the defendant's and the debtor's business relations with third parties. E.g., In re Peterson Distributing, Inc., 197 B.R. at 927; In re Keller Tool Corp., 151 B.R. 912, 914 (Bankr. E.D. Mo. 1993) ("Where, as here, the record has established that the Debtor and Defendant had no business dealings prior to the transaction that is the subject of this proceeding, the Court may look to the parties'

ordinary course of dealings in other business transactions"); but see In re Russell Cave Co., Inc., 259 B.R. 879, 883-84 (Bankr. E.D. Ky. 2001); In re Brown Transport Truckload, Inc., 152 B.R. 690, 692 (Bankr. N.D. Ga. 1992) ("Merely showing that the actions were taken in the ordinary course of the parties' respective ordinary course of business, without showing the prior course of dealing between the parties, is not sufficient"). I am persuaded that the better construction of § 547(c)(2)(B) would allow such evidence because such an interpretation is supported by the plain language of the statute, promotes the policy considerations behind § 547(c)(2) and encourages creditors to do business with financially distressed customers.

Under the plain language of section 547(c)(2)(B), the defendant must prove that the transfer was "made in the ordinary course of business . . . of the debtor and the transferee." As discussed above, the statute does not require the transfer to be made in the ordinary course of business between the debtor and the transferee. See In re Peterson Distributing, Inc., 197 B.R. at 926. Instead, the statute refers to the ordinary course of business of the debtor and the transferee. Id. Thus, the language of the statute requires the defendant to demonstrate that the transfer was made in the ordinary course of the debtor's business and in the ordinary course of the transferee's business. It does not, however, require a showing that the transfer was ordinary in the course of business dealings between the two parties. Therefore, although evidence of the parties' previous business dealings is certainly relevant to a determination of whether a transfer was subjectively "ordinary" in the parties' respective businesses, where such evidence is not available, the better reading of the statute also permits the

defendant to present evidence of what was ordinary in both the plaintiff's and defendant's respective business dealings with third parties.

In In re Peterson Distributing, Inc., 197 B.R. at 926, the court explained that allowing evidence of third-party business transactions promotes the policy behind § 547(c)(2)(B) and will not discourage creditors from doing business with customers who are facing financial distress:

> [A]llowing evidence of a creditor's and a debtor's relations with third parties promotes the policy objective underlying the ordinary course of business exception to a trustee's avoidance powers. The general purpose of Section 547(b) . . . is to (1) discourage unusual collection activity by creditors and unusual payment activity by a debtor which favors certain creditors over others and may precipitate bankruptcy; and (2) allow a trustee to avoid those unusual and preferential payments and recoup the money for the benefit of all creditors.
>
> The three requirements of the ordinary course of business exception to the trustee's avoidance powers ensure that a particular transaction is that of a "normal debtor-creditor relationship" and not so unusual that it threatens to heighten the likelihood of the debtor filing for bankruptcy. If the court were to adopt the . . . position that only creditors with significant pre-preference period relations with debtors can make a showing that late payments are ordinary, then creditors would be deterred from establishing new relationships with troubled debtors. Such deterrence, which is contrary to the goals of Section 547(c), is unnecessary given that a creditor can make a satisfactory showing that its preference period relations with a debtor were not unusual by offering evidence of its ordinary course of relations with other customers and the debtor's ordinary course of relations with other creditors.

Id. at 926-27.

Moreover, this reading of § 547(c)(2)(B) does not render § 547(c)(2)(C) "superfluous," as some courts have contended. See In re Brown Transport Truckload, Inc., 152 B.R. at 692 ("[S]uch a statutory construction would make § 547(c)(2)(C) superfluous, since that subsection requires that the transfer also be made according to ordinary business terms, which is determined by using an objective standard"). Although there may be circumstances (such as those found in this proceeding) when evidence of third-party transactions is considered to evaluate ordinariness under § 547(c)(2)(B), the inquiry under the two subsections is quite different:

> Subsection 547(c)(2)(C) is objective in that it requires a showing that the payments at issue comport with the ordinary course of business in the relevant industry . . . . Subsection 547(c)(2)(B) is subjective in that it requires a more particularized showing that the payments at issue comport with the ordinary course of business as established between the parties before the preference period or, absent such a relationship, with the ordinary course of business as established between the creditor and third parties and the debtor and third parties.

