

December 14, 2016

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# MY CUSTOMER FILED BANKRUPTCY: NOW WHAT?

## SUPPLEMENTAL MATERIALS

PRESENTATION FOR:

NACM'S 2016 AUDIO TELECONFERENCE  
SERIES

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# 1

## ADEQUATE ASSURANCE DEMAND

[On Creditor's Letterhead]

June 15, 2008

**VIA FEDERAL EXPRESS**

XYZ Company

**Re: Purchase and Supply Agreement dated October 1, xxxx  
between XYZ Company and Creditor (the "Agreement")**

Dear \_\_\_\_\_:

Following your meeting with our Comptroller and Director of Credit on June 1, xxxx, Creditor believes that grounds for insecurity exist under Official Code of Georgia (O.C.G.A.) §11-2-609 and other applicable law with respect to XYZ's ability to pay for goods hereafter sold and delivered based on the 30-day credit terms previously provided to XYZ ("Credit Terms"). Such grounds for insecurity are based on:

- XYZ's decision to close its mill in Birmingham, Alabama.
- Non-renewal in March of this year of XYZ's bank line of credit
- XYZ's inability to pay the interest due on its bond debt on August 1, 2008.
- Articles in the press regarding the financial condition of XYZ, Inc., including the *Debtwire* May 11, 2008 report regarding the prospective XYZ debt restructuring, which may include issuance of second lien debt, due in part to XYZ's "disastrous operating conditions.
- XYZ's most recent financial statements provided to Creditor that show a lack of liquidity and continuing losses
- Discussions with you regarding the possibility of XYZ filing Chapter 11

In light of the foregoing, pursuant to O.C.G.A §11-2-609 and other applicable law, Creditor demands adequate assurance of XYZ's ability to timely and fully pay for goods that Creditor shall sell and deliver to XYZ and to otherwise fully satisfy XYZ's obligations to Creditor, including full payment of all invoices for goods previously sold and delivered to XYZ on Credit Terms. In addition, Creditor is immediately suspending the Credit Terms on all sales to XYZ on and after the date of this letter and will sell to XYZ only on a cash-in-advance basis, until Creditor receives such assurances of payment. Creditor reserves all of its other rights and remedies, including, without limitation, the right to refuse and/or stop delivery under O.C.G.A §§11-2-702, 11-2-703 and 11-2-705.

Very truly yours,

**STOPPAGE OF DELIVERY NOTICE**

[DATE]

**VIA EMAIL, FAX, FEDERAL EXPRESS,  
AND CERTIFIED MAIL, R.R.R.**

**[CARRIER/WAREHOUSE]**

**Re: STOPPAGE OF DELIVERY DEMAND: [NAME OF CUSTOMER]**

Dear [INSERT]:

Demand is hereby made on you to stop delivery of all of the goods of the above customer in your possession, including, without limitation, all of the goods identified in the Schedule annexed hereto, pursuant to §§2-702, 2-703 and 2-705 of the Uniform Commercial Code.

Please contact the undersigned for instructions in connection with the return of the goods. We make this demand for stoppage of delivery without prejudice to all other rights and remedies available to us, at law or in equity.

Very truly yours,

[NAME OF CREDITOR]

By: \_\_\_\_\_

Title: \_\_\_\_\_

cc: [Name and Address of Debtor]

**SCHEDULE TO STOPPAGE OF DELIVERY DEMAND**

<u>INVOICE NO.</u>	<u>INVOICE DATE</u>	<u>INVOICE AMOUNT</u>	<u>BILL OF LADING NO.</u>
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3

**BANKRUPTCY RECLAMATION DEMAND**

**TO DEBTOR/TRUSTEE  
[CREDITOR LETTERHEAD]**

[DATE]

**VIA EMAIL, FAX, FEDERAL EXPRESS  
AND CERTIFIED MAIL, R.R.R.**

[NAME AND ADDRESS OF  
DEBTOR(S)/RECIPIENT(S) OF GOODS]

Re: Reclamation Demand by [Name of Creditor]

Dear \_\_\_\_\_:

Demand is hereby made upon you, pursuant to § 2-702 of the Uniform Commercial Code, and/or § 546(c)(1) of the United States Bankruptcy Code, for the return of all goods that the undersigned had sold to you and you had received within forty-five (45) days before your bankruptcy filing date of [fill in the date of the bankruptcy petition]. This demand specifically includes, but is not limited to, goods identified in the Schedule annexed hereto.

Please contact the undersigned for instructions in connection with the return of the goods.

You are further notified that all goods subject to our right of reclamation must be protected and segregated by you and shall not be used for any purpose whatsoever except those specifically authorized following notice and a hearing by the Bankruptcy Court or other court.

