



Avoiding Preference Claims by Bankruptcy Trustees

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In these economically unstable times, companies are increasingly experiencing problems with customers who make payments to them and then file bankruptcy. If a customer pays your company and then files a bankruptcy petition within 90 days of making the payment, the customer's bankruptcy trustee may demand that you return the payment to him. A payment made by a debtor within 90 days before he files bankruptcy is called a preference.

The reasoning behind the preference statutes is two fold. Firstly, a primary goal of the bankruptcy code is to treat like creditors equally. If one creditor is paid in full on the eve of an individual's bankruptcy filing and another creditor gets nothing, this goal is frustrated. Secondly, the preference statutes discourage a rush to the courthouse doors to secure a judgment against a struggling company or individual. As such, wrongdoing by a creditor is irrelevant in a preference case. The remedy, the return of the claimed preferential payment, is not viewed as a punishment to the creditor but rather as a method for treating all creditors equally and thus, presumably, fairly.

The bankruptcy code does have some protections in place for creditors who receive payments immediately before the debtor files bankruptcy.

By way of example, payments made in the ordinary course of business and pursuant to ordinary business terms are not deemed preferential. Additionally, a payment which qualifies as a contemporaneous exchange for goods or services is not subject to the preference statutes.

What this means for companies is that there are things they may be able to do to avoid a preference claim by a trustee. For instance, if you have knowledge that a customer is struggling financially, do not extend credit to the customer but rather require immediate payment for goods or services provided. Additionally, if bankruptcy is imminent, you may consider applying monies received to the most recent, versus the oldest, invoice as such a payment is more likely to be deemed made according to ordinary business terms.

If you receive a demand letter from a bankruptcy trustee alleging that a payment is preferential, consider seeking legal counsel experienced in bankruptcy issues to determine what your rights may be relative to return of that payment.