In re Peterson Distributing, Inc., 197 B.R. at 926-27 (footnotes omitted) (holding that the defendant satisfied the requirements of §§ 547(c)(2)(B) and (C) where it offered evidence of both the course of business in the diesel fuel industry and the ordinary course of business as between the debtor and other suppliers and as between the defendant as other purchasers of diesel fuel).

Indeed, while the dealings of Quad and H&R with third parties may be relevant to determining whether pre-bankruptcy transfers were made in the ordinary

course of their respective businesses, as will be discussed below, the focus of section 547(c)(2)(C) will be upon the business practices of H&R's industry. Thus, there will be little evidentiary overlap.

Therefore, while some cases have held that, where a defendant cannot establish a pre-preference period course of dealings, it cannot accept late payments from the debtor and meet the requirements of section 547(c)(2)(B), see, e.g., In re Russell Cave Co., Inc., 259 B.R. 879, 883-84 (Bankr. E.D. Ky. 2001); In re Brown Transport Truckload, Inc., 152 B.R. 690, 692 (Bankr. N.D. Ga. 1992), I am not persuaded that Congress intended to adopt such a per se rule. As noted above, such a statutory interpretation would discourage a creditor in a newly-formed business relationship from accepting late payments from the customer – i.e., the creditor would be at risk because it could not be assured that the debtor would not shortly file for bankruptcy, in which case it could lose all § 547(c)(2) protection. This result is not consistent with the policies established by section 547(c)(2).

Accordingly, I find the reasoning of In re Peterson Distributing, Inc. to be persuasive, and, as a result, H&R may satisfy its burden under section 547(c)(2)(B) by providing evidence both of its dealings with other customers and Quad's dealings with other vendors. Further, in light of the evidence stipulated to by the parties, H&R has satisfied its burden of persuasion on this requirement.

In their statement of facts, the parties stipulated that Quad had business dealings with thirty-nine vendors other than H&R and that all of these vendors were paid by Quad in the same time sequence as H&R. Statement of Facts ¶ 9. The

average days between invoice date and check issuance date for these vendors was 60 to 75 days.

Here, each payment to H&R was made between 60 and 86 days from the invoice date. For the ten invoices paid by Quad pre-petition, the average number of days was 69.4. Since this figure is within the average range of payments made by Quad to its other vendors that was stipulated to by the parties (60 to 75 days), I find that H&R has satisfied its burden of proving that the transfers were made in the ordinary course of Quad's business.

In consideration of what was ordinary in H&R's business dealings, the stipulation provided that 81% by dollar volume of H&R's business was paid by five customers with weighted average invoice payments between 50 and 71 days. Statement of Facts ¶ 11 and Exhibit C. Since the information pertaining to Quad's payments was presented in actual, and not weighted, numbers, these figures are difficult to compare. However, the parties also stipulated to the testimony of H&R's Controller, Mr. G. Scott Jacoby, who would testify that H&R's five major customers paid their invoices between 42 and 96 days. Id. ¶ 14. Moreover, the stipulation provided that none of H&R's customers paid in 2002 in accordance with the thirty-day payment terms on the invoice and that this was also H&R's experience in 2000. Id.

This evidence proves generally that it was ordinary for H&R to accept late payments from its debtors. In fact, the five customers constituting 81% of its business paid their invoices late – in as many as 96 days. Although the range of days

in which these customers paid their invoices is wide – 42 to 96 days – I find it is sufficient to establish the degree of lateness that H&R would ordinarily accept from its customers. Because Quad paid all of H&R's invoices within this range, I conclude that H&R's acceptance of these payments was in the ordinary course of its business dealings.

Therefore, because the defendant has provided uncontroverted evidence that the payments at issue were made in the ordinary course of Quad's business and accepted in the ordinary course of H&R's business, H&R has satisfied its burden of proof under § 547(c)(2)(B).