We make this demand for reclamation without prejudice to all other rights and remedies available to us, at law or in equity, including but not limited to, our right to an allowed administrative expense claim under § 503(b)(9) of the Bankruptcy Code for all goods received by you within twenty (20) days before the date of commencement of your bankruptcy case.

Very truly yours,

[Name of Creditor]

By: \_\_\_\_\_

Title: \_\_\_\_\_

[page 1 of reclamation letter]

**SCHEDULE TO RECLAMATION DEMAND**

Invoice No.

Invoice Date

Invoice Amount

[page 2 of reclamation letter]

4  
**PROOF OF CLAIM FORM**

**Fill in this information to identify the case:**

Debtor 1 \_\_\_\_\_

Debtor 2 \_\_\_\_\_  
(Spouse, if filing)

United States Bankruptcy Court for the: \_\_\_\_\_ District of \_\_\_\_\_  
(State)

Case number \_\_\_\_\_

Official Form 410

**Proof of Claim**

12/15

**Read the instructions before filling out this form. This form is for making a claim for payment in a bankruptcy case. Do not use this form to make a request for payment of an administrative expense. Make such a request according to 11 U.S.C. § 503.**

**Filers must leave out or redact** information that is entitled to privacy on this form or on any attached documents. Attach redacted copies of any documents that support the claim, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, judgments, mortgages, and security agreements. **Do not send original documents;** they may be destroyed after scanning. If the documents are not available, explain in an attachment.

A person who files a fraudulent claim could be fined up to \$500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.

**Fill in all the information about the claim as of the date the case was filed. That date is on the notice of bankruptcy (Form 309) that you received.**

**Part 1: Identify the Claim**

<p><b>1. Who is the current creditor?</b></p>	<p>_____</p> <p>Name of the current creditor (the person or entity to be paid for this claim)</p> <p>Other names the creditor used with the debtor _____</p>		
<p><b>2. Has this claim been acquired from someone else?</b></p>	<p><input type="checkbox"/> No</p> <p><input type="checkbox"/> Yes. From whom? _____</p>		
<p><b>3. Where should notices and payments to the creditor be sent?</b></p> <p>Federal Rule of Bankruptcy Procedure (FRBP) 2002(g)</p>	<p><b>Where should notices to the creditor be sent?</b></p>	<p><b>Where should payments to the creditor be sent? (if different)</b></p>	
	<p>_____</p> <p>Name</p>	<p>_____</p> <p>Name</p>	
	<p>_____</p> <p>Number Street</p>	<p>_____</p> <p>Number Street</p>	
	<p>_____</p> <p>City State ZIP Code</p>	<p>_____</p> <p>City State ZIP Code</p>	
	<p>_____</p> <p>Contact phone</p>	<p>_____</p> <p>Contact phone</p>	
	<p>_____</p> <p>Contact email</p>	<p>_____</p> <p>Contact email</p>	
	<p>Uniform claim identifier for electronic payments in chapter 13 (if you use one):</p>		
<p><b>4. Does this claim amend one already filed?</b></p>	<p><input type="checkbox"/> No</p> <p><input type="checkbox"/> Yes. Claim number on court claims registry (if known) _____</p> <p style="text-align: right;">Filed on _____ MM / DD /YYYY</p>		
<p><b>5. Do you know if anyone else has filed a proof of claim for this claim?</b></p>	<p><input type="checkbox"/> No</p> <p><input type="checkbox"/> Yes. Who made the earlier filing? _____</p>		

**Part 2: Give Information About the Claim as of the Date the Case Was Filed**

6. **Do you have any number you use to identify the debtor?**  No  
 Yes. Last 4 digits of the debtor's account or any number you use to identify the debtor: \_\_\_\_\_

7. **How much is the claim?** \$ \_\_\_\_\_ **Does this amount include interest or other charges?**  
 No  
 Yes. Attach statement itemizing interest, fees, expenses, or other charges required by Bankruptcy Rule 3001(c)(2)(A).

8. **What is the basis of the claim?** Examples: Goods sold, money loaned, lease, services performed, personal injury or wrongful death, or credit card.  
Attach redacted copies of any documents supporting the claim required by Bankruptcy Rule 3001(c).  
Limit disclosing information that is entitled to privacy, such as health care information.  
\_\_\_\_\_

9. **Is all of part of the claim secured?**  No  
 Yes. The claim is secured by a lien on property.

**Nature of property:**  
 Real estate. If the claim is secured by the debtor's principal residence, file a *Mortgage Proof of Claim Attachment* (Official Form 410-A) with this *Proof of Claim*.  
 Motor vehicle  
 Other. Describe: \_\_\_\_\_

**Basis for perfection:** \_\_\_\_\_  
Attach redacted copies of documents, if any, that show evidence of perfection of a security interest (for example, a mortgage, lien, certificate of title, financing statement, or other document that shows the lien has been filed or recorded.)

