Ordinary Business Terms: Setting the Standard for 11 U.S.C. s 547(c)(2)

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Comment

Ordinary Business Terms: Setting the Standard for 11 U.S.C. § 547(c)(2)(C)

I. INTRODUCTION

The Bankruptcy Code permits a bankrupt estate to recover certain transfers made by its debtor prior to declaring bankruptcy. The trustee of a bankrupt estate obtains this power under the law of avoidable preferences. Deciding which transfers are avoidable and which are exempt from the trustee’s avoidance powers requires solving an evidentiary question that is currently causing confusion among several courts. Although the Code defines eight exceptions to the general

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2. See 11 U.S.C. § 547(b) (1988). The trustee of the bankrupt estate has “avoidance” or “preference” powers as enumerated in § 547(b) of the Bankruptcy Code, which states:

   (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 90 days and one year before the date of the filing of the petition, if such creditor at 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.

Id.

Simply stated, a preference is a transfer by an insolvent debtor to one or more creditors whereby the creditor to whom the property was transferred is put in a better position than other creditors with respect to priority claims to the assets of the insolvent. BLACK’S LAW DICTIONARY 1178 (6th ed. 1990); see also Note, Preferential Transfers and the Value of the Insolvent Firm, 87 YALE L.J. 1449 (1978) (analyzing the relationship between insolvency and preference law).

3. See infra part III.
preference rules,\(^4\) it fails to define clearly the circumstances under which the exceptions apply. One of these exceptions, known as the ordinary-course-of-business defense,\(^5\) has recently inspired litigation focusing on the meaning of section 547(c)(2)(C)’s statutory language.

Pursuant to section 547(c)(2)(C), the third and last element of the ordinary-course-of-business exception, a trustee may not avoid a transfer if the payment was made “according to ordinary business terms.”\(^6\) Courts and commentators currently disagree on what evidence a creditor must introduce to prove that the payment terms of the preferential transfer were “ordinary business terms” under section 547(c)(2)(C).\(^7\) Clarification of this subsection’s language is vitally needed by creditors\(^8\) who are understandably concerned with protecting their credit transactions from a trustee’s avoidance power\(^9\) should a debtor file bankruptcy. In short, creditors need to know precisely what “ordinary business terms” are in order to conform their business dealings to the appropriate standard.\(^10\) Currently, such

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4. 11 U.S.C. § 547(c)(1)-(8) (1988), as amended by 1994 Bankruptcy Reform Act, supra note 1, § 304(f), 108 Stat. 4106, 4133-34. Following the introductory language in § 547(c), which states that a trustee cannot avoid certain transfers under § 547(b), the statute provides eight numbered paragraphs setting forth the exceptions to the trustee’s avoidance power. Id. If creditors can qualify under any one or more of these exceptions, then payments they received from the debtor during the preference period are protected to that extent from the trustee’s avoidance power as set forth in § 547(b). See id.

5. Id. § 547(c)(2)(A)-(C) (1988). The ordinary-course-of-business exception consists of the following three statutory elements:

- (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.

Id. (emphasis added).

In other words, by proving each of the elements under § 547(c)(2), a creditor protects a transaction that would otherwise be subject to the trustee’s avoidance. See id. Throughout this Comment, the phrase “ordinary-course-of-business exception” is used interchangeably with the “ordinary-course-of-business defense” or with § 547(c)(2).

6. Id. § 547(c)(2)(C).

7. See, e.g., In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1031 (7th Cir. 1993) (discussing split in the circuits on this issue and stating that even the scholarly literature is inconclusive).

8. In this Comment, “creditor” is used to signify the person or entity claiming to be owed, and “debtor” is used to signify a person or entity owing a debt or obligation prior to a voluntary or involuntary bankruptcy proceeding. Once bankruptcy proceedings begin, the “bankrupt” will be used to signify the former debtor.

9. See supra note 2 and accompanying text. The burden of proving the unavoidability of a transfer is on the creditor or party in interest who is defending the action. 11 U.S.C. § 547(g) (1988).

10. Creditors deserve guidance on how to create payment terms that will not fall prey to the trustee’s avoidance power. More specifically, creditors seek clarification of what
business planning is virtually impossible due to recent court decisions imposing inconsistent evidentiary burdens under section 547(c)(2)(C) on creditors facing adversary proceedings.\(^{11}\)

These decisions also reveal that courts need clarification on the evidentiary requirements of section 547(c)(2)(C).\(^{12}\) Courts have lamented Congress' failure to flesh out the concept of "ordinary" under this section of the Code.\(^{13}\) Like creditors, courts inconsistently determine whether the phrase "ordinary business terms" refers to what is ordinary between the particular debtor and creditor at issue, between that debtor and other creditors, between that creditor and other debtors, or generally between any debtor and creditor in the industry.\(^{14}\)

This Comment highlights the difficulties courts and commentators\(^{15}\) face when interpreting section 547(c)(2)(C). First, it briefly traces the legislative history of the original Bankruptcy Act of 1898\(^{16}\) to current provisions of the Bankruptcy Code,\(^{17}\) highlighting the statutory changes that lend guidance to the correct interpretation of section evidence they must produce in order to exempt a payment under the ordinary-course-of-business exception. See infra part III.


12. See Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.), 18 F.3d 217, 219, 221 (3d Cir. 1994) (criticizing the district court for not refining the contours of § 547(c)(2)(C) and stating that the question of what is meant by "ordinary business terms" is of great importance).

13. See, e.g., Campbell v. Cannington (In re Economy Milling Co., Inc.), 37 B.R. 914, 921-22 (D.S.C. 1983) (noting that even the legislative history provides no guidance as to the meaning of § 547(c)(2)(C)'s "ordinary business terms").

14. See infra part III.

15. See Michael J. Herbert, The Trustee Versus the Trade Creditor: A Critique of Section 547(c)(1), (2) & (4) of the Bankruptcy Code, 17 U. RICH. L. REV. 667, 692 (1983) (describing the ordinary-course-of-business terms requirement as "the most opaque requirements to date").

Another commentator identified the problem in 1986. See David J. DeSimone, Section 547(c)(2) of the Bankruptcy Code: The Ordinary Course of Business Exception Without the 45 Day Rule, 20 AKRON L. REV. 95 (1986). According to DeSimone, "[t]he big problem with section 547(c)(2)(C) is determining what the benchmark for the objective standard should be. Business practice in general? Practices in a particular industry? ... And, how does one define the industry? This could be a problem for the courts." Id. at 127.


Next, this Comment explains how courts have historically interpreted section 547(c)(2)(C) under either a party-focused or industry-terms analysis, and discusses the inconsistency among the circuits in choosing between the interpretations. Furthermore, this Comment analyzes whether a creditor must produce independent evidence that the terms at issue comply with "industry terms" in order to escape the trustee's avoidance powers.

In deciding these issues, this Comment promotes a view that is consistent with the underlying objectives of preference law. Specifically, it urges courts to refrain from requiring positive evidence of industry-term compliance unless the policy objectives of preference law are not otherwise met. Finally, this Comment encourages Congress to end the controversy by providing official comments to clarify the evidentiary requirements of "ordinary business terms."

II. BACKGROUND

Preference law governs relationships among creditors even before bankruptcy proceedings begin, by deterring self-interested behavior of certain creditors during the transitional period between a debtor's insolvency and bankruptcy. More specifically, preference law requires the return of payments made as a result of self-interested creditor behavior to the bankrupt estate so that the remaining creditors

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18. See infra part II.
19. See infra part II.D.
20. See infra part III.
21. See infra part IV. Although courts historically considered this to be the minority view, one court recently and more logically dubbed this as the view of the "new majority," See In re Excello Press, Inc., 967 F.2d 1109, 1114 n.3 (7th Cir. 1992).

Furthermore, a thorough analysis of the § 547(c)(2)(C) issue may require more than merely choosing one of the two prevailing interpretations. For instance, Tolona has added another dimension to the analysis by using the minority, or "new majority" approach while lowering the threshold of evidence needed to show term compliance with the industry standard. In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1033 (7th Cir. 1993). Using this watered-down standard, the court required "industry terms" evidence under § 547(c)(2)(C) but accepted evidence of "general business terms" as sufficient proof of the standard. Id.

22. See infra parts IV-VI. If a creditor acts consistently with the purposes of preference law, this author argues against imposing further evidentiary hurdles.
23. See infra part V.
24. See infra part V.
may eventually receive a larger share of the estate.\textsuperscript{26} Accordingly, the trustee of the bankrupt estate, armed with section 547(b),\textsuperscript{27} may avoid any transfer of the debtor's property to a creditor (1) made to or for the benefit of a creditor,\textsuperscript{28} (2) made on account of an antecedent debt,\textsuperscript{29} (3) made while the debtor is insolvent,\textsuperscript{30} (4) made to an insider on or within ninety days before a debtor files the bankruptcy petition,\textsuperscript{31} or (5) which enables the creditor to receive more than it would receive under bankruptcy liquidation.\textsuperscript{32} As one court described, such avoidance power under preference law is necessary to protect both the debtor and the creditor and to prevent situations such as the following:

If there were no rule against preferences, an insolvent debtor, teetering on the edge of bankruptcy and besieged by creditors, might have an incentive to buy off the most importunate of his creditors, necessarily at the expense (the debtor being insolvent) of other creditors, in the hope of keeping afloat a little longer. Knowing that the debtor might do such a thing, an unsecured creditor who sensed that a debtor might be about to go belly-up would have a strong incentive to petition him into bankruptcy so that the debtor could not deplete the assets available to pay this creditor by paying another unsecured creditor instead.\textsuperscript{33}

Nevertheless, eight exceptions or affirmative defenses to section 547(b) allow creditors to defeat a trustee's avoidance actions in certain circumstances.\textsuperscript{34} In effect, these exceptions encourage creditors to

\begin{itemize}
\item \textsuperscript{26} See Cullina, supra note 25, at 153.
\item \textsuperscript{27} 11 U.S.C. § 547(b) (1988); see supra note 2.
\item \textsuperscript{28} Id. § 547(b)(1).
\item \textsuperscript{29} Id. § 547(b)(2).
\item \textsuperscript{30} Id. § 547(b)(3). The Code defines a firm as insolvent when "the sum of such entity's debts is greater than all of such entity's property, at a fair valuation . . . ." Id. § 101(32)(A) (1988 & Supp. V 1993). Under the preference provisions, there is a rebuttable presumption that the debtor was insolvent during the 90 days immediately preceding the date the bankruptcy petition was filed. Id. § 547(f). This 90-day period is commonly known as the preference period. See id. Once a creditor rebuts this presumption, the burden shifts to the trustee to prove by a preponderance of the evidence that the debtor was indeed insolvent at the time of the allegedly preferential transfer. See 4 COLLIER ON BANKRUPTCY § 547.21, at 547-93 to -94 (15th ed. 1993).
\item \textsuperscript{31} 11 U.S.C. § 547(b)(4)(A)-(B) (1988). If the creditor was an insider at the time of the transfer, a trustee may avoid any transfer made between 90 days and one year before the date the debtor filed the bankruptcy petition. Id. § 547(b)(4)(B).
\item \textsuperscript{32} Id. § 547(b)(5)(A)-(C). Trustees have long enjoyed the power to avoid preferential transfers. See generally Vern Countryman, The Concept of a Voidable Preference in Bankruptcy, 38 VAND. L. REV. 713, 718-50 (1985) (tracing the evolution of the American concept of preferential transfers). For a detailed history of preference power, see Lissa L. Broome, Payments on Long-term Debt as Voidable Preferences: The Impact of the 1984 Bankruptcy Amendments, 1987 DUKE L.J. 78, 79.
\item \textsuperscript{33} In re Xonics Imaging, Inc., 837 F.2d 763, 765 (7th Cir. 1988).
\item \textsuperscript{34} 11 U.S.C. § 547(c)(1)-(8) (1988), as amended by 1994 Bankruptcy Reform Act,
continue doing business with struggling debtors. The exception set out in section 547(c)(2) requires proving three distinct elements found in subsections (A), (B), and (C).

