

August 30, 2010

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## Overview

Verasun Energy Corporation and twenty-four of its subsidiaries filed for Chapter 11 bankruptcy protection on October 31, 2008. In 2009, Verasun sold some of its plants to Valero and others to smaller companies.

In a letter dated August 20, 2010, counsel for the “reorganized debtors” has informed parties that sold corn to Verasun in the 90-day timeframe preceding the company’s bankruptcy filing that they have until September 30, 2010, to repay 80 percent of what Verasun paid them for their corn. Such sellers should carefully consider the letter because it is possible that a seller’s failure to respond to the letter could result in the bankruptcy court authorizing 100 percent repayment. At the present time, it is not known what the total amount of payments are that the bankruptcy trustee has identified as having been made by Verasun to its suppliers within 90 days of Verasun’s October 31, 2008 bankruptcy filing.

## Preference Payments

As noted above, on August 20, 2010, 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.<sup>1</sup>

The letters requested that the supplier provide a response by September 30, 2010, and indicated that the trustee would be willing to accept 80 percent of the alleged preferential payments.

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.<sup>2</sup> Since the Verasun bankruptcy was filed on October 31, 2008, the look-back period for non-insiders extends to payments that cleared the Verasun bank accounts on or after August 3, 2008.<sup>3</sup>

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 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.<sup>4</sup>

### **Defenses To The Trustee's Preference Claims**

**Traditional defenses.** If the trustee demonstrates the six elements of an avoidable preference, traditional preference defenses can be employed. These include ordinary course of business<sup>5</sup>, contemporaneous exchange for value<sup>6</sup> and subsequent new value.<sup>7</sup> 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.<sup>8</sup>

#### ***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."<sup>9</sup> 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.<sup>10</sup> In short, the transaction must be a cash sale where delivery of the corn 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, a Verasun 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.<sup>11</sup> Ordinary course of business is shown by demonstrating that the transfer was consistent with a pattern of previous transfers between the parties.<sup>12</sup> 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.”<sup>13</sup>

**Note:** To demonstrate an ordinary course of business, corn suppliers should gather all of the receipts for corn deliveries delivered to Verasun, along with all check stubs and deposit slips for the deposit of checks received from Verasun for at least six months prior to October 31, 2008. Any other record of transactions with Verasun 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 corn was delivered to Verasun if receipts have been 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.”<sup>14</sup> Thus, if a corn supplier delivered corn to Verasun *after* the date of any payment that that the trustee is attempting to recover and did not get paid for the corn, the supplier will have provided new value to Verasun, 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.

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<sup>1</sup> Preference is defined in 11 U.S.C. §547(b).

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

<sup>3</sup> 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).

<sup>4</sup> 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).

<sup>5</sup> 11 U.S.C. §547(c)(2).

<sup>6</sup> 11 U.S.C. §547(c)(1).

<sup>7</sup> 11 U.S.C. §547(c)(4).

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

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<sup>9</sup> In re Jones Truck Lines, Inc., 130 F.3d 323, 326 (8th Cir.1997).

<sup>10</sup> *Id.* at 327.

<sup>11</sup> *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).

<sup>12</sup> *Id.*

<sup>13</sup> *Id.*

<sup>14</sup>*See, e.g.*, In re Accessair, Inc., 314 B.R. 386, 395 (B.A.P. 8th Cir. 2004).