**Value of property:** \$ \_\_\_\_\_  
**Amount of the claim that is secured:** \$ \_\_\_\_\_  
**Amount of the claim that is unsecured:** \$ \_\_\_\_\_ (The sum of the secured and unsecured amounts should match the amount in line 7.)

**Amount necessary to cure any default as of the date of the petition:** \$ \_\_\_\_\_

**Annual Interest Rate** (when case was filed) \_\_\_\_\_%  
 Fixed  
 Variable

10. **Is this claim based on a lease?**  No  
 Yes. Amount necessary to cure any default as of the date of the petition. \_\_\_\_\_  
Filed on \_\_\_\_\_

11. **Is this claim subject to a right of setoff?**  No  
 Yes. Identify the property: \_\_\_\_\_

**12. Is all or part of the claim entitled to priority under 11 U.S.C. § 507(a)?**

A claim may be partly priority and partly nonpriority. For example, in some categories, the law limits the amount entitled to priority.

- |   |                                    |
|---|------------------------------------|
| <input type="checkbox"/> No   |                                    |
| <input type="checkbox"/> Yes. Check one:  | <b>Amount entitled to priority</b> |
| <input type="checkbox"/> Domestic support obligations (including alimony and child support) under 11 U.S.C. § 507(a)(1)(A) or (a)(1)(B).  | \$ _____                           |
| <input type="checkbox"/> Up to \$2,775* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use. 11 U.S.C. § 507(a)(7).  | \$ _____                           |
| <input type="checkbox"/> Wages, salaries, or commissions (up to \$12,475*) earned within 180 days before the bankruptcy petition is filed or the debtor's business ends, whichever is earlier. 11 U.S.C. § 507(a)(4). | \$ _____                           |
| <input type="checkbox"/> Taxes or penalties owed to governmental units. 11 U.S.C. § 507(a)(8).  | \$ _____                           |
| <input type="checkbox"/> Contributions to an employee benefit plan. 11 U.S.C. § 507(a)(5).  | \$ _____                           |
| <input type="checkbox"/> Other. Specify subsection of 11 U.S.C. § 507(a)(____) that applies.  | \$ _____                           |

\* Amounts are subject to adjustment on 4/01/16 and every 3 years after that for cases begun on or after the date of adjustment.

**Part 3: Sign Below**

**The person completing this proof of claim must sign and date it. FRBP 9011(b).**

If you file this claim electronically, FRBP 5005(a)(2) authorizes courts to establish local rules specifying what a signature is.

**A person who files a fraudulent claim could be fined up to \$500,000, imprisoned for up to 5 years, or both. 18 U.S.C. §§ 152, 157, and 3571.**

*Check the appropriate box:*

- I am the creditor.
- I am the creditor's attorney or authorized agent.
- I am the trustee, or the debtor, or their authorized agent. Bankruptcy Rule 3004.
- I am a guarantor, surety, endorser, or other codebtor. Bankruptcy Rule 3005.

I understand that an authorized signature on this Proof of Claim serves as an acknowledgment that when calculating the amount of the claim, the creditor gave the debtor credit for any payments received toward the debt.

I have examined the information in this Proof of Claim and have a reasonable belief that the information is true and correct.

I declare under penalty of perjury that the foregoing is true and correct.

Executed on date \_\_\_\_\_  
MM / DD / YYYY

\_\_\_\_\_  
Signature

**Print the name of the person who is completing and signing this claim:**

Name \_\_\_\_\_  
First name Middle name Last name

Title \_\_\_\_\_

Company \_\_\_\_\_  
Identify the corporate servicer as the company if the authorized agent is a servicer.

Address \_\_\_\_\_  
Number Street

City State Zip Code

Contact phone \_\_\_\_\_ Email \_\_\_\_\_



**BEST PRACTICES FOR PREPARING A PROOF OF CLAIM**

By Scott Cargill<sup>1</sup>  
Lowenstein Sandler PC

In recent years many organizations have delegated responsibility for filing proofs of claim in bankruptcy cases to either in-house legal staff or collection departments. The primary objectives of preparing a proof of claim are to ensure the form is appropriately completed, accompanied by adequate supporting documentation, and timely filed with the bankruptcy court. However, once filed, creditors too often assume that there is nothing more they can do until notice is sent that their claim has either been objected to or that they will receive a distribution on account of their claim. Creditors often do not realize, or fail to take advantage of, the fact that they may be permitted to amend their claim—even subsequent to the bar date—to include additional claims that a creditor may have been unaware of at the time the original proof of claim was filed. This oversight can be particularly costly to a creditor in cases where the bar date is established soon after the bankruptcy petition is filed and proofs of claim must be prepared on an expedited basis. Following a methodical, well thought through approach in preparing proofs of claim will increase the likelihood that a creditor's proof of claim will be accepted in the first instance, and subsequent amendments will be permitted, if necessary.

