

DEFENSES TO BANKRUPTCY PREFERENCE CLAIMS

Trustees involved in bankruptcies take a shotgun approach and ask for all money and assets to be “paid back” to the bankruptcy court if received within ninety days prior to the date of the bankruptcy filing. Trustees earn a percentage of all monies and assets that flow through Bankruptcy Court proceedings; consequently, their demands are all inclusive without any consideration to those circumstances where the creditor is allowed to retain assets and payments. A debtor is deemed insolvent ninety days prior to the filing of any bankruptcy. This is the premise for the Trustees’ demand that preferential payments be paid back to the Bankruptcy Court for re-distribution. Although somewhat unusual but not uncommon, the bankruptcy trustee in a Chapter 11 and especially a Chapter 7 treats all payments and transfer of assets during the last ninety days leading up to the bankruptcy filing as preferential. There are defenses to these bankruptcy preference claims, which are also known as avoidable preferences. Avoidable preferences mean that exceptions are allowed and in those situations a creditor can avoid the “pay back” preference. The most common defenses of bankruptcy preference claims are as follows:

1. Payments made by a debtor in the “debtor’s ordinary course of business.”
2. New value considerations including COD transactions, Special Orders and Lien Rights.
3. Two-year statute of limitations.
4. Application of the “Necessity Doctrine.”

A creditor who receives a Trustee’s demand to return a preferential payment has a number of alternatives, which range from disregarding the demand to acquiescing and returning all of the money. It is our recommendation that in every instance arguments be advanced to the Trustee that payments made to your company are not considered preferential. Based on one or more defenses, you will have to provide the specific particulars and tie them into your defense. In every situation where we have passed along information to assist a client in defeating a preferential claim, there has never been an instance where a Williams & Williams client has paid 100% of what was being demanded by the bankruptcy Trustee.

A creditor can use the defense that the payment occurred in the debtor’s ordinary course of business, if it can be shown through payment history that previous payments were consistently late and outside terms. This pattern of lateness was the debtor’s established normal course of business. If there is no prior evidence of deviation from invoice terms, then the courts will find that the payment is a preference.

Special orders are considered due and payable when raw materials are secured. If it can be shown that end user consumers took deposits, then such transactions would be considered not only as ongoing new consideration but also application of the “Necessity Doctrine.”

The Necessity Doctrine is payment favoritism shown by a debtor because the creditor’s merchandise is considered indispensable and crucial to the debtor’s business. Accordingly, the Necessity Doctrine could be applied to a featured name brand supplier or a seller providing “gallery” inventory and merchandise to a “gallery” retailer.

New value consideration can be in the form of additional merchandise being shipped within the 90-day preference period. This amounts to new and additional consideration tendered to the debtor within the 90-day period and thus any payments made would be avoidable, as the Bankruptcy doctrine does not discourage new value consideration to a financially struggling company.

COD transactions are considered new value and since credit was not extended on the COD transaction, any NSF checks given on a COD order should be treated as an Administrative Claim in bankruptcy. Attempted payments tendered as COD are considered a contemporaneous exchange or “new value.” In addition, lien rights that could be asserted are an acceptable defense of a preference. The existence of Lien Rights or Artesian Lien Rights at the time of a preference payment in itself is considered “new consideration,” as payment nullified the need to subsequently perfect and file a “Claim of Lien.”

Williams & Williams has more detailed information, if a client wishes to defeat preferential claims made by the bankruptcy Trustee. The particulars are available upon request.