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- by Roger A. McEowen

Overview

Agriprocessors, a slaughterhouse and meatpacking plant in Postville, Iowa, that utilizes glatt kosher processing of cattle, chicken, turkey, duck, lamb and veal, filed for Chapter 11 bankruptcy on November 4, 2008. The company, the nation's largest kosher meatpacking plant, filed bankruptcy upon facing a drop in demand for their products and higher costs associated with a May 2008 immigration raid. Agriprocessors is being operated at the present time by Chapter 11 bankruptcy trustee, Joseph E. Sarachek of Triax Capital Advisors.

Now the bankruptcy court has informed livestock sellers that sold livestock to Agriprocessors in the 90-day timeframe preceding the company's bankruptcy filing that they have 10 days from a letter dated November 23, 2009, to repay 80 percent of what Agriprocessors paid them for their livestock. Apparently, at the present time it appears that the bankruptcy court has approved an extension to the due date for repayment to December 15, 2009. In any event, it remains possible that a seller's failure to respond to the letter could result in the bankruptcy court authorizing 100 percent repayment. The bankruptcy trustee has identified approximately \$50,000,000 of payments made by Agriprocessors to its

suppliers within 90 days of Agriprocessors' November 4, 2008 bankruptcy filing.

Preference Payments

As noted above, on November 23, 2009, the bankruptcy trustee sent letters to many suppliers indicating that the trustee was investigating and seeking recovery of the payments made to suppliers based upon a preference theory under bankruptcy law.¹ The letters requested that the supplier provide a response within 10 days and indicated that the trustee would be willing to accept 80 percent of the alleged preferential payments if paid within 10 days of the date of the letter.

A preference is a payment to the creditor within a specified relevant look-back period before a bankruptcy filing that allows the creditor to recover more money than it would have received from the bankruptcy estate if a bankruptcy had been filed on the date the payment on the antecedent "old" debt was made. As applied to most suppliers, the look-back period is 90 days. It is one year for insiders.² Since the Agriprocessors bankruptcy was filed on November 4, 2008, the look-back period for non-insiders extends to payments that cleared the Agriprocessors' bank accounts on or after August 6, 2008.³

Under state law, a debtor can ordinarily “prefer” one creditor by paying that creditor while choosing not to pay anything to a second creditor. The second creditor is then left to exercise any of its remedies under the law to collect the debt. When limited assets are available to satisfy debts, the result may be that some creditors are paid in full while other creditors receive nothing. The Bankruptcy Code attempts to level the playing field by recovering payments received within the applicable look-back period and then distributing the assets of the debtor’s bankruptcy estate pro rata to all of the debtor’s unsecured creditors.

Unfortunately, the suppliers, including numerous beef and poultry suppliers who did nothing wrong are being asked to provide information to the trustee to establish their defenses to potential preference actions. Some will have strong defenses that the trustee will acknowledge when provided with the data and, thus, the trustee will cease further inquiry. Some will have partial defenses that may provide room for negotiation of lower settlements with the trustee. But, some suppliers may not have a defense to the claim of preference by the trustee.

Trustee’s Burden to Establish an Avoidable Preference

The bankruptcy trustee bears the burden of proof to recover a preference and must provide a listing of documents that a supplier should assemble to assist the supplier’s lawyer in fashioning a cogent response to the trustee’s inquiry. In order for the trustee to avoid a preferential transfer, the trustee must demonstrate the following six elements by a preponderance of the evidence:

- There must be a transfer of an interest of the debtor in property;
- On account of an antecedent debt;
- To or for the benefit of a creditor;
- That is made while the debtor was insolvent;
- Within 90 days prior to the commencement of the bankruptcy case (or one year for insiders); and
- The transfer must have left the creditor better off than it would have been if the transfer had not been made and the creditor had asserted its claim in a Chapter 7 liquidation.⁴