Amendments to timely filed proofs of claim can be submitted to cure defects in the original claim, to describe the original claim in greater detail or even to plead a new theory of recovery, so long as the new theory is based upon the same set of facts as the original claim. However, amendments will only be allowed when the original claim provides notice of the

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possible existence, nature and amount of the amended claim. The amendment must also not be filed in bad faith or to the unfair prejudice of the debtor. To maximize a creditor's ability to assert the full amount of its damages against a debtor, it is essential that a creditor first preserve its ability to file amendments to proofs of claim. This can only be accomplished by devoting sufficient resources and planning to the preparation of the original claim form.

The person who prepares the original proof of claim should be knowledgeable as to all the material facts and circumstances giving rise to the claim. This will avoid a creditor drafting a claim so narrow as to preclude the creditor from later expanding the claim through amendment. At a minimum, the person with first-hand knowledge of the factual circumstances should carefully review the proof of claim for accuracy before it is filed. A creditor should also consider requesting a copy of the debtor's schedules to determine what amount the debtor believes the creditor is owed. This may be especially helpful when a creditor deals with the debtor on numerous contracts or in different lines of business. If the debtor's schedules reveal that the amount owed is materially larger than the creditor's own calculations, this should be a red flag that the creditor has potentially overlooked some debtor accounts or contracts and a more comprehensive review is required.

The time and resources allotted to drafting a proof of claim will of course depend on the particular circumstances of each case. For instance, claim drafting should be a relatively straight-forward matter in situations where a vendor ships a limited quantity of goods to a debtor prepetition and has copies of all the unpaid invoices. However, when a significant portion of goods or services were provided over an extended time period, and/or involve intricate reconciliation and setoff issues, it is entirely possible that a creditor may not have all the information necessary, or sufficient time, to perform a full reconciliation of receivables until

after the bar date has passed. If a creditor finds itself in this situation, the documentation submitted with the original proof of claim form should explicitly state that the claim is only an estimate and is subject to amendment based upon review of additional information.

Creditors must also consider whether some portion of their claim is entitled to priority status under the Bankruptcy Code (for example, customer deposits, wages, commissions, pension disbursements, etc.). If a creditor is unsure whether a portion of its claim may fall into priority categories, it is good practice to explicitly state in the proof of claim that an amendment may be filed to seek priority status, or check with bankruptcy counsel prior to filing the proof of claim. A creditor should be as specific as possible regarding which priority may be sought, the magnitude of the claim, and the factual circumstances giving rise to the priority claim.

For creditors filing proofs of claim premised upon complex breach of contract claims or lease agreements, the need to devote adequate time to drafting the claim is even more acute. If a creditor's claim does not fall squarely within one of the categories listed in the "Basis of Claim" box on the proof of claim form a creditor should not hesitate to annex a statement explaining the factual basis of the claim. A creditor should also consider what theory, or theories, of damages a claim is premised upon and specify them in the annexed statement. If more than one theory of recovery exists, all theories should be explicitly set forth in the alternative. This may prove helpful in the event a debtor is successful in defeating the creditor's primary theory of recovery.

A creditor should include all relevant dates and terms of the transaction involving the claim and include copies of all relevant documents. If the circumstances warrant, a creditor should explicitly state that it does not have copies of certain documents that are in the debtor's or a third party's possession. Most importantly, the creditor should be as specific as possible as to the factual circumstances that gave rise to the claim. By giving the bankruptcy court details of

the factual circumstances, the court will be more inclined to allow the claim in the first instance, and to allow an amendment to the claim for additional damages, if necessary.

After filing the original proof of claim a creditor should be extremely diligent in obtaining additional information regarding its claim and should file any amendments, if necessary, as soon as possible. If subsequent investigation reveals that information in the original claim was incorrect, this should be explicitly stated in the amendment. The amendment should also expressly state the increased claim amount and detail exactly how the new claim amount was arrived at, its nexus to the proof of claim that was originally filed, and why the information contained in the amendment could not have been furnished with the original claim.

Taking the time to gather information and properly prepare a claim means little if the proof of claim form is not timely filed in the appropriate manner with the bankruptcy court. If a debtor objects to a claim and makes an initial showing that the claim was untimely or improperly filed, the creditor will have to produce evidence to the contrary. In many jurisdictions simply asserting that the claim was mailed to the bankruptcy court prior to the bar date will not be enough to demonstrate proper filing. Therefore, a vital part of any creditor's best practices for preparing a proof of claim must include procedures for verifying that the proof of claim form was properly received by the bankruptcy court.

