

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation



Fox Rothschild LLP
ATTORNEYS AT LAW

L. Jason Cornell, Esq.

302.252.5833

jcornell@foxrothschild.com

L. John Bird, Esq.

302.622.4263

jbird@foxrothschild.com

919 North Market Street, Suite 1300

P.O. Box 2323

Wilmington, DE 19899

www.foxrothschild.com



A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

■ Table of Contents

■ Introduction

■ Time Limitations For A Preference Claim

■ Elements Of A Preference Claim

■ Core Defenses To A Preference Claim

● Ordinary Course Of Business

● New Value

● Contemporaneous Exchange

● Other Defenses

■ Limiting Preference Exposure

■ References

I.	Introduction.....	3
II.	Time Limitations For A Preference Claim.....	3
	A. Statute of Limitations	3
	B. Service of the Summons and Complaint.....	3
	C. Entities Commencing the Litigation	4
III.	Elements Of A Preference Claim.....	4
	A. Transfer of the Interest of the Debtor.....	4
	B. To or for the Benefit of a Creditor	4
	C. For an Antecedent Debt.....	5
	D. During the 90 Days Prior to Filing for Bankruptcy	5
	E. While the Debtor was Insolvent.....	5
	F. The Creditor Receives More Than They Would Under Chapter 7	6
IV.	Core Defenses To A Preference Claim.....	6
	A. Ordinary Course of Business.....	6
	B. New Value	6
	C. Contemporaneous Exchange.....	6
V.	Ordinary Course Of Business.....	7
	A. Elements of the Defense	7
	B. Debt Incurred in the Ordinary Course	7
	C. The Subjective Standard	7
	D. Payment Inside or Outside of Invoice Terms	8
	E. Change in Payment Terms.....	8
	F. The Objective Standard: Ordinary According to Industry Terms	8
	G. Proving the Objective Standard.....	9
	H. Relying on Employee Testimony	9
	I. Expert Testimony for the Objective Standard	9
	J. Length of Relationship Between the Parties.....	10
VI.	New Value	11
	A. Must New Value Remain Unpaid?.....	11
	B. Can a Creditor's Proof of Claim Constitute New Value?	12
VII.	Contemporaneous Exchange.....	12
	A. Intended To Be Contemporaneous.....	12
	B. Substantially Contemporaneous	13
	C. When Payment Occurs.....	14
VIII.	Other Defenses.....	14
	A. Statutory Lien	14
	B. Mere Conduit	14
	C. Critical Vendor.....	14
	D. Refunds	15
	E. Deficient Complaint	15
IX.	Limiting Preference Exposure	15
	A. Require Cash Transactions.....	16
	B. Deposit Checks Immediately.....	16
	C. Consider Secured Transactions.....	16
	D. Exercise Your Ability to Create a Lien.....	16
	E. Keep Your Transactions with Customers "Ordinary"	16
	F. Keep Good Books and Records	16
	G. Don't Wait.....	17
X.	References	17



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

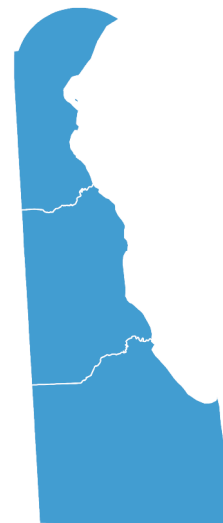
- **Introduction**
- **Time Limitations For A Preference Claim**
- **Elements Of A Preference Claim**
- **Core Defenses To A Preference Claim**
 - **Ordinary Course Of Business**
 - **New Value**
 - **Contemporaneous Exchange**
 - **Other Defenses**
- **Limiting Preference Exposure**
- **References**

I. Introduction

Under Chapter 5 of the Bankruptcy Code, a trustee, debtor or assignee of the debtor may recover payments made by the debtor during the ninety days prior to the commencement of a bankruptcy proceeding. The policy behind allowing plaintiffs to bring preference claims is twofold: (i) to discourage creditors from aggressive attempts at collecting from a debtor and (ii) to distribute assets evenly among all creditors by recovering payments that constitute “avoidable transfers.”

As more companies file for bankruptcy, more creditors are forced to defend themselves in preference actions. The purpose of this booklet is to address common issues that arise in preference litigation. The information provided here is intended to provide businesses, as well as their counsel, with a better understanding of the claims and defenses that arise when a party is defending a preference action. Where possible, we have cited cases from the Third Circuit Court of Appeals, the U.S. District Court for Delaware, or the U.S. Bankruptcy Court of the District of Delaware.