This exception, the ordinary-course-of-business exception, prevents the trustee from avoiding a debtor's pre-bankruptcy preferential transfer if the payment was made and the debt was incurred in the ordinary course of business between the debtor and that creditor, and if the payment was made according to "ordinary business terms." Although most courts currently have little difficulty in interpreting the evidentiary burdens imposed by the first two elements, subsection (C) causes much confusion.

Courts and commentators have argued that without the exceptions listed in section 547(c), creditors would either stop extending credit altogether, insist on early repayment, or force debtors into early bankruptcy at the first hint of financial hardship. Such creditor action would disserve societal interests by precipitating premature bankruptcy that more tolerant debtor-creditor relationships could prevent.

supra note 1, § 304(f), 108 Stat. 4106, 4133-34.

35. See Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.), 18 F.3d 217, 219 (3d Cir. 1994). The Molded court opined that "the ordinary course exception to the preference rule is formulated to induce creditors to continue dealing with a distressed debtor so as to kindle its chances of survival without a costly detour through, or a humbling ending in, the sticky web of bankruptcy." Id.


37. Id. § 547(c)(2).

38. See supra notes 26-32 and accompanying text.

39. 11 U.S.C. § 547(c)(2)(A)-(B). For the exact text of these statutory elements, see supra note 5. See also supra notes 27-32 and accompanying text.

40. Id. 11 U.S.C. § 547(c)(2)(C). See supra note 5 which sets forth the statutory elements.

41. See In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1031 (7th Cir. 1993). The Tolona court explained:

The first two requirements are easy to understand: of course to defeat the inference of preferential treatment the debt must have been incurred in the ordinary course of business of both debtor and creditor and the payment on account of the debt must have been in the ordinary course as well. But what does the third requirement—that the payment have been "made according to ordinary business terms"—add?

Id. (quoting 11 U.S.C. § 547(c)(2)(C) (1988)).

While courts have resolved most issues pertaining to the first two elements of § 547(c)(2), any remaining litigation relating to these elements is beyond the scope of this Comment.


43. See Tolona, 3 F.3d at 1032. Judge Posner insightfully noted:
A. General Policy Objectives of Preference Law

The legislative history of the Code and pre-Code bankruptcy rules confirms that there are at least two policy objectives of preference law. These include (1) deterring unusual credit transactions or the "race of diligence," and (2) preserving the bankrupt estate to ensure equality of distribution among creditors.

1. Deterring the Race of Diligence

Congress' goal of deterring the "race of diligence" by preventing unusual credit transactions somewhat reflects traditional freedom of contract principles. As early as the late 1500s, English bankruptcy law

Unless the favoring of particular creditors is outlawed, the mass of creditors of a shaky firm will be nervous, fearing that one or a few of their number are going to walk away with all the firm's assets; and this fear may precipitate debtors into bankruptcy earlier than is socially desirable.

Id.

By insulating normal business transactions, § 547(c)(2) attempts to allay the concerns of would-be nervous creditors by creating a safe harbor for financial dealings. Morren Meat, 92 B.R. at 740. As a result of this repose from aggressive creditor action, debtors have an increased opportunity to rehabilitate themselves. Id.

44. Pre-Code bankruptcy law includes English common law, American common law, and the 1898 Act. See infra part II.A.1.

45. This Comment uses the term "race of diligence" as short-hand to describe unusual and undesirable creditor behavior such as insisting on early repayment or instituting aggressive collection actions at the first sight of financial hardship. As noted by one commentator:

The race of diligence harms the creditors as a group primarily because it is likely to bring about the dismemberment of the debtor business. Once bankruptcy is filed, the unpaid creditors must look to the remaining assets of the debtor business to satisfy their claims. Because a piecemeal sale of a dismembered business typically generates less value than its sale as a going concern, the race of diligence reduces the total assets available to the creditors as a group.


46. Afilalo, supra note 45, at 627 (stating that "Congress specifically intended the preferences section of the Bankruptcy Code to deter this 'race of diligence' and to promote equality of distribution among creditors."); DeSimone, supra note 15, at 98 (describing equality of distribution as the most fundamental concept underlying bankruptcy and acknowledging that discouraging the race of diligence is another goal of preference law); see Herbert, supra note 15, at 696 (stating that "[t]he usual rationales for the law of preferences are to avoid dismemberment of the debtor and to ensure equality of distribution."); see also Broome, supra note 32, at 113 (describing the principal objective of the preference provision as being facilitation of equality of distribution among creditors of the debtor); Issac Nutovic, The Bankruptcy Preference Laws: Interpreting Code Sections 547(c)(2), 550(a)(1), and 546(a)(1), 41 Bus. LAW. 175, 180 (1985) (stating that "[b]ankruptcy policy seeks to ensure the creditors of a ratable share of the assets owned by the debtor" and commenting that the preference laws are designed to protect this goal).
upheld transfers so long as they were made for good consideration and according to “bona-fide” contract terms. Subsequent English bankruptcy laws, focusing on the debtor’s intent, were then incorporated in modified form in American common law and the Bankruptcy Act of 1898.

Under the 1898 Act, a trustee seeking to avoid a debtor’s payment carried the burden of proving that the creditor had reasonable cause to believe that the debtor was insolvent when making the payment. This evidentiary requirement demonstrated Congress’ reluctance, absent a creditor’s fraud or a lack of good faith, to interfere with business transactions much the way that early English courts refused to avoid payments because of strict adherence to freedom of contract principles. In essence, Congress sought to deter only those creditors with knowledge of the debtor’s financial problems from advantageously insisting on repayment to the detriment of those remaining creditors without such knowledge or advantage.

47. Countryman, supra note 32, at 714-15 (discussing English law’s focus on freedom of contract in the 1500s). Thus, in the absence of proof of criminal conduct or fraud, freedom of contract preserved most transfers. Id.

48. See David A. Ontko, Comment, Ordinary Business Terms Must Not be Ignored: The Forgotten but Critical Role of § 547(c)(2)(C) in the Ordinary Course of Business Exception to the Preference Rules, 6 BANKR. DEVS. J. 429, 431 (1989) (discussing the change of focus in early English bankruptcy law). Although strict enforcement of contract rights was an underlying principle of the first English bankruptcy laws, English courts later analyzed bankruptcy law in terms of preferential transfers and equitable distribution of the bankrupt estate. Id. Under English bankruptcy law, the trustee was required to prove the debtor’s intent to give a preference in order to avoid the transfer. Id. at 431-32.

49. 1898 Act, supra note 16; see Ontko, supra note 48, at 431-32 (discussing preference law developments from the English system to this country’s current approach). The Supreme Court recently looked to English law when deciding whether a bankruptcy court may conduct a jury trial in Grandfinanciera S.A. v. Nordberg, 492 U.S. 33, 43-47 (1989). Noting that bankruptcy suits were proceedings “at law” in England, the Court held that the Seventh Amendment’s jury trial guarantee likewise applied to bankruptcy suits in the United States. Id. at 46-49.

50. 1898 Act, supra note 16, § 60(b). Although English law and American law focus on the intent of different parties, Ontko asserts that they are consistent in protecting the majority of normal business transactions since the intent element is difficult to prove. See Ontko, supra note 48, at 431-32.

51. See Countryman, supra note 32, at 714-15; supra text accompanying note 47.

52. This statement assumes that creditors who know a debtor is in financial trouble will try to maximize their recovery, to the detriment of other creditors, by racing to enforce their claims and perhaps precipitating an early bankruptcy. Afilalo, supra note 45, at 626-27 (discussing how self-interested creditor behavior runs counter to societal interests). Preventing such action keeps money in the estate allowing all creditors to share equally in a larger portion of the estate if bankruptcy inevitably results. Id.
Thus, Congress sought to deter a race of diligence or a race to the courthouse. Indeed, the 1898 Act treated creditors favorably as a class since only those transfers to a small class of “knowledgeable” creditors were subject to preference attacks. Because the trustee carried the burden of proving the creditor’s knowledge, creditors were not burdened by evidentiary requirements and were able to protect most of their transactions from the trustee’s avoidance powers.

2. Seeking Equality of Distribution

The presumption in favor of creditors disappeared in 1978 when Congress enacted the Bankruptcy Code. The Code expanded the objectives of preference law by focusing on preventing transfers that, in effect, infringed upon equality of distribution of the bankrupt estate. Under the 1978 Reform Act, Congress enacted preference provisions that eliminated the 1898 Act’s reasonable-cause-to-believe requirement due to intense criticisms that this intent-focused analysis placed too much of an evidentiary burden on the trustee and that frequent failures to prove the requisite intent deterred equality of distribution.

53. See supra note 52 and accompanying text; see also H.R. Rep. No. 595, 95th Cong., 1st Sess. 177-78 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6138-39 (describing the trustee’s power to avoid pre-bankruptcy transfers as a deterrent to creditors who compete to dismember a debtor); supra note 43.

54. See supra notes 50-52 and accompanying text.

55. See supra note 48, at 432 (noting that routine payments for such expenses as rent, inventory, or supplies were usually protected since trustees could rarely prove that such trade creditors had the requisite reasonable-cause-to-believe the debtor was insolvent). Ontko also discusses how, prior to the 1978 Amendments, such expenses were commonly excepted from preference attacks under a judicial doctrine known as the “Current Expense Rule.” Id.; see also In re Brenton’s Cove Dev. Co., 52 B.R. 287 (Bankr. D.R.I. 1985). The court in Brenton noted that “[u]nlike the amended statute, former § 547(c)(2) included a 45-day rule which was virtually always dispositive, because unless the transfer occurred within 45 days after the debt was incurred, there was no need to consider whether payment was in the ordinary course of business . . . .” Id. at 292 n.7.

56. 1978 Reform Act, supra note 16. In 1978, after years of study and debate, Congress completely overhauled the federal bankruptcy system. Through the 1978 Reform Act, Congress enacted a Bankruptcy Code to replace the 1898 Act. Id. Several provisions of the 1978 Reform Act were again recently amended in the 1994 Bankruptcy Reform Act, supra note 1. These recent amendments do not solve the problems on which this Comment focuses.