Filing the proof of claim as far in advance of the bar date as possible will give a creditor the greatest flexibility to correct any irregularities. Most importantly, a creditor should carefully review the bar date notice and all instructions accompanying the proof of claim form. Specifically, the creditor should determine if the claim is to be filed directly with the bankruptcy court, or if the court has appointed a third party claims agent to accept the proofs of claim. The use of claims agents has become increasingly popular in recent years, particularly in large

Chapter 11 cases. Therefore, a creditor should not assume that a claim form will be accepted by the court clerk. The instructions should provide a creditor with specific details regarding where the proof of claim form must be sent and the methods of delivery that are acceptable. Generally, a proof of claim form will not be accepted if it is sent via e-mail or facsimile. Creditors who have questions regarding specific claim filing procedures should contact their bankruptcy counsel as early as possible.

At a minimum, creditors should send the original proof of claim form by certified mail with a return receipt requested. It is also good practice to include a duplicate completed proof of claim form and a self-addressed stamped envelope, along with a request that the bankruptcy clerk, or claims agent, return a time-stamped duplicate to the creditor. A creditor should maintain an exact duplicate of the proof of claim that was sent, accompanied by a contemporaneous memo indicating the name of the individual that sent the claim form, the address that it was sent to, and the method of delivery. If the creditor does not receive the return receipt card and the duplicate copy in a reasonable time, it is prudent to check with the court or the claims agent to determine the status of the claim. All telephone conversations in this regard should be followed with a letter memorializing the details of the conversation. Such contemporaneous writings will prove invaluable to a creditor in the event the claim is challenged by a debtor many months, or even years, following the bar date.

In situations where the proof of claim is being filed on or immediately prior to the bar date, it is best practice for a creditor to arrange to have a messenger deliver the proof of claim to the court clerk, or the claim agent, and to have the messenger return the time-stamped copy of the proof of claim form to the creditor. Alternatively, an increasing number of jurisdictions permit the electronic filing of proof of claim forms with the bankruptcy court. Local counsel in

districts where bankruptcy courts utilize electronic filing can assist a creditor by filing the proof of claim online and receive near instantaneous confirmation of the filing. Many of the electronic filing jurisdictions also allow access to the public via the internet to review the claims registry and verify that the creditor's claim was filed.

selected topic

Bruce Nathan, Esq.

## Preference Checklist

A trustee can recover a preference by satisfying all of the following requirements: (a) the debtor transferred its property to or for the benefit of a creditor [section 547(b)(1)]; (b) the transfer was made on account of antecedent or existing indebtedness that the debtor owed the creditor [section 547(b)(2)]; (c) the transfer was made when the debtor was insolvent, based on a balance sheet definition (liabilities exceeding assets) and presumed during the 90-day preference period to make it easier for the trustee to prove [section 547(b)(3)]; (d) the transfer was made within 90 days of the debtor's bankruptcy filing, in the case of a transfer to a non-insider creditor [section 547(b)(4)]; and (e) the transfer enabled the creditor to receive more than the creditor would have received in a Chapter 7 liquidation of the debtor [section 547(b)(5)].

### Frequently Asserted Preference Defenses

When a debtor or trustee satisfies all of the requirements of an avoidable preference claim, the burden shifts to the preference defendant to reduce or eliminate preference exposure by satisfying the requirements of one or more of the preference defenses contained in section 547(c) of the Bankruptcy Code. These defenses are intended to encourage creditors to continue doing business with, and extending credit to, companies in financial distress.

The section 547(c)(1) contemporaneous exchange for new value defense excuses any payment or other transfer that the debtor and creditor had intended as a contemporaneous exchange for new value and that was, in fact, a substantially contemporaneous exchange. A creditor that provides new goods and/or services or waives lien rights fully secured by the debtor's assets substantially contemporaneously with the payment or other transfer replenishes the debtor and should not be forced to return the transfer.

There are two versions of the section 547(c)(2) ordinary course of business defense that could apply in a bankruptcy case. According to the version of section 547(c)(2) that applies to bankruptcy cases filed prior to the October 17, 2005 effective date of the recent changes to the Bankruptcy Code, a transfer is subject to the ordinary course of business defense if it was (A) in payment of a debt incurred by a debtor in the ordinary course of business or financial affairs of the debtor and the creditor; (B) made in the ordinary course of business or financial affairs of the debtor and the creditor; and (C) made according to ordinary business terms. The first requirement, the incurrence of debt in the ordinary course of business of the debtor and creditor, is straightforward and frequently satisfied by credit extensions to the debtor. The second requirement, payment in the ordinary course of business of the debtor and creditor, requires some consistency between the alleged preference payment and the debtor's and creditor's payment history and is regarded as the subjective prong of the ordinary course of business defense. The third requirement, payment according to ordinary business terms, requires proof that the alleged preference was consistent with the payment practices in the relevant industry.

