



Bankruptcy Court Decision Highlights Ordinary Course Defense to Preferential Transfer Claims

A bankruptcy filing creates a complex legal landscape for creditors, including those that may have received payments from the debtor in the months immediately preceding the bankruptcy filing. These creditors, already facing large unpaid amounts due from the debtor, often receive demands to return payments properly paid by the debtor — *i.e.*, “claw-back” claims — for equitable distribution amongst the greater creditor body.

The Bankruptcy Code includes affirmative defenses to claw-back claims, which protect certain pre-petition date transfers by the debtor to those creditors. One of those defenses is the “ordinary course of business” defense. In his recent decision in *In re ASPC Corp.*, Adv. Pro. No. 20-2077, 2024 WL 1381655 (Bankr. S.D. Ohio Mar. 29, 2024), the Hon. John E. Hoffman, Jr., of the United States Bankruptcy Court for the Southern District of Ohio (the “Bankruptcy Court”) analyzed the aptly named “ordinary course of business defense,” and confirmed that a creditor will prevail — *i.e.*, retain those payments received from the debtor pre-petition — if it can satisfy either the objective or subjective test discussed below.

The Ordinary Course of Business Defense

The Bankruptcy Code provides that a debtor or trustee may assert claims to recover certain payments made by the debtor to a creditor during the ninety (90) day period immediately preceding the bankruptcy filing, or one (1) year for payments to an “insider” (the 90 days or 1 year depending on the transferee, commonly known as the “Preference Period”). The Bankruptcy Code provides certain statutory defenses to preference claims, including that the alleged preferential transfers were made in the “ordinary course of business.” The ordinary course defense precludes the claw-back of payments made during the Preference Period if that transfer: (1) was made in payment of a debt incurred by the debtor in its ordinary business dealings with the creditor, and (2) was made in the ordinary course of business of the industry in which the debtor participates (the “Objective Test”) **or** according to the ordinary business terms established between the debtor and the creditor (the “Subjective Test”). The creditor has the burden of proof to establish the defense.

In re ASPC Corp.

In *In re ASPC Corp.*, Judge Hoffman analyzed the statutory framework of the ordinary course of business defense, and the creditor’s burden of proof to defeat a preferential transfer claim.

The adversary proceeding concerned a preference action in which the liquidating trustee in the bankruptcy proceeding sought to avoid certain transfers received by Sturm Ruger & Company, Inc. (“Ruger”) from the debtor during the Preference Period.

In determining whether to avoid those transfers, the Bankruptcy Court considered the distinction between the Objective and Subjective Tests under Bankruptcy Code § 547(c)(2). The Bankruptcy Court recognized that prior to the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), § 547(c)(2) used the conjunctive “and” between the Objective and Subjective Tests, which required that a preference defendant needed to prove that transfers were made **both**: (1) in the ordinary course of business or financial affairs of the debtor and the defendant, and (2) according to ordinary business terms. *In re ASPC Corp.*, 2024 WL 1381655, at *7. BAPCPA revised the statute to replace the conjunctive “and” with the disjunctive “or” between the Objective and Subjective Tests: “a preference defendant need only prove that a transfer satisfies **either of the two tests — not both.**” *Id.* (emphasis added).

Based upon Ruger’s expert report that concluded that the payments were made within the ordinary course of business in the debtor’s industry (small arms, firearm industry), the Bankruptcy Court held that the debtor’s payments to Ruger were made according to ordinary business terms. In response to the liquidating trustee’s arguments that Ruger had modified the debtor’s credit limits, thereby modifying the course of conduct between the parties, the Bankruptcy Court stated:

This case illustrates the importance of BAPCPA’s replacement of the conjunctive “and” with the disjunctive “or” between the subjective and objective tests for the ordinary course of business defense. Although the Court need not decide the issue, there appears to have been a change in the manner in which Ruger dealt with [the debtor] before and during the Preference Period as to credit limits. Were § 547(c)(2) still written in the conjunctive, Ruger would likely be unable to satisfy the subjective test, and therefore may have been unable to establish that the Transfers were made in the ordinary course of business. But because preference defendants now need only satisfy *either* the subjective or objective test, Ruger can avail itself of the ordinary course of business defense by satisfying the objective test alone.

Id. at *11 (emphasis in original).

CONCLUSION

The recent decision in *In re ASPC Corp.* highlights both the relevant standard applicable to establish the ordinary course of business defense to a preferential transfer claim, as well as the burden of proof. Judge Hoffman’s decision focuses upon BAPCPA’s reconstruction of the ordinary course of business defense, and that creditors need only satisfy the Objective *or* the Subjective Test — not both.

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