

## **Bankruptcy Preferences - Do you have to give it back?**

Word on the street is that one of your long time customers is having cash flow problems and is having difficulty paying his creditors. You're concerned because you recently made numerous sales to him, but he assures you he will pay. True to his word, the customer makes the payment to you. However, the customer's financial condition does not improve, and he eventually files for bankruptcy. While you may be saddened by this news, you are glad that your receivables have been paid before the bankruptcy filing. Then, several months later, you receive a letter that the payment made to you was a "preferential transfer". The letter demands that you repay the money.

Generally speaking, federal bankruptcy law allows a debtor to recover certain payments or "preferential transfers" that were made to a creditor a short time before the filing of the debtor's bankruptcy. Specifically, section 547 of the United States Bankruptcy Code sets forth several elements of a preferential transfer under federal bankruptcy law. These elements are: (1) a transfer; (2) of property of the debtor (3) to or for the benefit of a creditor; (4) on account of an antecedent debt; (5) while the debtor was insolvent; (6) within 90 days of bankruptcy or one year in the case of insiders; and, (7) which enables the creditor to receive more than if the bankruptcy estate was liquidated in a Chapter 7 case.

The debtor or trustee has the burden of proof with respect to all elements of a preference, except for the rebuttable presumption the debtor was insolvent within the 90 day period prior to the bankruptcy (but not the one year insider period). So if the debtor meets this burden, do you have to pay the money back? The answer is - maybe.

The good news for creditors is that even if the debtor can ultimately prove the elements necessary to prove a preferential transfer, there are numerous defenses available to a creditor to defeat the claim.

One of the most common defenses against a preference claim is that the transfer was an "ordinary course" transfer. There are three components to this defense that the creditor must prove in order to successfully assert it. One, the debt that the transfer satisfied must have been one that typically existed between the creditor and the debtor. Two, the transfer must have been paid in a time and manner that is consistent with other prior payments made by the debtor to the creditor. Third, the transfer must be consistent with other transfers that are standard in the creditor's or debtor's industry.

Other common defenses include the "new value" defense, which rewards creditors that continued to do business with the debtor during the final weeks prior to its bankruptcy filing; the "contemporaneous exchange" defense, which includes COD transfers and the like; and the defense for transfers in situations in which (a) the creditor is granted a purchase money security interest 90 days before the bankruptcy filing to enable the debtor to receive inventory, and (b) the creditor perfects the security interest on or before 20 days after the debtor receives the property. There are other available defenses, but are not discussed due to the scope of this article.

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