The version of section 547(c)(2) that applies to bankruptcy cases filed on and after October 17, 2005 retains the requirement that the indebtedness paid by the alleged preference was incurred in the ordinary course of business or financial affairs of the debtor and creditor. However, this version of section 547(c)(2) is easier to prove because the creditor must satisfy either the subjective test, requiring a showing of some consistency between the alleged preference payment and the debtor's and creditor's payment history, or the objective test, requiring a showing of the payment's consistency with the range of terms applicable to the relevant industry.

The new value defense, arising under section 547(c)(4) of the Bankruptcy Code, applies where the creditor had provided new value (such as shipping goods or providing services) to the debtor subsequent to the preference. The new value cannot be secured by a security interest in the debtor's assets that is otherwise unavoidable and cannot be paid by an otherwise unavoidable transfer to or for the creditor's benefit. The new value defense is designed to protect a creditor from preference risk to the extent the creditor had replenished the debtor by providing new goods or services subsequent to the preference.

The section 547(c)(4) new value defense is not a net result rule. The defense does not provide for a netting of all payments received by the creditor against the new goods and/or services provided by the creditor to the debtor during the 90-day preference period, that would limit preference risk to the extent the payments exceeded the value of new goods and/or services. A creditor determines new value under section 547(c)(4) by offsetting the value of new

goods and/or services from only prior, and not subsequent, preference payments.

The section 547(c)(4) new value defense clearly applies to new value that was unpaid on the bankruptcy filing date. Several United States Circuit Courts of Appeal (the federal courts immediately below the United States Supreme Court) and other courts have reached conflicting results on the applicability of the new value defense to paid-for new value. The Third Circuit Court of Appeals (covering New Jersey, Pennsylvania, Delaware and the Virgin Islands) in *New York City Shoes, Inc.*; the Seventh Circuit Court of Appeals (covering, Illinois, Indiana and Wisconsin) in *Matter of Prescott*; and the Eleventh Circuit Court of Appeals (covering Alabama, Florida and Georgia) in *In re Jet Florida Systems, Inc.* ruled that new value must remain unpaid in order to be eligible as a defense to a preference claim. The Fourth Circuit Court of Appeals (covering Maryland, North and South Carolina, Virginia and West Virginia) in *JKJ Chrysler-Plymouth*; the Fifth Circuit Court of Appeals (covering

Louisiana, Mississippi and Texas) in *Matter of Toyota of Jefferson, Inc.*; the Eighth Circuit Court of Appeals (covering Arkansas, Iowa, Minnesota, Missouri, Nebraska and North and South Dakota) in *In re Jones Truck Lines, Inc.*; and the Ninth Circuit Court of Appeals (covering Arizona, California, Idaho, Montana, Nevada, Oregon and Washington) in *In re IRFM, Inc.* ruled that paid-for new value reduces preference exposure as long as the new value was not paid by a "otherwise unavoidable transfer." ■

*Bruce Nathan, Esq. is a partner in the New York City office of the law firm of Lowenstein Sandler PC. He is a member of NACM and is on the Board of Directors of the American Bankruptcy Institute and is a former co-chair of ABI's Unsecured Trade Creditors Committee. He can be reached at bnathan@lowenstein.com.*

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## THE PREFERENCE CHECKLIST

Unsecured trade creditors seeking to analyze and prepare their defenses to a preference claim should consider the checklist below:

### 1. Bankruptcy Filing

- Download and save to Excel all available payment history up to two to three years before the commencement of the 90-day preference period.
- Pull invoice copies and proofs of delivery for all items in payment history.
- Pull statement of account and all unpaid invoices and proofs of delivery.
- Pull credit file, including credit application, contract, if any, D&B info, financial statements for the debtor, all notes in file, correspondence and preserve all emails during payment history.

### 2. Response to Preference Demand Letter

- Do not ignore the demand.
- Request a list of all checks that make up the preference claim and copies of cancelled checks or proof of wire transfer with remittance instructions.
- Check whether all payments claimed as preferences were actually received by the creditor. A payment is made during the preference period based on check clear date. Confirm whether any of the claimed payments were bounced checks (NSE, return to maker, etc.).
- Statute of Limitations — Determine whether the statute of limitations has expired or will imminently expire. A

complaint must be filed not greater than two years from the date of the bankruptcy filing or, if a permanent trustee is selected before the end of the two-year period, not later than the greater of two years after the bankruptcy filing or one year after such selection.

- If the amount of preference claim is less than \$5,000 for bankruptcy cases filed before 4/1/07 and \$5,475 for bankruptcy cases filed on and after 4/1/07, a preference lawsuit cannot be commenced.