No two preference claims are the same. The findings of the courts in the cases discussed herein are obviously case specific. Any individual or organization that receives a demand letter or adversary complaint seeking the recovery of preference payments should consult with an attorney. Finally, since these materials are intended for a more general audience, we have tried where possible to avoid using jargon understood only by attorneys. For those in the legal profession, we have added endnotes with citations for much of the information offered.



II. Time Limitations For A Preference Claim

A. Statute of Limitations

The debtor has two years from the date it filed its petition for bankruptcy to file a complaint seeking the recovery of a preference payment. However, if the court appoints a trustee, the limitations period for filing the lawsuit extends one year from the date the trustee was appointed.¹ Preference litigation cannot be commenced once the court closes or dismisses the debtor’s bankruptcy.

B. Service of the Summons and Complaint

The two-year time period, or statute of limitations, is not the only deadline governing the commencement of the preference action. The statute of limitations governs when the preference complaint must be filed with the court. The Federal Rules of Bankruptcy Procedure govern how long the plaintiff has to serve the complaint on the party receiving the payments (i.e. the defendant).

Under the Federal Rules, the party filing the lawsuit must serve the defendant within 120 days.² Note, however, that the party may request an extension of time in which to complete service. The party commencing the lawsuit can achieve service in a number of methods, including mailing the summons and complaint to the defendant by First Class mail.



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

C. Entities Commencing the Litigation

Different types of entities can commence the preference litigation. In some instances, the reorganized debtor will seek recovery of the payments. In other circumstances, a trustee appointed to administer the debtor's case for the benefit of creditors might pursue the preference litigation. Similarly, it is not uncommon for the debtor to assign its preference claims to a third party such as the unsecured creditors committee or a litigation trust.

III. Elements Of A Preference Claim

In order to establish that a party received a preferential transfer (i.e. preferential payment), the plaintiff must prove (i) that the debtor transferred an interest of property of the debtor to the creditor, (ii) the transfer was on account of an antecedent debt and (iii) the debt arose before the debtor made the transfer.³ Further, the preferential payments must (iv) be made while the debtor was "insolvent", (v) be made within 90 days before the debtor filed for bankruptcy, and (vi) provide the creditor with a greater return than it would receive if the debtor had liquidated and distributed its assets under a chapter 7 bankruptcy liquidation.⁴

A. Transfer of an Interest of the Debtor

Under 11 U.S.C. § 547(b), an avoidable preference must involve an "interest of the debtor in property."⁵ If the debtor uses another entity's property to pay a creditor of the debtor, such a payment cannot be a preferential transfer.⁶ Although the Bankruptcy Code does not define "interest of the debtor in property," the Supreme Court has defined the phrase to mean "property that would have been part of the estate had it not been transferred before the commencement of the bankruptcy proceedings."⁷ Section 541 of the Bankruptcy Code defines property of the estate to include all legal or equitable interests of the debtor in property at the time the debtor commences its bankruptcy proceeding.⁸ To satisfy this element of a preference claim, the plaintiff must submit evidence that the preferential transfer "diminished the Debtors' estate".⁹



B. To or for the Benefit of a Creditor

In order for a transfer to be avoided, it must have been made for the benefit of the party from which it is being sought. This means that if a creditor was not the final recipient of a transfer, they are not the party that will have to repay the transfer.¹⁰ This is not a very common situation, and is best understood through an example. Suppose a debtor was to make a cash payment to an employee of a delivery service. When trying to recover the transfer, the debtor would not sue the individual, as the payment was not for his benefit.¹¹ Rather, the company that employed the individual is the party who was benefited, and would appropriately be pursued for repayment of the transfer. Occasionally there are companies that serve a similar, intermediary role as the employee in this example, collecting payments for other companies' benefit. In these situations, this element of a preference claim may be challenged. This is discussed in more detail in Section VIII under the Mere Conduit defense.