57. See 1978 Reform Act, supra note 16. Thus, in 1978 the Code favored trustees by not requiring them to show that any particular creditor was intentionally trying to obtain more than his share. Id. “Whereas transfers previously had been presumed to be legitimate in the absence of a specific showing of bad faith, transfers under the [1978] Code were presumed improper unless deemed ‘normal’ and ‘not unusual’ within the ordinary course of business.” Ontko, supra note 48, at 434.

58. See 1978 Reform Act, supra note 16.

59. See supra notes 49-52 and accompanying text.
distribution.60

The newly enacted Code created a presumption of insolvency during the ninety days preceding the filing of the debtor’s bankruptcy petition.61 This presumption relieved the trustee of the burden of proving either the debtor’s insolvency or the creditor’s knowledge of the insolvency at the time of the preferential transfer.62 Consequently, a creditor could no longer rely on or exploit the safe harbor protection informally established under the 1898 Act by the trustee’s frequent inability to show the requisite intent and knowledge. The avoidance provisions in the 1978 Reform Act essentially widened the scope of avoidable transfers, and, indeed, represented a new trend in augmenting the trustee’s power to avoid pre-bankruptcy transfers.63

This new trend arguably indicated that Congress was no longer primarily concerned with whether creditors advantageously exerted payment pressure by engaging in a race of diligence. Rather, Congress now seemed to focus on ensuring that equality of distribution existed among all creditors, whether or not they used unfair creditor pressure.64 Under a strict equality of distribution policy, the trustee held augmented power to avoid pre-bankruptcy transfers even for general expenses such as payments for rent, inventory, or supplies.65 Thus, creditors faced virtually insurmountable evidentiary burdens stemming from the trustee’s increased power to avoid any transfer that resulted in an unequal estate distribution.66

Perhaps in recognition of the new Code’s harshness toward creditors, Congress enacted section 547(c)(2), which, in 1978, contained seven exceptions to the trustee’s avoidance power.67 The legislative history accompanying these exceptions demonstrates that

60. See, e.g., Ontko, supra note 48, at 433. Arguably, the 1898 Act did not treat all creditors equally since it often allowed a preferred creditor to receive more than an unpreferred creditor. See id. This inequality resulted from the trustee’s frequent inability to avoid preferential transfers for lack of proof of the creditor’s knowledge about the debtor’s financial state. See id.

61. 11 U.S.C. § 547(f) (1988); see Broome, supra note 32, at 96 n.91 (discussing the hardship trustees faced, prior to the 1978 Reform Act, in attempting to prove the debtor was insolvent in the 90 days prior to filing bankruptcy).

62. See supra notes 54-55 and accompanying text.

63. 11 U.S.C. § 547(b); see Ontko, supra note 48, at 433 (stating that this statutory change essentially transformed preference law into a strict liability statute).

64. See Broome, supra note 32, at 96. “These statutory requirements meant that a trustee could avoid any payment . . . .” Id.

65. See id. at 96 n.92.

66. See id.

67. Id.; see 11 U.S.C. § 547(c)(1)-(7). In 1994, Congress added an eighth exception for support or alimony payments for a former spouse or child. See 1994 Bankruptcy Reform Act, supra note 1, § 304(f), 108 Stat. 4106, 4133-34.
Congress was aware of the creditors' plights resulting from statutory changes based solely on the equality of distribution policy.\textsuperscript{68} Specifically, Congress explained that section 547(c)(2) was designed to "leave undisturbed normal financial 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."\textsuperscript{69} Thus, by recognizing these exceptions to the trustee's preference power, one of which is the ordinary-course-of-business exception,\textsuperscript{70} Congress preserved the race of diligence as an important, and arguably the primary, policy underlying bankruptcy preference law.

\section*{B. The Influence of Preference Policy on Statutory Changes}

The ordinary-course-of-business exception, codified at section 547(c)(2), may constitute the "first statutory embodiment of the general concept that pre-bankruptcy transfers by a debtor, not made because of the debtor's ailing financial condition, should not be avoidable by a trustee."\textsuperscript{71} The early version of this exception focused on timing.\textsuperscript{72} It allowed a creditor to retain any transfer received from a debtor within forty-five days of the date it was incurred, provided that the debtor made the payment in the ordinary course of business between the debtor and the creditor, and according to ordinary business terms.\textsuperscript{73} The forty-five day exemption, considered a normal trade cycle by Congress, essentially precluded complete equality of distribution since a debtor's payments to creditors within the forty-five day window were immune from a trustee's avoidance powers.\textsuperscript{74}

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  \item \textsuperscript{68} For a detailed discussion of the legislative history behind the 1978 Bankruptcy Reform Act, see Kenneth N. Klee, Legislative History of the New Bankruptcy Law, 28 DEPAUL L. REV. 941 (1979).
  \item \textsuperscript{70} 11 U.S.C. § 547(c)(2) (1988). The specific text of this affirmative defense is set forth at supra note 5; see also supra notes 34-35 and accompanying text.
  \item \textsuperscript{71} Andrew N. Herbach, Bankruptcy Preferences: New Developments in the Ordinary Course of Business Exception, Wis. B. Bull., Dec. 1987, at 25, 26.
  \item \textsuperscript{72} 11 U.S.C. § 547(c)(2)(B) (1978) (repealed 1984). Prior to the 1984 amendments, subparagraph (B) read as follows: "[M]ade not later than 45 days after such debt was incurred." \textit{Id.} The 1984 amendments struck this provision and redesignated subparagraphs (C) and (D) as (B) and (C), respectively. \textit{See} Bankruptcy and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 462(c)-(d)(1), 98 Stat. 333, 377-78 [hereinafter BAFJA].
  \item \textsuperscript{73} 11 U.S.C. § 547(c)(2)(B) (1978) (repealed 1984).
  \item \textsuperscript{74} This was true whether or not a creditor received proportionally more than like-class creditors unfortunate enough to have been paid beyond the 45-day cut-off period.
\end{itemize}
In 1984, Congress enacted more changes to the Code. In this effort, Congress considered but rejected several proposals calling for the reinstatement of the reasonable-cause-to-believe requirement to section 547(c)(2). Under these proposals, debt payments not meeting the forty-five day requirement would again receive protection so long as the trustee failed to prove that the preferred creditor knew the payment was intended as a preference payment over the rights of other creditors. Instead of adopting these proposals, however, Congress totally eliminated the forty-five day requirement. This action was in direct response to lobbyist pressure by various trade creditor groups with longer than forty-five day trade cycles.

Some commentators maintain that the 45-day rule was enacted to codify the judicially recognized "current expense rule." See Broome, supra note 32, at 97 & n.95. Yet, it should not be considered the statutory equivalent of the current expense rule since doing so would preclude its application to long-term debt, which the Supreme Court found was included within the ordinary course of business protection. See Union Bank v. Wolas, 502 U.S. 151, 160 (1991).


76. Broome, supra note 32, at 107. The Broome article provides a more complete discussion of the litigation problems involving the 45-day rule. Id. Broome summarizes proposals to resolve the perceived problems with automatically excluding protection for transfers outside the 45-day period. Id. One proposal was to reinstate the reasonable-cause-to-believe requirement in order to protect trade creditors with longer than 45-day trade cycles, such as commercial paper issuers, and other creditors receiving recurring debt payments, such as expenses for rent, inventory, and supplies. Id. Ontko notes that trustees would face a tough burden in proving these trade creditors received a monthly payment with knowledge of the debtor's financial problems. See Ontko, supra note 48, at 432. Since receipt of these payments is regular, trustees would face a tough burden in showing trade creditors received a payment with knowledge of the debtor's insolvency. See id.

77. BAFJA, supra note 72, § 462(c)-(d)(1). Despite the sparse legislative history of the 1984 amendments, some commentators contend that Congress rejected the reasonable-cause-to-believe bills due to its reluctance to impose evidentiary burdens on the trustee. See Afilalo, supra note 45, at 630-31; Ontko, supra note 48, at 433. Indeed, legislative reports verify that Congress disfavored unworkable standards. See S. REP. No. 65, 98th Cong., 1st Sess. 60 (1983) (noting that the 45-day limitation "places undue burdens upon creditors . . .").

78. For example, several commercial paper and other trade creditor groups with billing cycles beyond the 45-day period complained that they were unfairly excluded from the protection of § 547(c)(2). See Broome, supra note 32, at 100. The elimination of the 45-day rule would "relieve buyers of commercial paper with maturities in excess of 45-days of the concern that repayment of such paper at maturity might be considered as preferential transfers." Ontko, supra note 48, at 436 (quoting 130 CONG. REC. 58897
commentators suggest that Congress' refusal to reinstate the reasonable-cause-to-believe requirement signified that Congress considered equality of distribution as the primary policy behind preference law. They further argue that Congress would have enacted the reasonable-cause-to-believe proposals had it wished to promote the concept of avoiding only those payments prompted by creditors engaging in the race of diligence through unusual creditor practice.

C. The Supreme Court's Viewpoint on Preference Law Objectives

The Supreme Court eventually put an end to the speculation concerning the primary policy underlying preference law. After Congress eliminated the timing element of section 547(c)(2), courts began to focus on the meaning of "ordinary course of business" and on Congress' purpose for enacting preference law. In a decision adopting a plain meaning interpretation of section 547(c)(2), the Supreme Court, in *Union Bank v. Wolas*, unequivocally refused to subordinate the goal of deterring the race of diligence to that of providing equality of distribution.

The *Wolas* Court overruled the pre-*Wolas* majority rule which refused, as a matter of law, to apply section 547(c)(2) protection to

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79. See Broome, *supra* note 32, at 96. Broome argues:

By eliminating the "reasonable cause to believe" requirement, Congress deliberately shifted from a policy of avoiding only those preferential transfers that were made to creditors who had reason to know of the debtor's insolvency and may have therefore exerted pressure on the debtor, to a policy of preserving equal distribution, even in the absence of creditor pressure. *Id.* Further, Broome asserts that "[t]he most obvious indication that Congress did not wish to return to a concept of avoiding only those payments that might be the result of creditor pressures was its decision not to return to the "reasonable cause to believe" requirement as an element of a preferential transfer." *Id.* at 112. *But see* Afilalo, *supra* note 45, at 653 (relying on Supreme Court authority to reject this argument).

80. See Broome, *supra* note 32, at 96.

81. See Afilalo, *supra* note 45, at 631 (discussing the controversy over whether Congress intended "ordinary course of business" to include non-trade business such as loans); *see also* Ontko, *supra* note 48, at 436 (discussing courts' shift in emphasis from timing to the meaning of "ordinary" under § 547(c)(2)).