### 3. Pre-suit Discussions

- Communicate defenses to trustee.
- Consult your attorney.
- Discussions might not happen if close to expiration of statute of limitations.

### 4. Receipt of Preference Summons and Complaint

- Determine answer deadline (usually 30 days from the date of the summons).
- Try to obtain an extension of time to answer the complaint to provide an opportunity to demonstrate defenses and resolve lawsuit.
- Immediately refer to counsel if creditor is unable to obtain an extension of time to answer complaint or a default has been entered.



- ❑ A corporation is not permitted to answer a complaint *pro se*.
- ❑ To the extent not previously done, obtain information regarding the alleged preferences, i.e., list of preference payments and copies of cancelled checks, wire information, payment advices, etc.
- ❑ Keep track of discovery requests and deadlines. Immediately refer to counsel if unable to obtain extension of discovery deadlines.

## ❑ 5. Rebuttal of Elements of Preference Claim

- ❑ Identify alleged preference payments not received by the creditor
- ❑ Cash in Advance—Determine whether the payments were cash in advance payments (i.e., paid in advance of shipment of goods or provision of services). Cash in advance payments are not preferences because they did not pay antecedent debt and, therefore, do not satisfy one of the requirements of a preference claim.
- ❑ Creditor paid out of trust funds (PACA, builders trust fund), which is not property of debtor, is not subject to preference risk.
- ❑ Solvency—Check bankruptcy schedules and financial statements covering the preference period or shortly before the preference period to rebut the presumption of insolvency (liabilities exceed assets).
- ❑ Creditor fully secured by debtor's assets, or paid from collateral proceeds is not subject to preference exposure.

## ❑ 6. Preference Defenses

- ❑ **Contemporaneous Exchange for New Value Defense**
  - ❑ For COD transactions or payments in exchange for waiver or release of lien rights against the debtor's property.
  - ❑ Although there are no bright line rules as to what constitutes a substantially contemporaneous transfer, a payment made within 10 days of provision of goods or services or waiver of lien should satisfy this defense. The further outside the 10-day period, the less likely this defense applies.
  - ❑ The defense is lost if the check bounces and is subsequently replaced, unless in the case of a bounced check in exchange for a lien waiver/release, the waiver/release is conditioned on receipt of good funds.
- ❑ **New Value Defense**
  - ❑ Prepare new value analysis and determine the net preference exposure after deducting new value.
  - ❑ New value is the value of goods or services provided during the 90-day preference period after receipt of the alleged preference payments. New value cannot be applied towards a check that was received after provision of goods or services.
  - ❑ New value should be counted as of the date it was provided—goods shipped, services provided—which might be invoice date.

- ❑ Most courts calculate new value after delivery of the payment, rather than clear date of the payment. Delivery is usually receipt of the preference, though some courts do the calculation from date of mailing of the payment.
- ❑ New value should include paid and unpaid new value as of the bankruptcy filing date. A caveat, a trustee in a jurisdiction that rejects paid new value might reject deduction of paid for new value; but its applicability as a defense might still be negotiable.

## ❑ Ordinary Course of Business Defense

- ❑ To prove the payments were ordinary between the debtor and creditor, the creditor should prepare a payment history (one year/one and a half years/two years/three years before the preference period) that compares the days outstanding prior to the preference period to the days outstanding during the preference period and shows that the average days to payment prior to the preference period was consistent with the days to payment during the preference period. Run different scenarios (different payment history durations) until the desired outcome is reached. Reduced terms during the preference period, change in mode of payment (regular check to wire), change in mode of delivery of payment (regular mail to overnight courier), collection action (threats to cut off shipments, decision to enforce credit limit) and an increased number of invoices paid during or shortly before the commencement of the preference period might result in inability to prove the payment was ordinary between the parties.
- ❑ The creditor can prove ordinary business terms by using industry data from sources such as the Credit Research Foundation, an industry credit group, D&B or comparable data for the creditor's and debtor's industries that shows the preference payment terms were consistent with the range of terms in the industry.
- ❑ **Administrative Claims**—Most courts do not consider, as new value, administrative priority claims on account of open invoices for goods and services provided after the bankruptcy filing date. Nonetheless, administrative claims should be asserted as a setoff to the preference and counterclaim and might reduce preference exposure, unless they are time-barred as having not been asserted prior to an administrative claims bar date.

## ❑ 7. Settlement

- ❑ Have counsel review settlement agreement.
- ❑ Make sure settlement agreement provides for a general release in favor of the creditor or, at least, waives all preference claims.
- ❑ Do not ignore the value of the creditor's right under Bankruptcy Code section 502(h) to file an unsecured claim for the settlement amount. That claim could reduce the amount of any settlement payment or provide a later recovery that effectively reduces the settlement amount.