B.

Finally, I must determine whether H&R has met its evidentiary burden to demonstrate that Quad's payments were made according to "ordinary business terms" as required by section 547(c)(2)(C). To satisfy the requirement imposed by section 547(c)(2)(C), H&R must prove by a preponderance of evidence that the transfers received during the preference period were "made according to ordinary business terms." Courts have recognized that this subsection requires an objective inquiry into "whether the payment practices at issue are consistent with what takes place in the industry." Matter of Gulf City Seafoods, Inc., 296 F.3d 363, 368 (5th Cir. 2002).

The evidentiary component of this subsection was analyzed extensively by the Third Circuit Court of Appeals in In re Molded Acoustical Products, Inc., 18 F.3d 217 (3d Cir. 1994):

> [Section 547(c)(2)(C)] does not imply that the creditor must prove the existence of some single, uniform set of industry-wide credit terms, a formidable if not insurmountable obstacle given the great variances in billing practices likely to exist within the set of markets or submarkets which once could plausibly argue comprise the relevant industry. The Seventh Circuit, conscious of this difficulty, eschewed a bright line approach, concluding that:
>
> > "ordinary business terms" refers to the range of terms that encompasses the practices in which firms similar in some general way to the creditor in question to engage, and that only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection C.
>
> In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1033 (7th Cir. 1993) (emphasis in original). Preferring to stay true to what scarce legislative history there is, we substitute the word "unusual" for "idiosyncratic" but otherwise adopt Tolona Pizza's definition.

Id. at 224; see also Matter of Gulf Seafoods, Inc., 296 F.3d at 369; In re R.D.F. Developments, Inc., 239 B.R. 336, 342 (6th Cir. BAP 1999). The Third Circuit further explained that application of this statutory standard will be affected by the "duration of the parties' [pre-bankruptcy] relationship." In re Molded Acoustical Products, Inc.,18 F.3d at 224.

> [W]hen the relationship in question has been cemented long before the onset of insolvency – up through and including the preference period – we should pause and consider carefully before further impairing a creditor

> whose confident, consistent, ordinary extension of trade credit has given the straitened debtor a fighting chance of sidestepping bankruptcy and continuing in business. Bankruptcy policy, as evidenced by the very existence of § 547(c)(2), is to promote such continuing relationships on level terms, relationships which if encouraged will often help businesses fend off an unwelcome voyage into the labyrinths of a bankruptcy.
>
> . . . [T]he more cemented (as measured by its duration) the pre-insolvency relationship between the debtor and the creditor, the more the creditor will be allowed to vary its credit terms from the industry norm yet remain within the safe harbor of § 547(c)(2). The likelihood of unfair overreaching by a creditor (to the disadvantage of other creditors) is reduced if the parties sustained the same relationship for a substantial time frame prior to the debtor's insolvency. After all, if at the starting point of the relationship insolvency was a distant prospect, a trade creditor does not unfairly overreach, impel insolvency, or inequitably advantage itself at other creditors' expense by tolerating more generous or commanding more stringent repayment schedules than its competitors.

Id., at 224-25. Thus, where the parties have a long-standing business relationship that began well before the debtor became financially distressed, they have more leeway to diverge from industry norms. See also In re Allegheny Health, Education and Research Foundation, 2003 WL 1921901, at *9.

When, as in this proceeding, the creditor and debtor did not have a long-standing business relationship, the Third Circuit has instructed that the defendant's burden to meet the standard of section 547(c)(2)(C) becomes more stringent:

> When the relationship between the parties is of recent origin, or formed only after or shortly before the debtor sailed into financially troubled seas, the credit terms will have to endure a rigorous comparison to credit terms used generally in a relevant industry. That is because in that

> class of cases we lack something better to look at to verify that the creditor is not exploiting the debtor's precarious position at the brink of bankruptcy so that it may advantage itself to the detriment of other creditors who continue to extend credit within the letter and spirit of the Code, or at the very least to verify that the creditor is refraining from "unusual" action to collect ordinary debts. In other words, in those situations there is no baseline against which to compare the pre-petition transfers at issue to confirm the parties would have reached the same terms absent the looming bankruptcy.