83. *Id.* at 161. In *Wolas*, the Court reversed the Ninth Circuit's decision in *In re ZZZZ Best Co.*, 921 F.2d 968 (9th Cir. 1990), which had held that payments on long-term interest loans were outside the avoidance protection afforded by § 547(c)(2). *Wolas*, 502 U.S. at 162; *see* Afilalo, *supra* note 45, at 635 (stating that *Wolas* rejected any arguments that Congress subordinated the deterrence policy when it refused to create a reasonable-cause-to-believe requirement).
preferential payments of interest and principal on long-term loans.84 One commentator noted that circuits upholding the majority rule had excluded loan payments from the scope of section 547(c)(2) because protecting those payments would contravene the equality of distribution goal of preference law.85 Justice Stevens, writing for the unanimous Wolas Court, however, emphatically stated that equality of distribution is not the primary purpose of preference law.86 Wolas confirmed that section 547(c)(2) aims ultimately at deterring the race of diligence,87 and further confirmed that equality of distribution would incidentally occur once creditors returned preferential transfers to the debtor’s estate.88 Thus, by discouraging creditors from engaging in the race of diligence, the Wolas Court arguably conceived that debtors could work their way out of difficult financial situations through cooperation with all of their creditors.89

The Wolas decision is also consistent with the House and Senate Reports on section 547(c)(2).90 The Court’s assertion that deterring the race of diligence is the primary policy of preference law follows the House and Senate explanation that the goal behind providing exceptions to preference law is to “leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or

84. Wolas, 502 U.S. at 162; see Afilalo, supra note 45, at 631-32. “The [pre-Wolas] majority rule construed the words ‘ordinary course of business’ to refer only to ‘the debtor’s normal business operations of selling goods or providing services, not borrowing money.’” Id. (quoting Aquillard v. Bank of Lafayette (In re Bourgeois), 58 B.R. 657, 660 (Bankr. W.D. La. 1986)).
85. See Afilalo, supra note 45, at 632-33.
86. Wolas, 502 U.S. at 161. “But the statutory text—which makes no distinction between short-term debt and long-term debt—precludes an analysis that diverts the policy favoring equal distribution from the policy of discouraging creditors from racing to the courthouse to dismember the debtor.” Id. at 162. Notably, this policy is the one frequently relied upon by those courts imposing heightened evidentiary burdens under § 547(c)(2)(C), by requiring that creditors show their business terms comply with industry terms. See infra part III.
87. See Wolas, 502 U.S. at 162 (“[E]ven if we accept the Court of Appeals’ conclusion that the availability of the ordinary business exception to long-term creditors does not directly further the policy of equal treatment, we must recognize that it does further the policy of deterring the race to the courthouse . . . .”); see also Afilalo, supra note 45, at 635.
88. Wolas, 502 U.S. at 162 (“[A]s the House report recognized, [the ordinary business exception to long-term creditors] may indirectly further the goal of equal distribution as well.”); see also Afilalo, supra note 45, at 635 (stating that “[s]ection 547(c)(2) . . . achieves equality only insofar as it precludes creditors from retaining the proceeds of the race of diligence.”).
89. Afilalo, supra note 45, at 635.
90. See supra notes 68-69.
his creditors during the debtor’s slide into bankruptcy.”91 The similarity between the Court’s reasoning in Wolas and the legislative history of section 547(c)(2), reveals that the Court, and arguably Congress, both look to preference law primarily to prevent the race of diligence.92

The Supreme Court’s current interpretive trend in other bankruptcy cases is also relevant in predicting what evidentiary requirements the Court would impose under section 547(c)(2)(C)’s “ordinary business terms” requirement.93 Because current bankruptcy law dates only to 1978, there are few Supreme Court decisions on bankruptcy issues.94 In those decisions, however, the Court has revealed itself as a textual interpreter.95 By narrowly relying on the plain meaning of statutory language, the Court scrutinizes the text of statutes without scrutinizing the consequences of its interpretation.96

A recent example of the Court’s textualism philosophy is demonstrated in Wolas where the Court refused to exclude long-term debt from ordinary-course protection in the absence of such limiting

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92. See supra notes 68-69, 86-88, and accompanying text; see also Afilalo, supra note 45, at 635 (arguing that § 547(c)(2) aims not at achieving equality of distribution but at deterring the race of diligence, and that equality of distribution comes only as a necessary consequence of the change in behavior that § 547(c)(2) produces). Afilalo contends that a court must find evidence indicating that a particular transfer was made in furtherance of a race of diligence before § 547(c)(2) protection applies. Id. Similarly, there appears to be a consensus among some courts and commentators on the purpose of § 547(c)(2)(C), which one commentator described as the protection of “recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor’s transferee.” 4 COLLIER ON BANKRUPTCY ¶ 547.10, at 547-48 (15th ed. 1993); see also In re Magic Circle Energy Corp., 64 B.R. 269, 272 (Bankr. W.D. Okla. 1986) (asserting that several courts have stated that “Congress found in Section 547(c)(2)(C) a means to protect normal financial relations between the debtor and its creditors.”).

93. Despite the split in the circuits, the Supreme Court has never addressed what evidentiary requirement should be imposed under § 547(c)(2)(C).

94. Robert K. Rasmussen, A Study of the Costs and Benefits of Textualism: The Supreme Court’s Bankruptcy Cases, 71 WASH. U. L.Q. 535, 536-37 (1993). Rasmussen also argues that due to resource constraints, the Court is more likely to grant certiorari for cases dealing with constitutional issues rather than for bankruptcy cases. Id. Hence, he asserts that bankruptcy cases are “some of the last cases put on the [Supreme Court’s] docket.” Id. at 596.

95. Id. at 536-37.

96. Id.
language in the statute.\textsuperscript{97} Here, the Court's precise language is relevant: "the text provides no support for [the trustee's] contention that § 547(c)(2)'s coverage is limited to short-term debt."\textsuperscript{98} In effect, by narrowly interpreting the limits of the ordinary-course-of-business exception, the Court restricted the trustee's avoidance power in such a way that favors creditors as a class over trustees.\textsuperscript{99} Because this result is also supported by the Court's conclusion that deterrence of the race of diligence is the primary policy of preference law,\textsuperscript{100} the Court has remained consistent in its action and reasoning.

\textbf{D. Untimeliness as a Factor in Judicial Interpretation of § 547(c)(2)(C)'s "Ordinary Business Terms"}

Despite the implicit congressional and explicit judicial acknowledgment that deterring unusual creditor behavior or the race of diligence is a key policy behind the preference statute,\textsuperscript{101} there still remains the question as to what is meant by "ordinary business terms." Much of the litigation over the meaning of section 547(c)(2)(C)'s "ordinary business terms" has developed in the context of late payments received by trade creditors.\textsuperscript{102} Courts presently disagree on whether creditors must make a positive showing that the late payment at issue was made according to "industry terms" in order to except the payment from the trustee's avoidance power.\textsuperscript{103} Although late payments seem inherently non-ordinary, some courts have ruled otherwise where lateness was consistent with the manner and timing of prior transfers between the parties.\textsuperscript{104} Other courts, however, have found

\textsuperscript{97} See Wolas, 502 U.S. at 155.
\textsuperscript{98} Id.
\textsuperscript{99} For a discussion of how the primary preference law policy of deterring the race of diligence favors creditors, see supra notes 53-55 and accompanying text.
\textsuperscript{100} See supra notes 86-88 and accompanying text.
\textsuperscript{101} See supra note 92 and accompanying text.
\textsuperscript{102} Compare Newton v. Andrews Distrib. Co. (In re White), 64 B.R. 843, 850 (Bankr. E.D. Tenn. 1986), where payments made about two weeks late, which was not unusual between the parties, fell within ordinary business terms with Ewald Bros., Inc. v. Kraft, Inc. (In re Ewald Bros., Inc.), 45 B.R. 52, 57 (Bankr. D. Minn. 1984), where the court found payments made approximately eight or nine days late instead of only one or two days late, like the parties' established practice, inconsistent with ordinary business terms. Although this Comment focuses on defining ordinary business terms with respect to late payments, the analysis suggests a method of determining the avoidability of any payment made and received during the preference period. See infra parts IV-V.
\textsuperscript{104} See infra part II.D.1 (summarizing the party-focused or prior-dealings view).
late payments ordinary only if they conform with the accepted manner and timing of transfers within the relevant industry. 105

Actually, both views can cull support from the statutory language of the Code. Notably, the first two elements of the ordinary-course-of-business defense contain qualifying language restricting the exception’s evidentiary scope to dealings between the “debtor and the transferee.” 106 Conversely, section 547(c)(2)(C) does not explicitly restrict the scope of the analysis to the parties. 107 Thus, many authorities readily conclude that, in the absence of qualifying language, subsection (C) necessitates that courts require independent, objective proof of conformity to industry standards. 108 Conversely, others argue that without language such as “according to ordinary business terms in the industry,” courts should analyze only the particular parties’ past dealings. 109

1. The Party-Focused View

Under the original majority or party-focused view, a court will exclude late payments from preference attacks when their manner and timing conform to the manner and timing of previous payments made and accepted between the parties. 110 Thus, a creditor has no burden under section 547(c)(2)(C) to introduce evidence that the payment terms at issue conform to an industry standard. 111 Where the manner

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105. See infra part II.D.2 (summarizing the industry-terms view).
106. See 11 U.S.C. § 547(c)(2)(A)-(B) (1988). This qualifying language appears only in subsections (A) and (B) of section 547(c)(2); see supra note 5 (quoting the exact text).
107. See id. § 547(c)(2)(C); see also supra note 5 (quoting the exact text).
108. See infra part II.D.2. Arguments such as this support the industry-terms view.
109. See infra part II.D.1. Arguments such as this support the party-focused or prior-dealings view.
111. E.g., Hertzberg v. American Elec. Contractors (In re Steel Improvement Co.), 79 B.R. 681, 683-84 (E.D. Mich. 1987) (categorizing the party-focused view as the majority view and the industry-terms view as the minority view). Since many circuits have recently rejected the party-focused view, however, its status as the majority view is questionable. See infra note 115, parts II.D.2, III.B-E.
112. E.g., Estate of Rave Communications, Inc. v. The Ink Spot (In re Rave Communications, Inc.), 128 B.R. 369, 372 (Bankr. S.D.N.Y. 1991) (looking to prior course of dealings between parties and contract terms to analyze § 547(c)(2)(C) requirement); Sunup/Sundown, 66 B.R. at 1022-23 (finding ordinary-course protection
and timing of the payments are inconsistent with the parties’ prior dealings, the ordinary-course-of-business exception does not apply and recovery of the preferential transfer is granted.\textsuperscript{112}

It follows, therefore, that the parties cannot avail themselves of an industry-accepted late payment policy when the debtor has consistently paid on time.\textsuperscript{113} Supporters of the party-focused view suggest that any additional evidentiary requirement which requires proof of industry-terms is overly burdensome and not necessary since the history of the parties’ past dealings sufficiently indicates whether the creditor has exerted pressure on the struggling debtor to secure payment.\textsuperscript{114}