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## Practice

Bruce S. Nathan, Partner in the firm's Bankruptcy, Financial Reorganization & Creditors' Rights Department, has more than 30 years' experience in the bankruptcy and insolvency field, and is a recognized national expert on trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters. Bruce has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed, and is currently representing the liquidating trust and previously represented the creditors' committee in the Borders Group Inc. Chapter 11 case. Bruce also negotiates and prepares letters of credit, guarantees, security, consignment, bailment, tolling, and other agreements for the credit departments of institutional clients.

Bruce was co-chair of the Avoiding Powers Committee that worked with the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 and also participated in ABI's Great Debates at their 2010 Annual Spring Meeting, arguing against repeal of the special BAPCPA protections for goods providers and commercial lessors, and was a panelist for a session sponsored by the American Bankruptcy Institute ("ABI") and co-sponsored by Georgetown University Law Center. Bruce also regularly speaks at conferences held by the National Association of Credit Management, its international affiliate, An Association of Executives in Finance, Credit and International Business ("FCIB"), Credit Research Foundation ("CRF"), and many credit groups on bankruptcy, insolvency, and creditor's rights issues; is a member of NACM's Government Affairs Committee, a regular contributor to NACM's *Business Credit*, a contributing editor of NACM's *Manual of Credit and Commercial Laws*, and co-author of *The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: An Overhaul of U.S. Bankruptcy Law*, published by NACM; and has contributed to CRF's Journal, *The Credit and Financial Management Review*.

Bruce is also a co-author of "Trade Creditor Remedies Manual: Trade Creditors' Rights under the UCC and the U.S Bankruptcy Code" published by the American Bankruptcy Institute ("ABI") at the end of 2011, has contributed to the *ABI Journal*, and is a former member of ABI's Board of Directors and former Co-Chair of ABI's Unsecured Trade Creditors Committee.

Bruce is recognized in the Bankruptcy & Creditor/Debtor Rights section of *Super Lawyers* (2012-2014) and in the 2014 *Super Lawyers Business Edition*. In March 2011, Bruce received the Top Hat Award, a prestigious annual award honoring extraordinary executives and professionals in the credit industry.

## Education

- **University of Pennsylvania Law School** (J.D., 1980)
- **Wharton School of Finance and Business** (M.B.A., 1980)
- **University of Rochester** (B.A., 1976), *Phi Beta Kappa*

## Affiliations

- New York State Bar Association
- American Bar Association
  - Commercial Financial Services Committee
  - Business Bankruptcy Committee
- American Bankruptcy Institute
  - Former Member, Board of Directors
  - Former Chair, Unsecured Trade Creditor Committee
  - Regular Contributor to *American Bankruptcy Institute Journal's* "Last in Line" Column
  - Speaker at 2007 Annual Spring Meeting: "Fifty Ways to Leave Your Debtor: Lesser Known Remedies For Jilted Creditors"
  - Panelist at "Chapter 11 At The Crossroads: Does Reorganization Need Reform?" A Symposium on the Past, Present and Future of U.S. Corporate Restructuring," on November 16-17, 2009, sponsored by ABI and co-sponsored by Georgetown University Law Center
  - Participated in the Great Debates at ABI's Annual Spring Meeting held on April 30, 2010 on whether Congress should eliminate the special BAPCPA protections for providers of goods and lessors (arguing against repeal)
  - Task Force on Preferences
  - Chair, Task Force on Reclamations
  - Uniform Commercial Code Committee and Task Force - Revised Article 9 Primer
- American Bankruptcy Institute's Commission to Study the Reform of Chapter 11
  - Co-chair, Avoiding Powers Advisory Committee
- Commercial Law League of America
- Association of Commercial Finance Attorneys
- National Association of Credit Management
  - Contributor to *Business Credit* - National Association of Credit Management Magazine
  - National Bankruptcy and Insolvency Group
  - Lecturer, National Association of Credit Management and Affiliates and Credit Groups on Bankruptcy, UCC Article 9, Consignments, Letter of Credit law and other credit-related issues
- Member of FCIB, an Association of Executives in Finance, Credit and International Business. Presented at **The 4th China International Credit and Risk Management Conference**, Shenzhen, China, September 21, 2007, and **FCIB Teleconference**, December 13, 2007, on key provisions of People's Republic of China's 2006 Law on Enterprise Bankruptcy, similarities to and differences with the U.S. Bankruptcy Code, and upcoming implementation challenges
- Media Financial Management Association
  - Member
  - Frequent Lecturer
  - Contributor to "The Financial Manager" on Creditors' Rights Issues
- Lecturer, Executive Enterprises Inc. the Bank Lending Institute and the Banking Law Institute on Commercial Loan Workouts & UCC Issues
- Past Contributor
  - *Credit Today*
  - *National Credit News*

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