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

■ Introduction

■ Time Limitations For A Preference Claim

■ Elements Of A Preference Claim

■ Core Defenses To A Preference Claim

● Ordinary Course Of Business

● New Value

● Contemporaneous Exchange

● Other Defenses

■ Limiting Preference Exposure

■ References

C. For an Antecedent Debt

In determining whether a creditor received a preferential payment, one of the first questions to ask is whether the alleged payments were made on account of an antecedent debt. An antecedent debt is created when a creditor receives a right to payment from the debtor for goods or services.¹² Section 547(b)(2) of the Bankruptcy Code requires that the party who is alleged to have received a preference must have been owed a “debt” by the debtor, and the debtor must have owed this debt before receiving the payment (or “transfer”) from the debtor.¹³ When a debtor owes a creditor a debt, the creditor is said to have a “claim” against the debtor.¹⁴ In the bankruptcy context, a claim is defined broadly to include a right to payment, regardless of whether such right to payment is in the form of a judgment, or is liquidated, unliquidated, legal, equitable or secured.¹⁵ Courts broadly construe the definitions of “debt” and “claim”.¹⁶

To determine whether an antecedent debt exists, courts look to when the debtor became “legally bound to pay” and when the transfer occurred.¹⁷ As an example, a debtor has been found to be legally bound on the day it signed a purchase order for the creditor’s goods,¹⁸ while a check is considered “transferred” on the date that the check is honored by the drawee bank (i.e. the bank of the company who wrote the check).¹⁹

D. During the 90 Days Prior to Filing for Bankruptcy

This portion of the law is as straightforward as it sounds. Considering the day of bankruptcy as day “0”, count back to day “90”.²⁰ The payment, or transfer, must be made on or within the time period from day “90” until the day the debtor filed for bankruptcy in order for the payment to be a preference. If the transfer was made prior to that time, except for a few situations related to fraud or insiders of the debtor, it is not likely to be considered a preference payment.

E. While the Debtor was Insolvent

To qualify as a preference, the payment must also be made while the debtor was “insolvent”.²¹ The Bankruptcy Code defines “insolvent” as a “financial condition such that the sum of such entity’s debts is greater than all of such entity’s property, at a fair valuation ...”²² This definition is often referred to as the “balance sheet” test for insolvency. However, such a test is only the starting point in analyzing whether a debtor is insolvent.²³ Courts also give consideration to factors such as whether the debtor recently recorded a profit, loss or experienced problems with cash flow.²⁴

The Bankruptcy Code provides that the debtor is presumed insolvent on or during the 90 days leading up to the commencement of the bankruptcy case (often referred to as the 90 day “preference period”).²⁵ It is this presumption imposed by the Bankruptcy Code that places the burden on the



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- **Core Defenses To A Preference Claim**
 - Ordinary Course Of Business
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

creditor being sued for the preference payment, to prove that the debtor was solvent.²⁶ Creditors who wish to argue that the debtor was solvent when the payments were made should strongly consider retaining an expert to support such a claim.

E. The Creditor Receives More Than They Would Under Chapter 7

To prove the creditor received a preferential transfer, the plaintiff must show that the creditor received more than it would have received had it not received the payment, but instead received a distribution in a chapter 7 liquidation.²⁷

Unfortunately for creditors, it is not difficult for a plaintiff to show that the payment received by the creditor was more than the creditor would receive under chapter 7. If the plaintiff can show that the distribution to creditors in the debtor's bankruptcy was less than 100 percent, any payment made to a creditor during a preference period would enable it to receive more than it would receive under a liquidation of the debtor.²⁸

IV. Core Defenses To A Preference Claim

A. Ordinary Course of Business

Even if the plaintiff can establish that the debtor made a preferential transfer as defined under the Bankruptcy Code, the party receiving the payment (or the party receiving an interest in the debtor) may still avoid returning the money by proving the payment was made in the "ordinary course of business". The ordinary course of business defense is the most widely used defense to a preference claim. Congress created the ordinary course defense in order to protect "recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor's" customers.²⁹

Thanks to the 2005 amendments to the Bankruptcy Code, it is now easier for creditors to prove payments were made in the ordinary course of business. Under the amended Code, a creditor that receives preferential payments may prove that each payment was received in the ordinary course of business between the debtor and creditor (the "subjective test") or by showing that the payments were made according to ordinary business terms (the "objective test"). Prior to the 2005 amendments, a creditor had to satisfy both the subjective and objective tests in order to satisfy the ordinary course of business defense.³⁰

B. New Value

A transfer is not considered a preference payment if the creditor who received the payment can show that it gave "new value" to the debtor after it received the preferential payment.³¹ To establish a new value defense, the creditor must show that after it received a preference payment, it provided the debtor with new value in the form of subsequent goods or services, and that the debtor did not fully compensate the creditor for this subsequent new value.³²

C. Contemporaneous Exchange

Creditors can also defend against a preference claim by showing that the payments received from the debtor were contemporaneous exchanges. The contemporaneous exchange defense requires the creditor who received preferential payments from the debtor to have provided the debtor with goods or services at about the same time as



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - **Ordinary Course Of Business**
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

it received payment. Additionally, the creditor and debtor must intend for the payments to be a contemporaneous exchange. Finally, the payments received by the creditor must indeed be contemporaneous.³³ This definition, however, begs the question of what is required for a payment to be “contemporaneous”.

