

Using the National Summary of Domestic Trade Receivables to help defend a preference action

CRF's quarterly National Summary of Domestic Trade Receivables has increased in participation to just under 600 records as of a recent report. Importantly, this data covers 284 Standard Industry Codes. We are hoping through a cooperative effort with NACM National and many of the NACM affiliates to increase that report to make it even more meaningful for you.

In a recent article co-written by Scott Blakely of Blakeley & Blakeley, LLP and Terry Callahan of CRF, it was pointed out that in defending a preference action, a creditor can utilize the data in the NSDTR to help answer the objective test that requires a creditor to establish the ordinary business terms within an industry. Ordinary business terms for the industry are generally defined as the range of terms that encompass the practices in which businesses similar in some way to the creditor in question engage. Creditor's are required to prove that the preferential transfers were objectively ordinary in relation to industry standards. Examining the industry standard requires: 1) An identification of the relevant industry; and, 2) an objective examination of its standards and practices to determine if this transfer is within the outer boundaries of the industry.

Although the industry standard does not require a creditor to establish the existence of a uniform set of business terms, it does require evidence of a prevailing practice among similarly situated members of the industry facing the same or similar problems. To establish the industry standard, the creditor must usually rely on evidence that is external to the debtor and creditor.

Utilizing empirical evidence generally in the form of industry payment history data compiled by an independent, authoritative source, such as that supplied by The Credit Research Foundation in the quarterly "National Summary of Domestic Trade Receivables" report, sets forth an index, by industry, based on information assembled from creditors. The data, which indexes six key metrics such as: Collection Effectiveness, Days Sales Outstanding, Best Possible DSO, Average Days Delinquent, Percent of Current AR and Delinquent AR over 91 Days Past Due, provides a valuable tool in establishing the criteria to meet the objective test to the "ordinary course" in a preference defense. The objective test, previously discussed, can be built based on a practical examination of the Best Possible Days Sales Outstanding index. A correlation can be made between BPDSO and terms based on the theory that BPDSO is calculated without the influence of past due receivables. Therefore, since there is no delinquency in the BPDSO figure, hypothetically all customers are paying according to terms. Consequently, examination of the BPDSO for any given industry will show a strong parallel to that industry's aggregated standard business terms.

An analysis of each quarter for the last 23 years illustrates that, across all industries, the median Best Possible DSO is 31.7 days and the average is 31.8 days. Arguably, the most common standard term across all industries is 30 days; therefore supporting the theory that the BPDSO for any given industry correlates to the standard industry terms.

Further utilizing the CRF data to support a specific industry, we can illustrate an example from the 1st quarter 2004 report for the apparel industry. The median BPDSO for that industry in the quarter January through March 2004 was 37.8 days. The upper quartile was 45.1 and the lower was 27.7 days. Using this data to establish a "standard" for a creditor in the apparel industry, it could be said that ordinary business terms range from 28 days to 45 days in the apparel industry.

We have heard for years from many credit executives that they've participated in the NSDTR and not found their industry listed in the results. The reason for that is simple. The report displays true medians and quartiles; and to determine a true median, you need at least three results. Obviously as with any statistical report, the more data, the more valid the results; therefore, we implore you when you receive your email request from us requesting data for an upcoming National Summary of Domestic Trade Receivables report, pass it along to you industry group members. Remind them that the results are FREE to any company who responds to the report. Send the email to your NACM affiliate and your industry group administrators and have them send it out (just have them cut it and paste it into their own email) and send to the industry group members.

Remember, this data is to help you, measure your performance on the six key performance metrics mentioned above and further, to help in establishing ordinary course industry terms. Please participate!