In re Molded Acoustical Products, Inc., 18 F.3d at 225-26 (emphasis added).

In order for a defendant to meet its burden under section 547(c)(2)(C), "courts do not look only at the manner in which one particular creditor interacted with other similarly situated debtors, but rather analyze whether the particular transaction in question comports with the standard conduct of business within the industry." In re Fred Hawes Organization, Inc., 957 F.2d 239, 246 (6th Cir. 1992). Moreover, as explained by the Third Circuit in Molded Acoustical, "ordinary terms are those which prevail in healthy, not moribund, creditor-debtor relationships." In re Molded Acoustical Products, Inc., 18 F.3d at 227. Thus, to satisfy this element, the defendant must provide some evidence as to what practices are generally adhered to by financially healthy members of the relevant industry.

In the instant matter, other than a long-ago transaction for which no record exists, Quad and H&R entered into their business dealings only a few months before the debtor filed for bankruptcy relief. Moreover, all of the payments at issue were made within the preference period, when the debtor was insolvent. Therefore,

H&R may not rely upon its business dealings with the debtor to establish the objective industry standard required by subsection 547(c)(2)(C).

As a result, I must evaluate the evidence offered by this defendant concerning industry practices. In so doing, I note that H&R may not meet its evidentiary burden by demonstrating that its dealings with Quad were consistent with its transactions with other customers. See, e.g., In re Gulf City Seafoods, Inc., 296 F.3d at 368 n.5 ("Following the Second, Sixth and Seventh Circuits, we hold that Ludwig cannot meet its burden under this objective test by simply showing that (1) its arrangement with Gulf City is similar to the credit arrangements Ludwig has with other debtors, or (2) the arrangement is similar to Gulf City's arrangements with other creditors"); Matter of Midway Airlines, Inc., 69 F.3d at 778-79.

In addition, to establish the objective industry standard, the focus is upon "creditor's industry," as that industry involves customers in businesses similar to the debtor's. See In re DeMert & Dougherty, Inc., 232 B.R. 103, 109 (N.D. Ill. 1999); see generally In re Molded Acoustical Products, Inc., 18 F.3d at 224; In re Tolona Pizza Products Corp., 3 F.3d at 1033.

In the parties' stipulation of facts, the defendant provided evidence relating to the payment practices of its five major customers as proof of the range of late payments it was willing to accept. As mentioned above, however, a defendant cannot satisfy § 547(c)(2)(C) by providing evidence of the business dealings of only those who are party to the dispute at issue. See In re Roblin Industries, Inc., 78 F.3d at 43 ("To permit a creditor to rely solely on such evidence would, in effect, shift the

burden to the [plaintiff] to offer evidence that other industry participants behaved otherwise"); Matter of Midway Airlines, 69 F.3d 792, 797-98 (7th Cir. 1995) ("Reliance solely on the experience of the creditor renders ineffectual the important dichotomy between the subjective requirements of 11 U.S.C. § 547(c)(2)(A)-(B), which can be satisfied through proof of the parties' own dealings, and the objective requirement imposed by 11 U.S.C. § 547(c)(2)(C), which requires reference to some external datum"); In re Fred Hawes Organization, Inc., 957 F.2d 239, 246 (6th Cir. 1992) ("[C]ourts do not look only at the manner in which one particular creditor interacted with other similarly situated debtors, but rather analyze whether the particular transaction in question comports with the standard conduct of business within the industry"); In re R.M.L., Inc., 195 B.R. 602, 616 (Bankr. M.D. Pa. 1996). Rather, the defendant must provide some evidence other than its own payment history with other customers or with the instant plaintiff. See, e.g., In re DeMert & Dougherty, Inc., 232 B.R. at 109.

To meet this burden, it was not necessary for H&R to offer expert testimony. See, e.g., Matter of Midway Airlines, 69 F.3d at 797. Nor it is mandatory that the defendant procure evidence from its competitors. Id. While such evidence would be probative, less expensive methods may be available.

