

Anatomy of a Preference

NACM Credit Learning Center

Val Venable, CCE



Anatomy of a Preference

Best Defense is a Good Offense

It is what you do before your customer files for bankruptcy that is going to effect how successful you are in defending any potential preference exposure.

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Anatomy of a Preference

Best Defense is a Good Offense

- Basic Credit Hygiene
 - Thorough and Accurate Documentation
 - Historical, Unemotional, Factual (HUF)
 - Consistent Practices
 - Knowledgeable Team

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Best Defense is a Good Offense

- Know your data
- Know your customer
- Understand the commercial relationship
- Know when to call your attorney

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Notice of Bankruptcy Filing

- Stop all collection activity
- Freeze activity on the account
- Stop any shipments in transit
- Obtain invoice copies and Proof of Delivery for all unpaid invoices
- Download or capture all shipment and payment activity for at least 27 months
- Secure any collection documentation

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- Elements of a Preference
 - Payment or transfer of property to or for the benefit of a creditor.
 - In payment of an antecedent debt.
 - Made while debtor is insolvent, (balance sheet test, presumed 90 days).
 - Made on or within 90 days prior to the filing, (1 yr for insider).
 - Creditor gets more than he would under a liquidation (Chapter 7).

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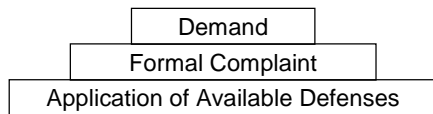


Proof of Solvency

- UCC 2-609 Adequate Assurance
- Recent financial statements
 - Sent through the mail is best
- Email or Letter from the Debtor
- Confirmation of notes taken during phone call
- Collector notes

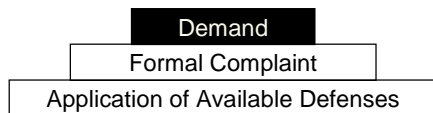
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The Demand Letter

- **DO NOT JUST WRITE A CHECK!!!**
- Review letter for accuracy
 - Did they send it to the right Creditor?
 - Is the amount they demanded correct?
- Request back up documentation
 - If there are no payment details with the letter, ask for them.

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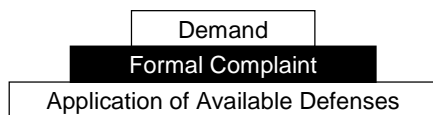
The Demand Letter

- Cannot initiate a lawsuit for under \$5,475.
- If amount of preference is between \$5,474 and \$10,950, must be brought in the jurisdiction of the creditor.

Note: if you have already resolved part of the preference demand and the attorney for the trustee decides to bring suit, they will do so for the full amount, not the amount still in dispute.

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Complaint to Avoid and Recover Transfer

- Filed with the bankruptcy court as an adversary proceeding
- Will provide a brief background of the case, including filing dates and applicable plan information.

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Order Establishing Procedures and Deadlines for Adversary Proceedings

- May be split by dollar range
- Provides deadlines for answers or responses
- Penalty for no response
- Provides schedule for request for documents, retaining experts, and completion of discovery.

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Statute of Limitations

- Two years from date of filing, or
 - One year after first trustee appointed if done within the two year period.
- ❖ Expiration of the statute of limitations is an affirmative defense, which means it must be raised prior by the time answers are filed.

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The trustee may not avoid a transfer...

- Contemporaneous exchange for new value
- § 547(c)(1)
- Ordinary course of business
- § 547(c)(2)
- Creates a security interest in property acquired by the debtor
- § 547(c)(3)
- After such transfer, gave new value
- § 547(c)(4).

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• Payment by a credit card

- Courts are mixed
 - Some feel that the even though the debtor was directing payment from a third party (the credit card bank), they had sufficient control over the initiating and directing of the funds creating an interest in them.
 - A ruling by District of Kansas in 2007 feels that neither the debtors assets or liabilities changed; the transfer neither benefited nor harmed the estate so there was no avoidable transfer.

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Anatomy of a Preference Contemporaneous Exchange



Date	Invoice #	Invoice \$	Payment #	Payment \$	Potential Preference
5/1/09	12345	500.00			
7/2/09	23456	750.00			
7/6/09			CK# 759	750.00	

- Intent of the transaction was simultaneous
- Gap between shipment date and payment date could be transit time, weekends or holidays.
- Be aware of any payment instructions on remittance advise

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- Ordinary Course 547(c)(2)
 - to the extent that such transfer was...
 - A payment of a debt incurred by debtor in the ordinary course of business or financial affairs of the debtor **and**
 - Made in the ordinary course of business or financial affairs of the debtor **or**
 - Made according to ordinary business terms.

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- Ordinary Course 547(c)(2)
 - The legislative history states its purpose is to leave undisturbed normal financial relations because it does not detract from general policy of the preference section to discourage unusual action by either the debtor or his creditors during the debtor's slide into bankruptcy.

