

# Preference Payments in the Bankruptcy Arena



## **Petroleum Equipment & Services Association** *Credit Interchange Division*

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# A HISTORY OF BANKRUPTCY PREFERENCES



- WHERE DOES THIS CONCEPT COME FROM?
  - EQUALITY of Distribution
  - Ideally, equal treatment (or as equal as we can get) for those similarly situated must be achieved.
  - Transfers that benefit one creditor at the expense of other creditors is unfavorable.
    - ✦ But - these transfers encourage:
      - a race among creditors
      - produce favoritism by the debtors
      - ultimately result in inequality of distribution.

# HISTORY



- Preference laws were created to help discourage these unequal transfers and achieve (or attempt to achieve) equality of distribution.
- Preference laws seek to deter individual creditor action by threatening recapture of transfers made during the debtor's period of vulnerability.

# HISTORY



- Maximization of the bankruptcy estate.
- Preferential transfers will result in diminishment of estate assets, thus frustrating decisions that would achieve maximization of creditor recoveries.

# Elements



- A transfer is a preference under 11 U.S.C. § 547 (b) if it was:
  - A transfer of an interest of the DEBTOR in property
  - To or for the benefit of a CREDITOR
  - On account of an antecedent debt
  - Made while the Debtor was INSOLVENT
  - Made within 90 days before the petition date ( 1 year for insiders); and
  - Enabled the Creditor to receive more than it would have in a Chapter 7 bankruptcy

# TRANSFER OF AN INTEREST OF THE DEBTOR IN PROPERTY



- “Transfers” most commonly mean:
  - Monetary payments.
  - Non-monetary acts such as the recordation of a deed of trust or the perfection of a security interest.
- Of an interest of the debtor in property:
  - “Property of the estate”
  - All legal or equitable interests of the debtor in property as of the commencement of the case

# TO OR FOR THE BENEFIT OF A CREDITOR



- “Creditor”
  - Includes anyone with a right to payment from the estate, or equitable remedy against the estate.
- Direct transfers from Debtor to creditor are more easily identifiable.

# ANTECEDENT DEBT



- Transfer preferential only if Debtor incurred debt to creditor **before** the transfer.
- Antecedent debts include contingent, unliquidated, or unfixed.
  - Common issue is timing of when debt was incurred.

# INSOLVENCY



- Insolvency means whether the Debtor's liabilities exceeded its assets on the date of the transfer.
- Debtor is presumed insolvent during 90-days pre-petition.
  - This presumption is rebuttable.

# PREFERENCE PERIOD



- 90 days pre-petition for most creditors;
  - 1 year for insiders
- Form of payment can be an issue:
  - For example, for checks, the date the check clears is generally the operative date, **not** the date the Debtor delivered the check to the creditor.
- Preference period extended from 90 days to **1 year for insiders**
  - Insider status determined at time of transfer
  - Includes not only officers and directors, but also relatives of such persons.
  - Also includes Debtor's affiliates.
  - Most important factor is control.

# GREATER THAN CHAPTER 7



- Only a preferential transfer if creditor received more than it would have received in a Chapter 7 liquidation.
- Court not bound to valuations in Debtor's schedules; actual facts and circumstances can be considered.
- May arise where creditor raised its status from unsecured to partially or wholly secured.

# DEFENSES



- § 547(c) has 9 statutory exceptions
- If trustee makes prima facie case under § 547(b), it becomes the creditor's burden to plead and prove a defense.
- Most Common Defenses:
  - Contemporaneous Exchange for New Value
  - Subsequent New Value
  - Ordinary Course of Business

# CONTEMPORANEOUS EXCHANGE FOR NEW VALUE



- Transfer occurs contemporaneously with creditor's providing **new value**, and the parties intended that the exchange be **contemporaneous**.
  - Litigation often arises where parties intended that transfer be contemporaneous, but there is a delay between incurring of debt and transfer.
- **Example: Cash-on-delivery (COD) exchange of money for goods or services.**
  - CANNOT require payment of outstanding invoices as a condition for delivering new goods.

# SUBSEQUENT NEW VALUE



- Preference amount reduced to the extent the creditor provided “new value” to the debtor after the date of the transfer.
- The rationale here is that such creditors have conferred a benefit on the bankruptcy estate through the provision of goods and services to a financially troubled company and should thus escape preference liability.