For example, some courts have detemined that a defendant's burden under § 547(c)(2)(C) was satisfied through evidence from employees of the defendant who were capable of testifying about their experiences with and understanding of the business practices of others in the relevant industry. See, e.g., In re Tolona Pizza

Products Corp., 3 F.3d at 1029; In re Ed Jefferson Contracting, Inc., 224 B.R. 740, 749 (Bankr. E.D. Mo. 1998) (affidavit of supervisor employed by the defendant that attested that the challenged transfers and their late acceptance were made according to ordinary business terms was sufficient); In re Speco Corp., 218 B.R. 390, 402 (Bankr. S.D. Ohio 1998). Where, however, the defendant fails to proffer any evidence of an industry standard exclusive of the parties' own dealings, it has not satisfied its burden under § 547(c)(2)(C). See, e.g., Matter of Gulf City Seafoods, Inc., 296 F.3d at 369; Matter of Midway Airlines, 69 F.3d at 799; In re R.M.L., Inc., 195 B.R. at 616.

In this proceeding, H&R provided limited evidence of the standard payment terms in Quad's industry. In their Statement of Facts, the parties stipulated to the testimony of Mr. Morton Perchick, vice-president of Kulicke & Soffa Industries, which operates a manufacturing business similar to that of Quad. Statement of Facts ¶ 10. According to this stipulation, Mr. Perchick has been associated with Kulicke & Soffa for 33 years in various financial and quality control capacities. Id. He would have testified that Kulicke & Soffa deals with over 100 vendors and paid vendor invoices between 37 and 95 days in 2000. Id.

Although such evidence may demonstrate that it was ordinary within the debtor's manufacturing industry to make late payments to its various vendors, this evidence does not establish the standard practices of the defendant's industry. See In re DeMert & Dougherty, Inc., 232 B.R. at 109; In re Sacred Heart Hospital of Norristown, 200 B.R. 114, 118-19 (Bankr. E.D. Pa. 1996) ("None of the foregoing cases suggests that a preference defendant can succeed by confining his objective

evidence of 'ordinary business terms' to only the debtor's industry. The cases that mention any distinction between emphasis on the debtor's industry as opposed to the creditor's industry appear to uniformly assume without expressly deciding the issue that the focus must be on the creditor's entire industry").

Insofar as objective evidence of its own industry standard is concerned, the stipulation only provided evidence that relates to the defendant's experience with its own customers. Such evidence is not sufficient to establish industry standards under section 547(c)(2)(C). See In re Roblin Industries, Inc., 78 F.3d at 43; Matter of Midway Airlines, 69 F.3d at 797-98; In re Fred Hawes Organization, Inc., 957 F.2d at 246; In re R.M.L., Inc., 195 B.R. at 616.

Moreover, H&R only provided evidence of the payment ranges made by its five largest customers; even if such evidence were relevant to section 547(c)(2)(C), the defendant did not indicate how this range compared with payments made by the other customers with which it does business. Limiting the evidence to only the defendant's five largest customers may be misleading in its indication of the terms used by the industry as a whole, since the defendant may be more lenient with larger customers because their business is more important to the defendant. Indeed, the defendant's dealings with its own customers does not necessarily mirror those of other vendors in the defendant's industry – it is possible that this defendant was more willing to accept late payments than other members of the relevant industry.

Since the defendant did not provide sufficient evidence of the standard practices of its own industry – and as it may not have been particularly expensive or

difficult to provide such evidence – I find that H&R has not satisfied its burden of proving that the transfers at issue here were made according to ordinary business terms. Permitting H&R to satisfy its burden of proving the practices of its industry under § 547(c)(2)(C) by using the same evidence relied upon to satisfy § 547(c)(2)(B) would indeed render § 547(c)(2)(C) superfluous. Congress, however, clearly intended that the two subsections be separately proven by the defendant in a preference action. Therefore, the defendant must provide some additional evidence to satisfy its burden under § 547(c)(2)(C), which H&R has failed to do.