(paraphrased from ruling in Tennessee Valley Steel, Sixth Circuit, 1996)

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- Ordinary Course
 - No longer required to prove two prong defense
 - Objective – Ordinary in the industry
 - Subjective – Ordinary between debtor and creditor
 - Made according to ordinary business terms

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- Ordinary Course
 - Are you doing what you've always done?
 - Following standard collection process
 - Keeping accurate collection notes
 - Historical, Factual, Unemotional
 - Avoid making threats
 - Document any "grace" periods
 - Waiving of late fees

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- Ordinary Course
 - Days to pay
 - Days beyond terms
 - Determining "average"
 - Mean – true average of numbers
 - Mode – most frequently occurring
 - Median – midway between high and low
 - Standard Deviation – the spread of the data

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Anatomy of a Preference Ordinary Course – Days to Pay



Check #	Deposit Date	Check Amount	Invoice #	Invoice Date	Invoice Amount	Days to Pay
18263	2/13/09	16,532.00	114560	12/1/08	12,320.00	74
18263	2/13/09		114672	12/15/08	4,212.00	60
18547	2/27/09	12,982.00	114045	11/11/08	3,159.00	108
18547	2/27/09		114700	12/17/08	7,348.00	72
18547	2/27/09		114825	1/9/09	2,475.00	49
18790	3/12/09	3,993.00	114890	1/10/09	3,080.00	61
18790	3/12/09		114925	1/15/09	913.00	56
18964	3/30/09	7,371.00	114950	1/17/09	5,265.00	72
18964	3/30/09		115125	1/30/09	2,106.00	59
19334	4/22/09	10,655.00	115203	2/9/09	9,840.00	72
19334	4/22/09		115316	2/13/09	825.00	68
19635	5/5/09	7,788.00	115422	2/16/09	6,600.00	78
19635	5/5/09		115589	2/25/09	1,188.00	69

Mean 69 Mode 72 79 – 14 = 65 } OC
 Median 79 Std Dev 14 79 + 14 = 93 } Range

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Subsequent New Value



- Creditor gave new value to or for the benefit of the debtor –
- Not secured by an otherwise unavoidable security interest
- On account of which new value Debtor did not make an otherwise unavoidable transfer

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Subsequent New Value



- Shipment must occur after payment to which it will be measured

Date	Invoice #	Invoice \$	Payment #	Payment \$	Potential Preference
5/1/09	12345	500.00			
7/2/09	23456	750.00			
7/20/09			CK# 759	1,000.00	1,000.00

Date	Invoice #	Invoice \$	Payment #	Payment \$	Potential Preference
5/1/09	12345	500.00			
7/1/09			CK# 759	1,000.00	1,000.00
7/2/09	23456	750.00			250.00

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Subsequent New Value



- Unused value of shipments do not carry forward

Date	Invoice #	Invoice \$	Payment #	Payment \$	Potential Preference
5/1/09			CK# 655	1,000.00	1,000.00
5/15/09	24567	1,500.00			-
6/2/09			CK# 688	1,000.00	1,000.00

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Paid versus Unpaid New Value



- Was the payment an otherwise unavoidable transfer?
 - ✓ Was the payment that paid for the new value applied against an earlier payment made within the ordinary course of business?

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Paid versus Unpaid New Value



Date	Invoice #	Invoice \$	Payment #	Payment \$	Potential Preference
5/1/09			CK# 655	2,000.00	2,000.00
5/5/09	24478	1,500.00			500.00
5/15/09	24567	1,000.00			-
6/15/09			CK# 688	1,000.00	1,000.00

Date	Invoice #	Invoice \$	Payment #	Payment \$	Potential Preference
5/1/09			CK# 655	2,000.00	2,000.00
5/5/09	24478	1,500.00			500.00
5/15/09	24567	1,000.00			-
6/15/09			CK# 688	1,000.00	500.00

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Priority of Defenses



11 U.S.C. § 547(c)(4)(B)

(c) The trustee may not avoid under this section a transfer...

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor--

(A) not secured by an otherwise unavoidable security interest; and

(B) (B) on account of which new value the debtor did not make an **otherwise unavoidable transfer** to or for the benefit of such creditor

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Priority of Defenses



Check Number	Check Deposit Date	Check Amount	Paid Invoice Number	Paid Invoice Date	Paid Invoice Amount	DTP	Non - DC Invoice Paid < \$1, > \$1	New Value Inv Number	New Value Inv Amount	NV Inv Date	Pmt after DC	Potential Preference
1359	7/26/07	7,419.00										
	7/26/07		113673	5/15/07	283.00	72	283.00					
	7/26/07		113703	5/15/07	356.00	72	356.00					
	7/26/07		114931	5/17/07	2,210.00	70						
	7/26/07		115612	5/18/07	4,257.00	69						
	7/26/07		116341	5/21/07	313.00	66						
								148167	190.00	7/27/07		449.00
								148168	450.00	7/27/07		(1.00)
								148190	225.00	7/27/07		
								148235	165.00	7/27/07		
											539.00	

Check Number	Check Deposit Date	Check Amount	New Value Inv Number	New Value Inv Amount	NV Inv Date	Potential Preference
1359	7/26/07	7,419.00				7,419.00
			148167	190.00	7/27/07	2,229.00
			148168	450.00	7/27/07	6,779.00
			148190	225.00	7/27/07	6,554.00
			148235	165.00	7/27/07	6,389.00

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