# ORDINARY COURSE OF BUSINESS



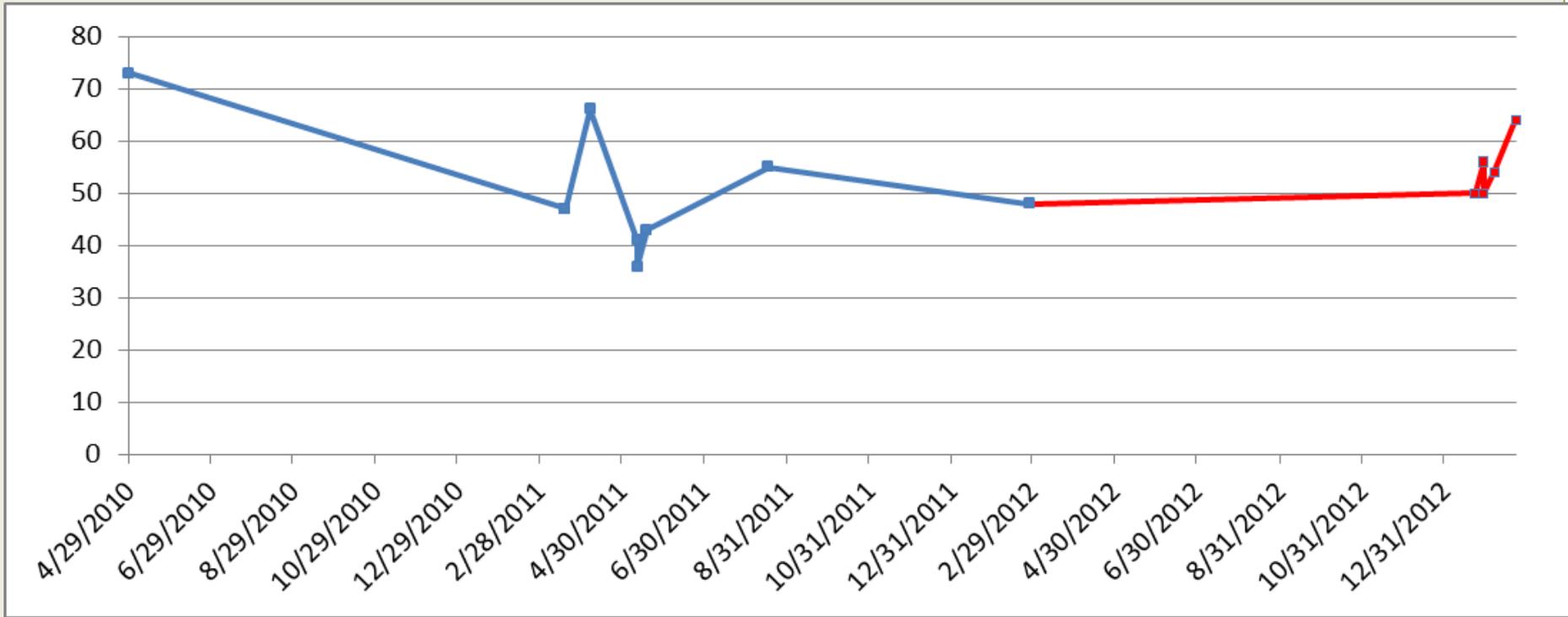
- Payment of debt incurred in the ordinary course of the debtor's business, and the payment was made either
  - (a) in the ordinary course of business between the parties; **or**
  - (b) according to ordinary business terms.
- The first part compares the preferential transfer with typical transfers made during the pre-preference period
  - similar days paid past invoice date
  - similar amounts
  - similar form of payment
  - payment was not the result of coercion by creditor
- The second part compares the transfer with industry standards.

# EXAMPLE: GMX Resources



Invoice No.	Invoice Date	Amount	Payment Date	Days Til Paid
077048	12/20/2012	\$ 6,829.08	2/22/2013	64
077049	12/20/2012	\$ 8,940.33	2/22/2013	64
076955	12/14/2012	\$ 61,536.60	2/6/2013	54
077488	12/4/2012	\$ 955.11	1/29/2013	56
076781	12/4/2012	\$ 5,325.49	1/29/2013	56
076828	12/10/2012	\$ 65,564.03	1/29/2013	50
076790	12/4/2012	\$ 63,945.75	1/23/2013	50
071386	1/10/2012	\$ 33,976.70	2/27/2012	48
067568	6/23/2011	\$ 19,014.13	8/17/2011	55
066154	4/6/2011	\$ 20,019.01	5/19/2011	43
066068	4/1/2011	\$ 5,585.00	5/12/2011	41
066126	4/6/2011	\$ 5,585.00	5/12/2011	36
064883	1/31/2011	\$ 58,189.40	4/7/2011	66
064884	1/31/2011	\$ 37,182.64	3/19/2011	47
064937	1/31/2011	\$ 5,282.00	3/19/2011	47
064945	1/31/2011	\$ 38,452.80	3/19/2011	47
064946	1/31/2011	\$ 44,411.68	3/19/2011	47
059007	2/15/2010	\$ 1,214.64	4/29/2010	73

# EXAMPLE



# PRACTICE TIPS



- Watch for signs that a customer is in financial distress.
- Require **immediate** payment instead of extending credit to the customer.
- When you receive payment, the general rule is that the payment is applied to the oldest invoice:
  - **Don't do that** -- apply the payment to the most current invoice
- Ask for a deposit for future services or products
  - This helps refute the “antecedent debt” element
- Ask for a letter of credit
- Ask for a corporate guarantee

# PRACTICE TIPS



- Respond early to demand letters from the Trustee or Debtor.
- Provide documents and other information supporting your defenses.
- Use a statistical analysis to support defenses.
- **Negotiate!**
- **Avoid trial!**

**Thanks PESA-CID for the  
Opportunity to Assist in this  
Timely Discussion.**

**Good Luck!**

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