The following provides a more in-depth look at these three defenses: ordinary course of business, new value and contemporaneous exchange. Thereafter, we look at other, less common, defenses to an avoidance action.

V. Ordinary Course Of Business

A. Elements of the Defense

Under 11 U.S.C. § 547(c)(2), a creditor is permitted to retain transfers received from a debtor made in the ordinary course of business.³⁴ To satisfy the “ordinary course of business exception,” the creditor must prove³⁵ (i) the transfers were made for a debt incurred in the ordinary course of business of the parties, and either (ii) the transfers were made in the ordinary course of business of the parties; or (iii) the transfers were made in accordance with ordinary business terms.³⁶

B. Debt Incurred in the Ordinary Course

The first component of the ordinary course defense, that the debt was incurred in the ordinary course, often is not subject to dispute. If the debtor incurred the debt pursuant to a typical business transaction, such a debt was likely incurred in the ordinary course. Instead, it is the two remaining components of the ordinary course defense that are often litigated, namely the “subjective” and “objective” prongs of the defense.

C. The Subjective Standard

The subjective component of the ordinary course of business defense requires showing that the payments were ordinary when compared to the prior financial history between the creditor and the debtor.³⁷ Establishing this defense requires comparing the transactions between the debtor and creditor before and during the preference period.³⁸

Courts consider many factors to determine whether payments were made within the ordinary course of the parties’ prior dealings. These factors include:

- the length of time the parties engaged in the type of dealing at issue;
- whether the payments at issue were in an amount that was greater than amounts usually paid by the debtor;
- whether the payments were tendered in a manner different from previous payments;



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

■ Introduction

■ Time Limitations For A Preference Claim

■ Elements Of A Preference Claim

■ Core Defenses To A Preference Claim

● Ordinary Course Of Business

● New Value

● Contemporaneous Exchange

● Other Defenses

■ Limiting Preference Exposure

■ References

- whether there appears to have been unusual action by the debtor or the creditor to collect on, or pay the debt; and,
- whether the creditor did anything to gain an advantage in light of the debtor's deteriorating financial condition.³⁹

Evidence of "non-ordinary course" behavior includes:

- changing credit terms during, or immediately prior to, the 90 day preference period;
- altering payment schedules;
- imposing a credit limit; and,
- changing payment terms.⁴⁰

D. Payment Inside or Outside of Invoice Terms

One issue that often comes up in preference litigation is whether payments received within invoice terms are, by definition, ordinary. Courts examining this issue choose not to create a presumption that payments within invoice terms constitute ordinary course of business transactions.⁴¹ Instead, the analysis focuses on the extent to which the parties changed credit terms during or immediately before the 90 day preference period.

A presumption does arise, however, for payments made by a debtor that fall outside of invoice terms.⁴² In Delaware, as well as other jurisdictions, "it is well settled" that payments made beyond the payment terms are considered to fall outside of the ordinary course of business defense.⁴³ However, this presumption can be rebutted by showing that payment outside of invoice terms (i.e. a late payment) was a normal and ordinary practice that routinely occurred between the parties.⁴⁴

E. Change in Payment Terms

A change in payment terms by the parties prior to, or during, the preference period does not mean that the payments that follow are avoidable preferences. A onetime change in terms, imposed by a creditor on the debtor, may be found to be "extraordinary" and not within the scope of the ordinary course defense.⁴⁵ However, where the parties routinely negotiated and modified changes to terms, such changes have in the past been deemed "ordinary" for purposes of section 547(c)(2) because of their repetition during the course of the parties' dealings.⁴⁶ Whether a change of terms falls under the umbrella of "ordinary course of business" does not depend solely on the timing of the change in terms. Instead, courts consider the change in terms as it relates to the relationship over time between the parties.⁴⁷