For this reason, the defendant has not meet its burden of persuasion under section 547(c)(2).

IV.

At trial, the defendant also raised the new value exception found in 11 U.S.C. § 547(c)(4). The defendant argues that it gave "new value" to the debtor, after at least some of the preferential payments were made, by incorporating the $3,000 per unit component parts it had purchased into the product that was ultimately shipped to Quad. The plaintiff, however, contends that § 547(c)(4) does not apply because all of the component parts were purchased by the defendant before it received any payments from Quad. Under slightly different reasoning, I agree with the plaintiff that § 547(c)(4) is not applicable under these circumstances.

Pursuant to that subsection:

> The trustee may not avoid under [section 547(b)] a transfer–
>
> (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor–
>
>> (A) not secured by an otherwise unavoidable security interest; and
>> (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

The term "new value" is defined in § 547(a)(2) as:

> [M]oney or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable by the debtor or the trustee under any applicable law, including proceeds of such property, but does not include an obligation substituted for an existing obligation.

The three elements of § 547(c)(4) were discussed by the Third Circuit Court of Appeals in In re New York City Shoes, Inc., 880 F.2d 679, 680 (3d Cir. 1989) (emphasis in original):

> First, the creditor must have received a transfer that is otherwise voidable as a preference under § 547(b). Second, after receiving the preferential transfer, the preferred creditor must advance "new value" to the debtor on an unsecured basis. Third, the debtor must not have fully compensated the creditor for the "new value" as of the date that it filed its bankruptcy petition.

(emphasis added); see also In re Lease-A-Fleet, Inc., 141 B.R. 853, 864 (Bankr. E.D. Pa. 1992).

This subsection is "designed to encourage trade creditors to continue dealing with troubled businesses." In re New York City Shoes, Inc., 880 F.2d at 680 (internal quotations omitted). As further explained by the Third Circuit,

> In the ordinary course of business, suppliers provide goods to businesses on credit. The financial pressure that would result if creditors were to force an ailing company to pay for supplies up-front could turn many a troubled company into a bankruptcy one. By allowing creditors to rely on payments of back debt in shipping new goods, section 547(c)(4) serves the purpose of avoiding unnecessary bankruptcies.

Id.; see also In re Lease-A-Fleet, Inc., 141 B.R. at 864. Section 547(c)(4) is also "designed to treat fairly a creditor who has replenished the estate after having received a preference." In re New York City Shoes, Inc., 880 F.2d at 681 (internal quotations omitted).

In this dispute, H&R argues that it provided "new value" to the debtor after receiving preferential payments by incorporating materials it had purchased into the finished product delivered to the debtor. By limiting itself to only the component parts it purchased, the defendant is therefore limiting the applicability of this exception to only the value of those parts incorporated – which the parties stipulated totaled approximately $3,000.00 per unit shipped.[4]

Nevertheless, I conclude that the defendant has not satisfied all three elements of this subsection. To succeed under a § 547(c)(4) defense, as noted above,

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[4] Whether such a limitation is necessary is debatable, as the definition of "new value" includes "goods" and "services," both of which were provided by the defendant in its manufacture of the base housings ordered by Quad.

the defendant must demonstrate that (1) it received a transfer that is otherwise voidable as a preference under § 547(b); (2) after receiving the preferential transfer, the defendant advanced "new value" to the debtor on an unsecured basis; and (3) the debtor did not fully compensate the creditor for the "new value" as of the date that it filed its bankruptcy petition. If the defendant satisfies these three elements,

> it is entitled to set off the amount of the "new value" which remains unpaid on the date of the petition against the amount which the creditor is required to return to the trustee on account of the preferential transfer it received.

Id. at 680.

Here, the defendant has satisfied the first element – the parties have stipulated that the payments in question are preferential and avoidable if an exception does not apply. However, the remaining two elements have not been proven.

The defendant claims that it has provided "new value" to the debtor by continuing to perform under the purchase order during the preference period and post-petition – after it had received the preferential transfers at issue in this dispute. According to the fact stipulation, there are two invoices for which H&R has not received full payment. The first was issued on October 9, 2000 and the second was issued on October 12, 2000 – both invoices were in the amount of $4,778.87, for a total of $9,557.74. Statement of Facts ¶ 15. Partial payment of these invoices, in the amount of $3,168.05, was made by the trustee. Id.