2. The Industry-Terms View

The industry-terms view imposes a different test in applying subsection (C) of section 547(c)(2).\textsuperscript{115} This test asks whether the manner and timing of the late payments conform to the general and accepted methods of the parties’ industry.\textsuperscript{116} Supporters of this industry-terms view argue that the party-focused view renders subsection (C) a nullity or superfluous, since such a subjective analy-
sis is repetitious of the tests required in subsections (A) and (B).\textsuperscript{117}

The industry-terms view finds further support in \textit{Jarecki v. G.D. Searle \& Co.},\textsuperscript{118} where the Supreme Court stated that any construction of one part of a statute which renders another part redundant or superfluous should be rejected.\textsuperscript{119} Likewise, all parts of a statute should, if possible, be given individual effect.\textsuperscript{120} Thus, several courts construing "ordinary business terms" argue for an interpretation which gives independent meaning to all three requirements of section 547(c)(2), by requiring a creditor to prove that the terms conform to an industry standard.\textsuperscript{121}

In effect, the industry-terms view, like any per se requirement, increases the evidentiary burden on a creditor by requiring the creditor to prove by independent evidence that its business terms are consistent with industry terms.\textsuperscript{122} For example, the creditor cannot establish an ordinary-course-of-business defense without introducing testimony that a payment received a certain number of days later would be regularly accepted in the relevant industry.\textsuperscript{123} Under the industry-terms view, this would be the result even if the debtor had paid according to the same terms during the parties' prior dealings.\textsuperscript{124}

### III. DISCUSSION

The circuits have split in adopting either the party-focused view, the industry-terms view, or some variant thereof. Furthermore, while the following discussion reveals that the current trend is to adopt the

\textsuperscript{117} See \textit{Logan v. Basic Distrib. Corp. (In re Fred Hawes Org., Inc.)}, 957 F.2d 239, 243-44 (6th Cir. 1992). The court stated:

\textit{In using the conjunctive "and" between subsections (B) and (C)—rather than the disjunctive "or"—Congress clearly intended to establish separate, discrete, and independent requirements which a creditor would have to fulfill to prevent avoidance. . . . [T]o hold otherwise would not only ignore the clear language of the statute, but would effectively render subsections (B) and (C) superfluous to each other.}

\textit{Id.}

\textsuperscript{118} \textit{367 U.S. 303 (1961).}

\textsuperscript{119} \textit{Id. at 307-08.}

\textsuperscript{120} \textit{Id.}

\textsuperscript{121} \textit{E.g., Fred Hawes, 957 F.2d at 244. In other words, to interpret subsection (C) independently from subsections (A) and (B) of § 547(c)(2), some courts contend that subsection (C) requires a positive showing that the terms of the disputed transaction comply with objective industry terms. See \textit{id}.}


\textsuperscript{123} \textit{See infra part IV.C.}

\textsuperscript{124} \textit{See infra part IV.C.}
industry-terms view, the circuits still disagree on what evidence sufficiently meets the standard. As a result, creditors have had little direction in determining what constitutes "ordinary business terms."

A. Circuits With Ambiguous or Incomplete Answers

Some circuits have been incomplete or cursory in addressing the issue of "ordinary business terms." For instance, although the First Circuit in WJM, Inc. v. Massachusetts Department of Public Welfare, stated that "ordinary business terms" refers to terms used in the industry, this statement is mere dicta since the court did not specifically address section 547(c)(2)(C)'s evidentiary requirements. WJM instead held that the late payment at issue was outside the ordinary-course-of-business exception because the payment was not incurred, as required by subsection (B), in the ordinary course of business between the debtor and the creditor.

Similarly incomplete in addressing subsection (C)'s evidentiary requirements, the Eleventh Circuit has simply concluded that late payments are categorically outside the meaning of section 547(c)(2)(C)'s "ordinary business terms." In In re Craig Oil Company, the court opined that the ordinary-course-of-business defense was meant to protect transactions traditionally protected by the "current expense rule." It reasoned that since late payments are by definition not current expense payments, they could not be made according to "ordinary business terms." Thus, the court found no need to

125. See infra part III.B-E.
126. See infra part III.B-E.
127. 840 F.2d 996 (1st Cir. 1988).
128. Id. at 1010-11. Other courts have criticized the WJM court for not defining what it meant when it called for an independent analysis of the business terms. See, e.g., Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.), 18 F.3d 217, 219 n.1 (3d Cir. 1994).
129. WJM, 840 F.2d at 1011.
130. Marathon Oil Co. v. Flatau (In re Craig Oil Co.), 785 F.2d 1563, 1567-68 (11th Cir. 1986). This court does not clearly explain what specific evidence or lack thereof was controlling. Instead, it simply found that the payment at issue was avoidable because (1) it was made by a cashier's check instead of the usual corporate check and (2) it was late. Id. at 1567-68.
131. Id. at 1563.
132. Id. at 1567. The court stated that the scope of the ordinary-course-of-business exception is "necessarily limited to trade credit which is 'kept current' or other transactions which are paid in full within the initial billing cycle." Id. The "current expense rule" was a judicially recognized rule used to protect short-term trade credit transactions under pre-1978 versions of the Code. See Ontko, supra note 48, at 432.
133. Craig Oil, 785 F.2d at 1567. The precise language of the court is as follows: "Since the foundation of this provision is the similarity of trade credit and current
discuss whether section 547(c)(2)(C) requires a creditor to show that the terms at issue coincide with "industry terms" or with prior terms agreed upon by the parties.

B. Recent Rejection of the Majority or Party-Focused View

Unlike the Eleventh Circuit, the Eighth Circuit does not deem all late payments inherently unusual. Moreover, despite its early support for a party-focused standard in defining "ordinary business terms," the Eighth Circuit recently adopted the industry-terms view.

Originally, the Eighth Circuit indicated that "ordinary business terms" should be defined according to prior dealings between the parties. In Lovett v. St. Johnsbury Trucking, the court held that the payments at issue were made according to ordinary business terms under section 547(c)(2)(C) "because the manner, form, and timing of these payments were consistent with the practice both parties followed previously." Nevertheless, despite this strong support for a party-focused analysis, the court equivocated that an evaluation of industry terms may also be necessary in certain circumstances.

Recently, the Eighth Circuit attempted to clarify its Lovett holding in In re U.S.A. Inns of Eureka Springs, Arkansas, Inc. In U.S.A. expenses, untimely payments are more likely to be considered outside the ordinary course of business and avoidable as preferences." Id. at 1567-68.

134. Although Craig Oil held that late payments are categorically non-ordinary, it essentially used the subjective approach in its examination of past business terms used between the parties. See id. at 1566-67 (discussing the significance of the preferential payment being made by a cashier's check when prior payments were made by corporate check).

135. Lovett v. St. Johnsbury Trucking, 931 F.2d 494, 498 (8th Cir. 1991). The Lovett court stated that "'[l]ate payments may be held to be made in the ordinary course of business, when such payment practices were well-established between the parties.'" Id. at 498 (quoting 4 COLLIER ON BANKRUPTCY ¶ 547.10, at 547-51 (15th ed. 1990)).

136. Id. at 494.

137. Id. at 499. In Lovett, although it appeared that payments made to a creditor came sooner during the 90-day preference period than during the preceding 12 months, the difference in timing was not sufficiently significant to overcome the creditor's evidence that the payments were according to "ordinary business terms." Id. The Lovett appellate court reversed the bankruptcy and district courts' rulings that a payment made within 90 days of filing a bankruptcy petition was not a payment made in the ordinary course of business. Id.

138. See id. The following language demonstrates that the court was confused about the evidentiary requirement imposed by § 547(c)(2)(C): "To the extent, if any, that subsection (c)(2)(C) requires comparison between the payment record of the particular debtor and the general practice in the industry regarding the time of payment, . . . [the creditor's] testimony . . . was sufficient to carry whatever burden [the creditor] may have had on this issue." Id. (emphasis added).

Inns, the bankruptcy court concluded that section 547(c)(2)(C) necessarily requires a separate, objective determination of whether payments are ordinary in relation to industry standards. The district court reversed, stating that the bankruptcy court had applied the wrong standard. The Eighth Circuit disagreed, and approving the bankruptcy court’s analysis, ultimately required the creditor to prove that the terms at issue coincided with industry terms. The court went on to say that what constitutes “ordinary business terms” will vary among industries. Thus, the Eighth Circuit adopted the following standard as its rule: “Subsection (c)(2)(C) does not require a creditor to establish the existence of some uniform set of business terms within the industry in order to satisfy its burden. It requires evidence of a prevailing practice among similarly situated members of the industry facing the same or similar problems.”

C. Heightened Evidentiary Burdens Under the Industry-Terms View

Some circuits strictly equate section 547(c)(2)(C)’s “ordinary terms” with an “industry terms” evidentiary requirement. The Ninth Circuit strongly supports the industry-terms evidentiary requirement, without regard for prior terms used between the parties. In Loretto Winery, the bankruptcy appellate panel for the Ninth Circuit considered the


142. Id. at 498. The district court interpreted Lovett as standing for the proposition that independent evidence of compliance with industry terms is not required by § 547(c)(2)(C). See id.

143. U.S.A. Inns, 9 F.3d at 684. The court noted that the district court’s interpretation was “at odds with the decisions of at least three other circuits that require an independent, objective standard of the practices of the relevant industry be applied under (c)(2)(C).” Id.

144. Id.

145. Id. at 685.

146. Id. U.S.A. Inns credited the Seventh Circuit for first endorsing this interpretation. Id. at 684 (discussing In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1031 (7th Cir. 1993)).

The evidentiary requirements imposed by section 547(c)(2)(C). The panel agreed with the trial court that subsection (C) necessarily requires a creditor to show that the business terms at issue comply with terms customarily used in the industry. The court reasoned that this industry-terms interpretation would avoid rendering subsection (C) a mere restatement of the party-focused test described in section 547(c)(2)(B). The Sixth Circuit also interprets section 547(c)(2)(C) as requiring strict proof of industry-term compliance. According to In re Fred Hawes Organization, Inc., section 547(c)(2)(C) requires objective proof that the payment is ordinary in relationship to prevailing industry standards. Specifically, the Fred Hawes court strictly required the creditor to introduce independent evidence that the terms at issue complied with industry terms, and not merely with terms used between the creditor and other debtors. Thus, the court found that the evidentiary requirements from those imposed under subsection (B) by noting that the latter subjectively requires proof that the debt and its payment are ordinary in relation to other business dealings between that creditor and that debtor. Id. at 244. Moreover, the Sixth Circuit noted that with respect to subsection (B), courts "eschew precise legal tests and instead engage in a fact-specific analysis." Id. Courts consider such factors as timing, amount of payment, and circumstances surrounding payment. Id. (citing Yurika Foods Corp. v. United Parcel Serv. (In re Yurika Foods Corp.), 888 F.2d 42, 45 (6th Cir. 1989)).