Defenses To The Trustee’s Preference Claims

Statutory trust. Suppliers of Agriprocessors do have several potential defenses that can be raised against the trustee’s claims of preference. First, livestock suppliers who sold animals directly to Agriprocessors may benefit from provisions under the Packers and Stockyards Act of 1921 (PSA) establishing a statutory trust for the benefit of livestock sellers. The PSA defines a “packer” as “any person engaged in the business (a) of buying livestock in commerce for purposes of slaughter, or (b) of manufacturing or preparing meats or meat food products for sale or shipment in commerce, or (c) of marketing meats, meat food products, or livestock products in an unmanufactured form acting as a wholesale broker, dealer, or distributor in commerce.”⁵ A “live poultry dealer” is a person engaged in the business of obtaining live poultry by purchase or under a poultry growing arrangement for the purpose of either slaughtering it or selling it for slaughter if such poultry obtained by such person is sold or shipped in commerce, or if poultry products obtained by such

person is sold or shipped in commerce, or if poultry products from poultry obtained by such person are sold or shipped in commerce.”⁶ Under the PSA, all livestock, poultry, inventory of, or receivables or proceeds from meat, poultry, meat food products, poultry products, or livestock products shall be held by the packer or live poultry dealer “in trust for the benefit of all unpaid cash sellers of such livestock [and poultry] until full payment has been received by such unpaid sellers.”⁷

Note: The PSA statutory trust provisions do not apply to packers who make purchases of less than \$500,000.00 per year⁸ and live poultry dealers who make purchases of less than \$100,000.00.⁹

When Congress passed the Bankruptcy Code in 1978, Congress considered the effects of the “new” bankruptcy legislation on statutory trusts. The Senate Report and statements of the floor managers of the bankruptcy bill in both the House and Senate demonstrated that the 1978 Bankruptcy Code would “not affect various statutory provisions...that create a trust fund for the benefit of a creditor of the debtor.”¹⁰ Congress specifically cited the statutory trust created in favor of sellers of livestock under PSA in its consideration of the Bankruptcy Code, and the Court of Appeals for the Sixth Circuit found the legislative purpose of Congress to be clear that “[s]tatutory trust funds are not the property of the debtor and are not subject to the statutory lien (§545) and preference (§547) provisions” of the Bankruptcy Code.¹¹ Accordingly, it is arguable that the funds paid by Agriprocessors, Inc. to the livestock suppliers are actually PSA trust funds that are not recoverable by the trustee.

Traditional defenses. If PSA does not apply, and the trustee demonstrates the six elements of an avoidable preference, traditional preference defenses can be employed. These include ordinary course of business¹², contemporaneous exchange for value¹³ and subsequent new value.¹⁴ A supplier asserting the defensive provisions of 11 U.S.C. §547(c) bears the burden to establish the applicability of a particular defense by a preponderance of the evidence.¹⁵

Contemporaneous exchange for new value. An otherwise preferential transfer is not avoidable if the transaction was a contemporaneous exchange for new value. Contemporaneous exchanges for new value “are not preferential because they encourage creditors to deal with troubled debtors *and* because other creditors are not adversely affected if the debtor’s estate receives new value.”¹⁶ A supplier utilizing this defense must show that the transfer was intended by the debtor and the creditor to be a contemporaneous exchange for new value to the debtor and the exchange was in fact contemporaneous.¹⁷ In short, the transaction must be a cash sale where delivery of the livestock is conditioned on contemporaneous cash payment and not a promise of payment in the future.

Ordinary course of business. A transaction that occurs in the ordinary course of business between the debtor and the creditor cannot be avoided. To establish an ordinary course of business defense, an Agriprocessors supplier will have to show that the debt was incurred in the ordinary course of business or financial affairs between the parties, and then establish that transfer of property to the supplier was ordinary in the course of business or financial affairs between the parties or was made according to ordinary business

terms.¹⁸ Ordinary course of business is shown by demonstrating that the transfer was consistent with a pattern of previous transfers between the parties.¹⁹ To demonstrate ordinary business terms, the creditor must first identify the relevant industry and provide evidence of industry practice. The creditor must next demonstrate that the transfer was made in a manner falling within these practices. Only dealings that are idiosyncratic or extraordinary fall outside ordinary business terms.”²⁰

Note: To demonstrate an ordinary course of business, livestock suppliers should gather all of the delivery weight tickets (commonly known as barn tickets) or receipts for livestock delivered to Agriprocessors, along with all check stubs and deposit slips for the deposit of checks received from Agriprocessors for at least six months prior to Nov. 4, 2008. Any other record of transactions with Agriprocessors can potentially be evidence of the ordinary course of business. For example, written notations of delivery on a calendar or note pad could be utilized to establish when livestock was delivered to Agriprocessors if the barn tickets have been lost or misplaced.