Although these invoices were sent in October 2000, the preferential payments in controversy were made by Quad from November 8, 2000 to December 4,

2000 – after the unpaid invoices were issued and the goods shipped. Section 547(c)(4), however, requires that the new value be transferred to the debtor after the preferential transfers are made. Thus, since both unpaid invoices and their products were provided to Quad before any of the preferential payments were made, the defendant cannot offset their unpaid balance against the amount of the preferential transfers it received from Quad.

After Quad filed its bankruptcy petition in December 2000 – and after the preferential transfers were made – H&R did provide "new value" to Quad by continuing to perform under the contract. In fact, H&R issued post-petition invoices from January 26, 2001 through March 23, 2001. However, all of these shipments were made on a "cash on delivery" basis and, therefore, have been paid in full. Thus, § 547(c)(4) would not apply to these shipments. See In re Lease-A-Fleet, Inc., 141 B.R. at 864 ("It is clear . . . that § 547(c)(4) can be invoked only as to 'new value' which has not been subsequently paid for by the Debtor").

Accordingly, the defendant has not demonstrated that § 547(c)(4) would allow it to off set any unpaid balances against the amount of the preferential payments it received from Quad.

V.

In sum, the parties have stipulated that the payments made by Quad to H&R from November 8, 2000 through December 4, 2000 are preferential and

therefore avoidable under 11 U.S.C. § 547(b) unless an exception under 11 U.S.C. § 547(c) applies. The defendant argues that both the ordinary course of business exception, § 547(c)(2), and the new value exception, § 547(c)(4), apply to except these transfer from avoidance, at least in part.

The defendant, however, failed to sustain its burden of proof under § 547(c)(2) because it failed to show that the transfers were made according to the "ordinary business terms" prevalent in the defendant's industry. More specifically, the defendant did not produce any evidence of what the standard payment terms were in its own industry. In addition, the defendant's argument under § 547(c)(4) must also be rejected because it did not advance any "new value" to the debtor after receipt of the preferential payments, for which it was not paid in full.

Accordingly, I conclude that the preferential payments that Quad made to H&R during the ninety-day preference period – totaling $49,975.54 – are avoidable under 11 U.S.C. § 547(b) and recoverable by the debtor (as the debtor in possession) pursuant to 11 U.S.C. § 550(a) and 11 U.S.C. § 1107(a).[5]

An appropriate order shall be entered.

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[5]Although H&R is liable to the bankruptcy estate for the pre-petition payments it received, it will be entitled to assert an unsecured claim for the amounts repaid to the estate. See 11 U.S.C. § 502(d), (h); Fed. R. Bankr. P. 3002(c)(3). If it submits a timely claim, it will apparently receive a significant distribution as an unsecured creditor, as the bankruptcy estate has sufficient funds to do so.

UNITED STATES BANKRUPTCY COURT
FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In re	:	Chapter 11
QUAD SYSTEMS CORPORATION	:	
Debtor	:	Bankruptcy No. 00-35667F
QUAD SYSTEMS CORPORATION	:	
Plaintiff	:	
v.	:	
H&R INDUSTRIES, INC.	:	
Defendant	:	Adversary No. 02-0972

....

ORDER

....

AND NOW, this 15 day of July, 2003, for the reasons stated in the accompanying memorandum, it is hereby ordered that judgment shall be entered against the defendant in the amount of $49,975.54, pursuant to 11 U.S.C. §§ 547 and 550.

BRUCE FOX
Chief Bankruptcy Judge

IN RE: Chapter 11
QUAD SYSTEMS CORPORATION Bankruptcy No. 00-35667F
Quad Systems Corporation Adversary No. 02-0972
v.
H&R Industries, Inc.

Copies of the Chief Bankruptcy Judge's Memorandum and Order dated July 15, 2003, were mailed on said date to the following:

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