149. Id. at 709. In an unpublished decision, the Ninth Circuit cited Loretto approvingly in a decision finding that § 547(c)(2)(C)’s “ordinary terms” meant “industry terms.” Unicom Computer Corp. v. International Business Machs. Corp. (In re Unicom Corp.), No. 92-17070, 1994 WL 134191, at *2 (9th Cir. Apr. 13, 1994).
150. Loretto, 107 B.R. at 709-10. As stated by the court, “to graft upon the relevant terms anything but an objective yardstick would either ignore the operative nomenclature altogether, thereby making it a nullity, or interpret it in a manner which duplicates the requirement of subparagraph (B), thereby making it superfluous.” Id. at 709.
151. See Logan v. Basic Distrib. Corp., (In re Fred Hawes Org., Inc.), 957 F.2d 239, 244 (6th Cir. 1992). This decision is inconsistent with the Sixth Circuit’s prior and more lenient position taken in Waldschmidt v. Ranier (In re Fulghum Constr. Corp.), 872 F.2d 739 (6th Cir. 1989), where the court found that an examination of the parties’ past business terms sufficiently showed that the alleged preferential payment was made according to “ordinary business terms.” Id. at 743. Although the court acknowledged that industry practices “might be relevant to the § 547(c)(2)(C) analysis,” id. at 743 n.5, Fulghum did not burden the creditor with producing evidence of compliance with industry terms since there was no evidence in the record that the industry practices differed from those of the parties. Id. Thus, the Sixth Circuit stands with the Eighth Circuit in recently rejecting prior decisions supporting the party-focused approach.
152. Fred Hawes, 957 F.2d at 239.
153. Id. at 245. The Fred Hawes court distinguished the subsection (C) evidentiary requirements from those imposed under subsection (B) by noting that the latter subjectively requires proof that the debt and its payment are ordinary in relation to other business dealings between that creditor and that debtor. Id. at 244. Moreover, the Sixth Circuit noted that with respect to subsection (B), courts “eschew precise legal tests and instead engage in a fact-specific analysis.” Id. Courts consider such factors as timing, amount of payment, and circumstances surrounding payment. Id. (citing Yurika Foods Corp. v. United Parcel Serv. (In re Yurika Foods Corp.), 888 F.2d 42, 45 (6th Cir. 1989)).
154. Id. at 245-46. “[I]n looking at industry standards, a court may also refer to the manner in which the parties conduct their business with other, unrelated parties. This
proffered testimony concerning industry terms did not satisfy section 547(c)(2)(C)'s high evidentiary burden.155

D. Unique Definition of “Ordinary Business Terms”

The Tenth Circuit flatly refused to endorse specifically either the party-focused view or the industry-terms view. Instead, it formulated its own definition of “ordinary business terms.”156 In In re Meredith Hoffman Partners,157 the Tenth Circuit discussed two possible interpretations.158 Under the reading it credited to the Eighth Circuit, “ordinary business terms” would mean terms that creditors in similar situations commonly use, even if the situation is extraordinary.159 The court rejected this interpretation, however, in favor of its own definition.160

According to the definition developed by the Tenth Circuit in Meredith Hoffman, the phrase “ordinary business terms” means those terms that are used in usual or ordinary situations or during “normal financing relations.”161 The court weakly attempted to clarify this definition by further stating that ordinary business terms are “the kinds of terms that creditors and debtors use in ordinary circumstances, when debtors are healthy.”162

E. Flexible Use of the Industry-Terms Analysis

Some circuits have created more flexible industry-terms standards in defining “ordinary business terms.” These flexible standards broaden the range of applicable industries from which to determine ordinar-
iness, or allow greater departures from industry terms, based on the length of the parties' relationship.

For example, the Seventh Circuit defines "ordinary business terms" as "the range of terms that encompasses the practices in which firms similar in some general way to the creditor in question 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." Judge Posner endorsed this flexible "industry terms" view in *In re Tolona Pizza Products Corp.*, where he concluded that a strict use of "industry terms" would impose major difficulties on creditors in meeting their evidentiary burdens. For instance, he noted that creditors may face almost impossible evidentiary burdens in attempting to define what the relevant industry is, or, if there is more than one industry, which industry's terms should serve as the benchmark for "ordinariness." Moreover, the Tolona decision noted how variances in billing practices even within an industry could make it difficult to satisfy the "industry terms" evidentiary requirement.

The Tolona standard served as the starting point for the Third Circuit's analysis in *In re Molded Acoustical Productions, Inc.* The Molded court adopted a modified Tolona standard that allowed for even greater flexibility in meeting the industry terms evidentiary burden. While crediting the Seventh Circuit with "the best rendering of the text of § 547(c)(2)(C)" so far, the Molded court opined that merely relaxing the breadth of the term "industry" was not enough to ameliorate the evidentiary burdens imposed by an industry-terms standard. Thus, the court modified the Tolona standard by

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163. *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1033 (7th Cir. 1993).
164. *Id.* in *Tolona*, the debtor was a maker of pizza who issued checks to its supplier-creditor during the preference period. *Id.* at 1031.
165. See *id.* at 1032-33.
166. *Id.* at 1033.
167. *Id.* Judge Posner candidly stated:

Not only is it difficult to identify the industry whose norm shall govern (is it, here, the sale of sausages to makers of pizza? The sale of sausages to anyone? The sale of anything to makers of pizza?), but there can be great variance in billing practices within an industry.

*Id.*

168. Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (*In re Molded Acoustical Prods., Inc.*), 18 F.3d 217, 220 (3d Cir. 1994).
169. *Id.*
170. *Id.* at 224. The court pointed out several problems presented by the "industry terms" evidentiary standard including: (1) the difficulty in defining the standard when there are several firms in the industry; (2) the possibility that a party may settle
calling for an analysis of the duration of the parties’ relationship. Under the Molded test, parties with a long and consistent pattern of dealing would be allowed to depart substantially from the so-called “industry terms.” Again, looking at the historical dealings between the parties, this court essentially created a hybrid standard comprised of both the party-focused and the industry-terms approach.

IV. ANALYSIS

In the face of sparse legislative history and confusion among the circuits, courts are still left with the following question: Under the ordinary-course-of-business exception, is it mandatory that a creditor introduce independent evidence that its business terms are consistent with industry terms in order to satisfy section 547(c)(2)(C)? In deciding this issue, courts should bear in mind whether such a per se standard is justifiable when a creditor’s dealings with a debtor, before and during the preference period, are consistent and do not show bad faith.

Perhaps instead of focusing narrowly on the choice between the party-focused or industry-terms views, courts should focus on how best to serve the overall policy considerations underlying this defense. Despite the natural affinity for a bright-line test to use in deciding summary judgments, a critical analysis of statutory changes, Supreme Court philosophy, recent circuit court decisions, and practical considerations weigh in favor of a flexible standard. Thus, even if industry terms are definable and relevant, creditors should not have to show conformity therewith in the absence of an inconsistent pattern of dealing. In situations where parties have consistent past dealings,
an analysis of the parties’ business terms should sufficiently answer the question whether the terms at issue are "ordinary."

A. Legislative Policy and Trends Do Not Promote a Strict Industry-Terms Evidentiary Burden

Certainly, policy objectives underlying preference law should have some bearing in defining "ordinary business terms." Freedom of contract is perhaps one of the most important principles to bear in mind when defining these terms.175 As in English Courts that preserved transactions based on freedom of contract principles,176 current bankruptcy preference law attempts to uphold normal financial relations.177 Just as contract terms may deviate from terms utilized by parties not involved in the contract, upholding normal financial relations may occasionally require deviation from strict industry terms. Thus, a certain amount of variation from industry terms is not necessarily inconsistent with the Code and its English ancestry. It is equally evident that both congressional policies behind preference law—deterring the race of diligence and promoting equality of distribution among creditors—play a role in the avoidance178 and exception179 provisions of this body of law. Indeed, this Comment characterizes statutory amendments to the Code as efforts to implement one or the other objective at various times.180 Nevertheless, an overall analysis of these statutory changes reveals that a strict industry-terms view is not in accord with the specific policy reasons behind the ordinary-course-of-business exception.

Under the 1898 Act, the reasonable-cause-to-believe requirement aimed primarily at preventing the race of diligence.181 By removing this provision in 1978, Congress exposed more creditors to the

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175. See supra notes 47-48 and accompanying text.
176. See supra notes 47-48 and accompanying text.
177. See supra notes 69, 87, 91, and accompanying text.
178. 11 U.S.C. § 547(b).
179. Id. § 547(c)(2).
180. See supra part II.A.1-2.
181. See supra notes 50-55 and accompanying text. When deterring the race of diligence is viewed as the primary policy of preference law, an analysis of the parties’ prior dealings should sufficiently demonstrate whether a creditor has attempted to gain an unfair advantage. See supra note 52 and accompanying text.
trustee's avoidance powers.\textsuperscript{182} If this expansion of the scope of avoidable transfers is considered as strictly an effort to promote the equality of distribution policy,\textsuperscript{183} then the additional industry-terms requirement, which also broadens the scope of avoidable transfers,\textsuperscript{184} is arguably consistent with Congress' earlier efforts.

A review of other enacted provisions of the 1978 Code, however, weakens this line of reasoning. For, in recognition of the creditor's difficulty in defending avoidance actions,\textsuperscript{185} Congress created the eight preference exceptions, including the ordinary-course-of-business defense,\textsuperscript{186} to protect a special group of trade creditors.\textsuperscript{187} By making an exception for these trade creditors, Congress demonstrated that equality among all creditors is not the only or most important policy controlling section 547(c)(2). Thus, it is improper for courts to justify a strict industry-terms requirement under section 547(c)(2)(C) with reference solely to the equality of distribution policy.