F. The Objective Standard: Ordinary According to Industry Terms

In addition to the "subjective" prong of the ordinary course of business defense, creditors are also protected from preference claims for payments made in accordance with ordinary business terms.⁴⁸ This method of defense, often referred to as the "objective test," refers to a range of terms similar to those of creditors in the parties' industries. Under section 547(c)(2)(B), a creditor must prove that the payments received from the debtor "were made according to ordinary business terms".⁴⁹ The Third Circuit, in the *Moulded Acoustical* decision, defined "ordinary business terms" as "the range of terms that encompasses the practices" used by companies similar to the creditor.⁵⁰



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - **Ordinary Course Of Business**
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

A creditor relying on the ordinary course of business defense must establish that the payment history between the creditor and debtor fit within ordinary industry standards.⁵¹ To do so, the creditor must consider how the transactions, including payment history, between the debtor and creditor compare to ordinary payment histories in the creditor's industry. Courts require specific information regarding the industry in which the creditor competes.⁵²

G. Proving the Objective Standard

Like the subjective prong or "test," a creditor relying on the objective prong of the ordinary course defense must prove, by a preponderance of the evidence, that the relevant transfers were ordinary according to industry standards.⁵³ It is not enough for a defendant, or defendant's expert, to testify that the payments in a creditor's industry vary to a wide degree. Evidence that is too broad will not satisfy the defense.⁵⁴ Instead, courts will look to see if the creditor provides objective, definitive evidence supported by industry data.

One example of a method used to establish that payments were made according to industry norms is to use a creditor's expert who testifies as to percentages of businesses within an industry that make payments late.⁵⁵ The court will consider ordinary terms in a healthy creditor-debtor relationship, not "moribund" (defined as "near death") relationships.⁵⁶ In the case *U.S. Interactive v. Sampson Travel Agency, Inc.* (*In re U.S. Interactive*), the court provides three examples in which the objective standard was not satisfied; (1) when the witness provides hearsay statements generalizing about the industry standard,⁵⁷ (2) testimony where the witness "guessed" about what would comply with the standard,⁵⁸ and (3) when the evidence presented was lacking in specificity, consisting merely of broad estimates of a wide range of delay time in payments.⁵⁹

H. Relying on Employee Testimony

A creditor in a preference action can rely on employee testimony to prove that business terms between it and the debtor were ordinary in its industry.⁶⁰ The Third Circuit Court of Appeals has made this point very clear: "testimony from employees of the parties involved in a preference payment dispute may be used to establish an industry standard as long as the court determines that the employees are credible and have significant and relevant industry experience."⁶¹ While this is one method of meeting the objective standard, it is a risky strategy. In preference litigation where large dollar amounts are at stake, the creditor-defendant should consider hiring an expert to testify in support of the industry standard.

I. Expert Testimony for the Objective Standard

Parties often offer expert testimony to support their arguments concerning the objective standard of the ordinary course defense. Questions sometime arise as to who is qualified to render an expert opinion on the objective standard and what such testimony should cover. In *HLI Creditor Trust v. Metal Tech. Woodstock Corp.* (*In re Hayes Lemmerz*), the court relied upon the defendant-creditor's expert to determine both the appropriate industry and the "ordinary business terms" for the industry standard portion of the defense.⁶²

In *Hayes Lemmerz*, the defendant retained a partner in a crisis management and litigation support firm who dealt regularly with the defendant's industry. The expert was a Certified Public Accountant, Certified Fraud Examiner and Certified Turnaround Professional.⁶³ In order to determine the industry standard for the



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

collection of receivables, defendant's expert spoke with employees of the defendant, familiarized himself with the industry of the defendant and the debtor and gathered industry information from Dun & Bradstreet and Standard and Poors' surveys and indices.⁶⁴

Defendant's expert testimony included reference to Dun & Bradstreet's Industry Norms & Key Business Ratios, including Standard Industrial Classification Codes (the "SICs") for defendant's industry. The defendant's expert in *Hayes* also cited to Standard and Poors' Capital IQ Company Screening Reports.⁶⁵ After reviewing this data, the expert was able to testify that the payment terms and payment history between the defendant and the debtor were consistent with the practices in the relevant industry and that such payments were made in the ordinary course of business.⁶⁶