Subsequent new value. In order to prevail on the subsequent new value defense contained in 11 U.S.C. §547(c)(4), a creditor must demonstrate that “(1) the creditor received a transfer that is otherwise avoidable as a preference under § 547(b); (2) after receiving the preferential transfer, the creditor advanced new value to the debtor on an unsecured basis; and (3) the debtor did compensate the creditor with an

‘otherwise unavoidable’ transfer for the new value as of the petition date.”²¹ Thus, if a livestock supplier delivered livestock to Agriprocessors *after* the date of any payment that the trustee is attempting to recover and did not get paid for the livestock, the supplier will have provided new value to Agriprocessors, Inc. and can offset the amount of new value given against any preference claim that the trustee makes.

Get Legal Help

Potential preference defendants should contact an attorney familiar with bankruptcy to help them assess their defenses and to properly organize the response to the trustee’s demands. If no reply is made to the trustee, litigation will most probably ensue. If sufficient organized information is provided to the trustee, the potential preference defendant stands the best chance of avoiding the expense and inconvenience of litigation. Contacting a bankruptcy attorney will also help the potential preference defendant determine whether settling with the trustee makes sense. Remember, 80 percent is only the opening offer. Trustees frequently accept less depending upon the circumstances of each case.

¹ Preference is defined in 11 U.S.C. §547(b).

² Insiders include relatives, officers, directors and affiliates of the debtor. 11 U.S.C. §101(31).

³ See *Barnhill v. Johnson*, 503 U.S. 393 (1992)(for preference purposes, the date of the transfer is the date the check clears the drawer’s bank, not the date the check was delivered to the payee).

⁴ See *In re Interior Wood Prods. Co.*, 986 F.2d 228, 230 (8th Cir. 1993); *In re Carney*, 396 B.R. 22, 24 (Bankr. N.D. Iowa 2008); *In re Honey Creek Cattle Co.*, No. 09-09017, 2009 Bankr. LEXIS 1947 (Bankr. N.D. Iowa Jun. 17, 2009).

⁵ 7 U.S.C. § 191.

⁶ 7 U.S.C. § 182.

⁷ 7 U.S.C. §§ 196, 197.

⁸ 7 U.S.C. § 196.

⁹ 7 U.S.C. § 197.

¹⁰ S.Rep. 989 at 82, 95th Cong., 2d Sess. (1978), U.S.Code Cong. & Admin.News 1978, pp. 5787 at 5868; 124 Cong.Rec. S17.413 (daily ed. Oct. 6, 1978) (remarks of Sen. DeConcini); 129 Cong.Rec. H11,096 (daily ed. Sept. 28, 1978) (remarks of Rep. Edwards) as cited in *Selby v. Ford Motor Co., et al.*, 590 F.2d 642, 648-49 (6th Cir. 1979).

¹¹ *Selby v. Ford Motor Co., et al.*, 590 F.2d 642 at 649 (6th Cir. 1979)

¹² 11 U.S.C. §547(c)(2).

¹³ 11 U.S.C. §547(c)(1).

¹⁴ 11 U.S.C. §547(c)(4).

¹⁵ *See, e.g.*, In re U.S.A. Inns of Eureka Springs, Arkansas Inc., 9 F.3d 680, 682 (8th Cir.1993).

¹⁶ In re Jones Truck Lines, Inc., 130 F.3d 323, 326 (8th Cir.1997).

¹⁷ *Id.* at 327.

¹⁸ *See, e.g.*, In re Pickens, No. 06-01120, 2008 Bankr. LEXIS 6 (Bankr. N.D. Iowa Jan. 3, 2008)(citing In re Ahaza Systems., Inc., 482 F.3d 1118, 1125 (9th Cir. 2007).

¹⁹ *Id.*

²⁰ *Id.*

²¹ *See, e.g.*, In re Accessair, Inc., 314 B.R. 386, 395 (B.A.P. 8th Cir. 2004).