Like the 1978 changes, the 1984 amendments to the Code do not necessarily support an additional industry-terms evidentiary hurdle under section 547(c)(2)(C). As stated earlier, some commentators argue that Congress' refusal to reinstate a reasonable-cause-to-believe requirement\textsuperscript{188} in 1984, signified Congress' aim to promote equality of distribution among creditors.\textsuperscript{189} A more plausible argument, however, is that in not reinstating this knowledge requirement, Congress sought to refrain from imposing unworkable evidentiary burdens on the trustee.\textsuperscript{190} Congress demonstrated this partiality for lighter evidentiary

\textsuperscript{182} See supra notes 56-57 and accompanying text.
\textsuperscript{183} See supra notes 57-60 and accompanying text. Essentially, as more transfers are avoided more transfers will be returned to the common pool that will be divided equally among like-classed creditors when the bankrupt estate is distributed.
\textsuperscript{184} The scope is broadened as a consequence of more transfers being avoided each time a creditor fails to produce evidence of compliance with industry standards. See supra notes 57-63 and accompanying text.
\textsuperscript{185} See supra text accompanying notes 65-66 (discussing that several monthly transactions fell prey to avoidance without the reasonable-cause-to-believe requirement).
\textsuperscript{186} 11 U.S.C. § 547(c)(2).
\textsuperscript{187} See supra notes 67-68, 78, and accompanying text. Furthermore, by removing the 45-day rule, see supra note 72 and accompanying text, Congress' intent to protect trade creditors with longer cycles is clear. See Countryman, supra note 32, at 769.
\textsuperscript{188} See supra notes 75-76 and accompanying text (discussing the House and Senate proposals to reinstate this requirement). As previously noted, these proposals suggest Congress' recognition of the need to further protect certain trade creditors. See supra notes 75-76 and accompanying text.
\textsuperscript{189} See Broome, supra note 32, at 96.
requirements by creating the presumption of insolvency in the ninety days preceding the bankruptcy petition.\textsuperscript{191}

Thus, requiring strict compliance with industry terms is inconsistent with former congressional attempts to lessen evidentiary burdens under the Code. Furthermore, it can be argued that Congress would oppose the industry-terms evidentiary requirement since it is proving too difficult to meet\textsuperscript{192} and is sparking a new breed of litigation.\textsuperscript{193}

**B. The Supreme Court Would Probably Reject an “Industry-Terms” Requirement**

According to the Supreme Court, deterring the race of diligence is the primary policy underlying preference law.\textsuperscript{194} Wolas’ statement that equality of distribution is not more important than the deterrence policy\textsuperscript{195} provides guidance for interpreting section 547(c)(2)(C)’s “ordinary business terms.” This statement suggests that the Court would not endorse an overinclusive\textsuperscript{196} evidentiary requirement that increases the scope of avoided transactions purely for the sake of equality of distribution. Rather, Wolas indicates that the Court stands

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\textsuperscript{192} See, e.g., Logan v. Basic Distrib. Corp., (In re Fred Hawes Org., Inc.), 957 F.2d 239, 246 (6th Cir. 1992) (finding lengthy testimony regarding industry terms to be nevertheless insufficient due to the court’s opinion that it lacked reliability).

\textsuperscript{193} See Youthland, Inc. v. Sunshine Girls of Fla., Inc. (In re Youthland, Inc.), 160 B.R. 311 (Bankr. S.D. Ohio 1993). This bankruptcy decision supports the assertion that the new “industry terms” compliance cases will only shift the litigation to a new arena discussing which industry applies, rather than reducing litigation. \textit{Id.} In \textit{Youthland}, the creditor, a clothing manufacturer who sought to except an alleged preferential transfer, introduced evidence of how the payment terms were consistent with terms used in the apparel industry. \textit{Id.} The court denied the request holding that the relevant industry terms to be examined with respect to the debtor, a retailer, was the children’s apparel industry terms. \textit{Id.} at 315-16.

\textsuperscript{194} Union Bank v. Wolas, 502 U.S. 151, 161 (1991). Arguably, analyzing the parties’ prior dealings would be sufficient to determine whether, at the time of the alleged preferential payment, the creditor was trying to join the race of diligence in order to opt out of the common-pool bankruptcy proceedings.

\textsuperscript{195} \textit{Id.} at 161.

\textsuperscript{196} Such an evidentiary burden is overinclusive because it allows creditors with insufficient industry-terms evidence to suffer financially the avoidance of transfer—even if the terms of the payment were not unusual, or were entirely consistent with the prior payment terms used between the parties. Thus, since the industry-terms evidentiary burden potentially results in avoidance of routine business transfers, the requirement is inconsistent with Congress’ aim to uphold “normal financial relations.” \textit{See supra} notes 69, 87, 91, and accompanying text.
behind a more individualistic approach in determining whether a creditor has entered the race of diligence.\textsuperscript{197}

The Court's history of using a textual rather than an interpretative analysis when construing bankruptcy provisions further supports this inference.\textsuperscript{198} For, just as \textit{Wolas} refused to exclude long-term debt from ordinary course protection where the statute did not explicitly exclude it,\textsuperscript{199} the Court would likely impose the "industry terms" evidentiary requirement only if such a requirement could be gleaned from the plain-meaning of the statute.\textsuperscript{200} Because of the absence of the words "in the industry" after the words "ordinary business terms" in section 547(c)(2)(C), the Court, using a plain-language or textualism analysis, would conclude that the statutory language does not support mandating an industry-terms evidentiary burden. Thus, the Court's rulings and interpretative philosophy together undercut the argument that section 547(c)(2)(C) necessarily requires a creditor to introduce evidence of strict compliance with industry terms.

\textbf{C. A Heightened Evidentiary Requirement is Unnecessary}

Despite the above conclusion that a mandated industry-terms evidentiary requirement is not supported by Congress or the Supreme Court, courts may occasionally still need an added element of objectivity to evaluate efficiently when to provide creditors with section 547(c)(2)(C) protection. To understand how this objectivity may be sufficiently established by analyzing the parties' prior dealings, consider the following hypothetical.

Suppose that despite the existence of a contract calling for payments within thirty days, a particular debtor has consistently, over a five-year period, paid its supplier-creditor within sixty days of the invoice date.\textsuperscript{201} Also imagine that many suppliers in this industry would

\textsuperscript{197}By looking only at the parties' prior dealings, only those unusual actions with respect to the parties' past business practices would be avoided. \textit{See supra} notes 47-55 and accompanying text.

\textsuperscript{198} \textit{See supra} text accompanying notes 93-100 (discussing how under its "plain-meaning" analysis, the Court will not limit a statutory provision in the absence of explicit qualifying language).

\textsuperscript{199} \textit{See supra} notes 97-98 and accompanying text.

\textsuperscript{200} If Congress wanted to require creditors to introduce industry-terms evidence to prove § 547(c)(2)(C) applies, it could have simply inserted the word "industry" between "ordinary business" and "terms" or appended "in the industry" after "ordinary business terms." Thus, the fact that Congress chose only the words "according to ordinary business terms" for § 547(c)(2)(C) arguably demonstrates Congress' intent to allow for flexibility.

\textsuperscript{201} Such lenient creditor behavior is more comprehensible when framed in a particular context. Thus, for purposes of this hypothetical, further imagine that the
accept payments as being "timely" if paid within forty-five days of the invoice date. Now, it so happens that the last payment received by the creditor was transferred during the last ninety days before the debtor declared bankruptcy, and thus is subject to the trustee's avoidance powers.202 The creditor defends against the avoidance action, urging that the ordinary-course-of-business defense protects the payment.

As evidence that the payment was not unusual or an effort to enforce its claim unfairly, the creditor, through the company's president, introduces testimony that it ordinarily accepted that debtor's late payments, even though the contract required payment in thirty days. The president further testifies that the creditor's leniency toward this particular debtor was due to the importance of the business and the otherwise good relationship between the parties over a number of years. The creditor's only testimony regarding industry terms was that payments received within forty-five days were normally accepted as "timely" in the industry.203

Where courts require strict compliance with industry standards, this evidence is insufficient to meet the evidentiary burden imposed by section 547(c)(2)(C).204 The problem with this result is that by requiring the payment to have been received within forty-five days, a court necessarily would upset the normal business relations between the parties, in an effort to treat like-class creditors equally. Unfortunately, this court would fail to realize that the particular creditor is not in the same class with other creditors, but was among a special group of creditors who gave the debtor more favorable credit terms, not because of a desire to bypass the bankruptcy rules, but because of the importance and stability of the long-term relationship between the parties.205

more tolerant creditor resides in the same small town as the debtor and has reason to believe that the debtor's business will be an ultimate success despite initial cash-flow problems. Also imagine that a more demanding creditor is located in a distant city and has no knowledge of the debtor's business acumen. Without such reassurance, the big-city creditor would understandably insist on strict payment terms.


203. This hypothetical is based, in part, on the factual situation in Tolona where the lower court, under a strict "industry terms" analysis, found that similar testimony failed to prove objectively the payment was not a preference. See In re Tolona Pizza Prods. Corp., 3 F.3d 1029, 1033-34 (7th Cir. 1993) and portions of transcript quoted in Brief of Plaintiff-Appellant at 14, Tolona, 3 F.3d 1029 (7th Cir. 1993) (No. 92-3386).

204. See Tolona, 3 F.3d at 1033 (arguing that the law should not create a single set of rules to decide what is normal in the industry).

205. Considering the additional facts discussed in note 201, this result sends a message to the small-town creditor to be as antagonistic as big-city creditors with respect to credit terms, or risk the trustee's avoidance power. Although this topic is beyond the scope of this Comment, such an atmosphere would probably hinder new
An even more disturbing situation would develop where the industry terms and party-established extra-contractual terms are transposed. In other words, suppose that the industry accepted any payment received within sixty days, while the creditor only introduced testimony that it accepted payments if made and received within forty-five days. Under a strict reading of the industry-terms evidentiary requirement, a creditor would fail to satisfy the burden of section 547(c)(2) since the testimony fails to show that the payment terms were consistent with those of the industry. In this situation, a strict industry-terms requirement penalizes a creditor who insists on a prompt payment plan, while rewarding less diligent payment practices. Even though the creditor has not exhibited unusual behavior, nor entered the race of diligence, the creditor in this example is penalized solely for his lack of sufficient industry-terms testimony. Thus, adopting such an inflexible rule in similar contexts fails to acknowledge the realities of modern business practices.

D. Use of “Industry-Terms” Analysis Should Be Limited

There are cases, however, where an evaluation of industry terms proves helpful. The obvious example is where no prior course of dealing exists between the parties. For such first-time transactions, requiring industry-terms evidence is reasonable in order to determine objectively whether the creditor was entering the race of diligence.

Moreover, where the parties' established practice falls so far outside the accepted industry standard, an analysis of industry terms is warranted. In such a case, the parties' conduct, however consistent it has been, is likely to be viewed as so unusual that it must have been an effort to position the creditor unfairly in an eventual bankruptcy proceeding. In Tolona, Judge Posner described such a special situation, noting that if a shrewd creditor knows, a priori, that consistent prior dealings are protected from avoidance actions, the creditor could work out a special deal with the debtor, before the preference period, of accepting late payments. The theory is that by establishing this late payment history, the creditor would get more favorable treatment in the event of bankruptcy.

Attempting to deter such extraordinariness, some circuits have adopted the per se industry-terms evidentiary requirement under business relationships and could jeopardize the flow of commerce that could be fostered within the community by more cooperative debtor-creditor relationships.

206. 3 F.3d 1029 (7th Cir. 1993).
207. See id. at 1032.
208. See id.
Obviously, agreeing on a late-payment policy prior to commencement of the parties’ relationship is beyond the range of normal financial dealings. In such a case, an analysis of the parties’ consistent late dealings would fail to uncover this fraudulent behavior and thus would fail to deter the race of diligence. Thus, the call for industry-terms evidence is reasonable in such specialized cases in order to protect against such unusual deals between the parties. As explained by Judge Posner in Tolona, the industry-terms requirement would reassure creditors that the debtor has not entered into some unusual payment scheme devised to favor a particular creditor unfairly upon an eventual bankruptcy.

Nevertheless, it remains unanswered how creditors must satisfy this evidentiary burden. Whose industry terms govern? How do courts account for variances within an industry’s billing practice? What if there is more than one relevant industry, each of which uses different payment terms? In recognition of the difficulties created by this evidentiary standard, the Tolona court stated that “the law should not push businessmen to agree upon a single set of billing practices.” Instead, Tolona advises courts to find that payment terms are “ordinary” if they are consistent with a range of terms appearing in

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209. As previously discussed in part III, several circuits, possibly a majority, have recently endorsed what used to be the minority view. See, e.g., Jones v. United Sav. and Loan Ass’n (In re U.S.A. Inns of Eureka Springs, Ark., Inc.), 9 F.3d 680, 684 (8th Cir. 1993); Logan v. Basic Distrib. Corp. (In re Fred Hawes Org., Inc.), 957 F.2d 239, 245 (6th Cir. 1992); Bell Flavor and Fragrances, Inc. v. Andrew (In re Loretto Winery, Ltd.), 107 B.R. 707, 709 (Bankr. 9th Cir. 1989). Despite this trend to endorse the industry-terms view, this Comment maintains that a per se application of this view is not consistent with the policies underlying bankruptcy preference law.

210. This type of pre-arranged late payment policy is distinguishable from that in which the payment terms are modified over time by late-paying conduct. When viewed in retrospect, as in the latter case, the resulting payment terms are less likely to be unusual or beyond the terms of acceptable business practices.

211. See supra part IV.C.

212. See Tolona, 3 F.3d at 1032.

213. Id. Posner’s exact language is instructive:

The second possible function of . . . [subsection C] is to allay the concerns of creditors that one or more of their number may have worked out a special deal with the debtor, before the preference period, designed to put that creditor ahead of the others in the event of bankruptcy. It may seem odd that allowing late payments from a debtor would be a way for a creditor to make himself more rather than less assured of repayment. But such a creditor does have an advantage during the preference period, because he can receive late payments then and they will still be in the ordinary course of business for him and his debtor.

Id.

214. See id. at 1033.

215. Id.
Despite this insightful analysis, Tolona still failed to instruct creditors specifically on the best way to structure their dealings so as to protect themselves from a trustee’s avoidance powers. Even courts applying Tolona’s watered-down industry-terms approach will continue to render decisions based on a case-by-case basis. One way to provide some predictability for creditors is to adopt the modified Tolona view as endorsed by the Molded court. Molded allows a departure from industry terms if the terms of the preferential payment are consistent with terms used in the creditor’s prior dealings with the debtor or with similarly-situated debtors. Hence, Molded does not impose a heightened evidentiary burden on creditors who do not utilize the type of unusual terms associated with secret or self-interested deals. On the other hand, creditors who have worked out special deals with debtors are on notice that a court will require the terms at issue to be similar to industry terms. Although creditors entering into special deals will continue to face inconsistent, fact-specific determinations of whether their evidence meets the industry-terms evidentiary threshold, the unusual or secretive nature of such transactions justifies the burden.

V. PROPOSAL

In analyzing section 547(c)(2)(C), courts have historically chosen between two prevailing views as to what is meant by “ordinary business terms.” These two views are often characterized as

216. Id. The court explained: “[O]nly dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore beyond the scope of subsection C.” Id.

217. The phrase “general billing practice” is vague and ambiguous. Consequently, it would be difficult for the creditor to determine, without the benefit of hindsight, whether the credit terms are in general agreement with general business practices.

218. In other words, the Tolona decision still does not provide predictability for concerned creditors since courts may disagree on whether the watered-down industry-terms requirement is met. Indeed, Judge Posner drew a strong dissent from Judge Flaum who, although agreeing with the standard, disagreed on whether the standard had been met by the evidence. Id. at 1033-34 (Flaum, J., dissenting) (“I agree with the majority that under 11 U.S.C. § 547(c)(2)(C) Rose was required to show that Tolona’s payments had been made in accordance with the ordinary business terms of the industry. . . . I respectfully dissent, however, because I cannot conclude that Rose in fact made the requisite showing.”).

219. See Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods., Inc.), 18 F.3d 217, 224 (3d Cir. 1994).

220. Id.

221. See supra notes 168-72 and accompanying text.

222. See supra parts II-III.
comprising a subjective, party-focused standard or an objective, industry-focused standard.\textsuperscript{223} Recently, many courts have required the payment terms at issue to be both subjectively and objectively ordinary.\textsuperscript{224} According to these courts, a party must offer evidence that the terms at issue comply with an industry standard in order to satisfy section 547(c)(2)(C).\textsuperscript{225}

These courts fail to recognize that objectivity may be established between two parties by other means, such as by examining the parties’ consistent and long-term prior course of dealings.\textsuperscript{226} Thus, for these courts, even evidence that two parties have consistently used the same payment terms over the course of several transactions will not necessarily establish that the payment terms are “ordinary.”\textsuperscript{227} For other courts, however, consistent prior dealings sufficiently satisfy the evidentiary burdens associated with section 547(c)(2)(C)’s “ordinary business terms” element of the ordinary-course-of-business defense.\textsuperscript{228} These inconsistent outcomes among the circuits leave creditors in a quandary over whether their current transactions would be protected from the trustee’s avoidance powers upon a debtor’s eventual bankruptcy.

Courts must come to an understanding of what they will accept as “ordinary business terms” so that creditors can extend credit without worrying over whether payments would survive a preference attack. For these creditors, predictability is of great importance. Without it, they may be forced to withdraw from this market and to extend only secured credit.\textsuperscript{229}

Therefore, when a court determines whether a payment is made according to “ordinary terms” under section 547(c)(2)(C), a court should adopt the following approach. The court should not require evidence of industry terms unless the parties have no prior course of dealings or the facts and circumstances indicate that the parties attempted to thwart the underlying policies of preference law by

\textsuperscript{223} See supra parts II-III.
\textsuperscript{224} See supra part III.
\textsuperscript{225} See, e.g., Logan v. Basic Distrib. Corp. (\textit{In re} Fred Hawes Org., Inc.), 957 F.2d 239, 246 (6th Cir. 1992).
\textsuperscript{226} See Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (\textit{In re} Molded Acoustical Prods., Inc.), 18 F.3d 217, 224-25 (3d Cir. 1994) (discussing the objectivity that is often ignored in the party-focused view).
\textsuperscript{227} See Fred Hawes, 957 F.2d at 245.
\textsuperscript{228} Molded, 18 F.3d at 224.
\textsuperscript{229} A discussion of priorities of secured creditors in bankruptcy proceedings is beyond the scope of this Comment.
entering the race of diligence. Thus, where the terms are so unusual that the only reasonable explanation is that the parties attempted to enter the race of diligence, even the parties’ consistent past practices should fail to satisfy section 547(c)(2)(C)’s “ordinary terms” requirement.

Even in these circumstances, however, a court should allow the creditor to prove that the debtor made the alleged preferential transfer according to terms used in either a specific industry, or according to general billing practices. Upon such proof, a court should not allow the trustee to avoid the transfer. In evaluating the creditor’s proffered evidence, a court should follow the reasoning set forth in Tolona and Molded. Under these cases, the creditor need not introduce evidence that the payment terms at issue complied with a specific industry’s terms. Rather, a creditor may prevail by proving that the terms of the transfer were consistent with non-industry specific general billing practices. Absent evidence that a creditor entered the race of diligence, or where parties have a history of prior dealings, a court should neither require the creditor to introduce specific “industry terms” nor general billing practices evidence. Under these circumstances, imposing such an evidentiary burden is inconsistent with legislative and judicial trends and policy. Instead, courts should require creditors to satisfy section 547(c)(2)(C)’s “ordinary terms” by introducing evidences that demonstrates the parties’ consistent prior course of dealing.

In implementing this proposal, a court should use the following evidentiary framework. Initially, the trustee has the burden of showing a lack of prior dealings between the parties or that the creditor’s actions were so extraordinary as to create the inference that the creditor was trying to win the race of diligence. Once the trustee meets the initial burden, the creditor must come forward with evidence

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230. For instance, where the terms at issue are truly extraordinary or where there is no prior course of dealing, courts should require evidence of industry terms. See supra part IV.D.
231. See supra part IV.
232. See supra part III.E.
233. See Tolona Pizza Prods. Corp. v. Rose Packing Co., 3 F.3d 1029, 1032 (7th Cir. 1993). Such a standard could be met, for instance, by the creditor’s evidence showing that the payment terms at issue in the preference action were similar to those used between this creditor and other debtors, between the debtor at issue and other creditors, or between any other creditors and debtors, unrelated to the particular debtor and creditor at issue. The court should evaluate the weight of the evidence of compliance with general billing practices, taking into account the credibility of the witnesses and reliability of the information presented.
234. See supra note 226 and accompanying text.
that the payment terms complied with terms used in the "industry." In evaluating whether the terms complied with industry terms, a court need only find that the terms were consistent with general billing practices rather than those of a specific industry. If a court finds the terms were consistent with general billing practices, it should disallow the trustee's avoidance action. If, however, a court finds the terms were inconsistent with general billing practices, the payment should be avoided.

By following this approach, the judicial system may slowly help clarify the meaning of section 547(c)(2)(C)'s "ordinary business terms" circuit by circuit. Yet, this circuit by circuit approach has, however, created confusion among the circuits. Therefore, Congress should step in and revise section 547(c)(2)(C) or provide official comments explaining this vague subsection. Unfortunately, Congress failed to address or to change the language in 11 U.S.C. § 547(c)(2) in the recent amendments to the Code made pursuant to the Bankruptcy Reform Act of 1994.

Hopefully, Congress will not overlook the section 547(c)(2)(C) problem the next time it passes bankruptcy legislation. When that time comes again, Congress should encourage an interpretation of section 547(c)(2)(C) that is most consistent with the primary purposes underlying preference law. This proposal suggests a workable framework to be used in interpreting section 547(c)(2)(C) "ordinary terms" requirement. Similar guidance by Congress would be highly appreciated by creditors, commentators, and courts forced to deal with the current ambiguity of section 547(c)(2)(C).

VI. CONCLUSION

In deciding whether to apply the ordinary-course-of-business exception, courts should interpret section 547(c)(2)(C) in a manner consistent with preference policy objectives. The Supreme Court has declared that preventing unusual credit transactions to deter the race of diligence is the primary purpose behind preference law. Thus, courts should not automatically impose a strict "industry-terms" requirement, since this would cause transfers to be avoided arbitrarily, whether or not the creditor was acting in a self-interested manner. Instead, courts should determine whether the terms at issue are con-

235. See supra parts II-IV.
236. Union Bank v. Wolas, 502 U.S. 151, 161 (1991). The Court also noted that equality of distribution would result as a consequence of promoting the primary policy of deterring the race of diligence. Id. at 162.
sistent with the primary policy of preference law—deterring the race of
diligence—by evaluating the parties’ prior course of dealings.

Where there are no prior dealings, or where the prior terms used
between the parties are truly extraordinary, then the court must impose
an added evidentiary burden. Under these circumstances, a court
should uphold the trustee’s avoidance action, unless the creditor
proves that the terms of the preferential payment were consistent with
general billing practices.

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