In *Hayes Lemmerz* the court found that the credit terms between the parties under which the transfers were made were consistent with "ordinary business terms" under section 547(c)(2).⁶⁷ The court accepted the testimony of the defendant's expert as to payment terms and found that the testimony of the plaintiff's expert on this issue was "too narrow and strict."⁶⁸

J. Length of Relationship Between the Parties

Under the subjective prong of section 547(c)(2), the relationship between the creditor and debtor is central to determining whether transfers were made in the ordinary course of business. Where the parties have extensive prior dealings, courts will often focus on those dealings in assessing a creditor's defenses.⁶⁹ Where the parties have a short history of dealings, the creditor must produce a "more extensive and exacting analysis of industry standards."⁷⁰

A long business history can shield a creditor from liability for a preference claim even if the creditor regularly called the debtor to collect on a debt.⁷¹ In *Miller v. Westfield Steel (In re Elrod Holdings)*, the court applied the ordinary course of business defense despite the creditor's calls to collect on a debt during the 90 day preference period. Because the creditor routinely called the debtor to collect unpaid debts over the course of the parties' ten year business history, the court found that such calls during the preference period were customary.⁷²

Where the parties have a limited business history, with few transactions, courts apply a more restrictive definition of ordinary course.⁷³ For creditors assessing the strengths of their ordinary course of business defense, they should recognize that if they had limited payment history with the debtor, a more "rigorous" scrutiny of the objective standard is applied.⁷⁴



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - **New Value**
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

Creditors who have a more extensive payment history with the debtor are also subject to a more flexible application of the objective, or “industry” standard.⁷⁵ In deciding whether to provide such flexibility, courts will look to see if the parties established a steady and enduring business credit relationship where the payment terms remained the same before and during the 90 day preference period.⁷⁶ In at least one situation, a creditor and debtor who transacted business over the course of only one year were found to lack the requisite duration and the less flexible standard was applied.⁷⁷

VI. New Value

Section 547(c)(4) of the Bankruptcy Code permits a creditor to keep an otherwise avoidable preference if the creditor gave new value to the debtor in exchange for the transfer.⁷⁸ The new value defense requires a creditor prove three things. First, the creditor must show that it received a preference payment from the debtor (this is normally a non-issue). Next, the creditor must show that after it received the preference payment, it provided the debtor with new value.⁷⁹ Finally, the creditor must not have been fully compensated by the debtor for the new value. Creditors who satisfy the elements of this defense receive a setoff for the amount of new value provided to the debtor.⁸⁰ Given that new value provides a dollar for dollar reduction in a creditor’s preference liability, the defense is widely used in preference litigation.

A. Must New Value Remain Unpaid?

Courts are split on whether a creditor must remain unpaid in order for the goods or services comprising new value to setoff a preference payment.⁸¹ Many Courts require that the creditor claiming a new value setoff show that they have not been paid for the new value.⁸² Other courts find that a creditor may be paid for the new value and still satisfy the Bankruptcy Code’s requirements for the defense.⁸³ The *Check Reporting Services* decision, issued in 1992 by the Bankruptcy Court for the Western District of Michigan, holds that the creditor does not have to remain unpaid in order to offset the new value against a preference claim.⁸⁴

In at least one decision, the Delaware Bankruptcy Court adopted the rationale in *Check Reporting* and found that a creditor does not have to remain unpaid.⁸⁵

Those courts which require creditors attempting to apply a new value defense to remain unpaid base their decisions, in part, on the nature of the payment history between the parties. If the creditor and debtor had a “running account,” courts have held that the creditor will not have to repay the preference payment.⁸⁶ Where the parties had just a couple of transactions, courts are likely to require that the creditor remain unpaid in order to apply the new value defense.⁸⁷



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - **Contemporaneous Exchange**
 - Other Defenses
- Limiting Preference Exposure
- References

By way of example, imagine a series of transactions within the preference period as follows: (a) the debtor pays the creditor \$100; (b) the creditor provides \$50 worth of new goods; (c) the debtor pays \$50 on account of the latest sale; and lastly (4) the creditor provides another \$20 of new goods. The analysis is as follows under each view:

Payments	Running Total if New Value Must Remain Unpaid	Running Total if New Value does not have to Remain Unpaid
\$100	\$100	\$100
-\$50	This transfer of goods does not reduce the preference total because it was paid for by the following \$50 transfer	\$50
\$50	\$150	\$100
-\$20	\$130	\$80

Thus, in courts that require transfers of new value to remain unpaid, the total recoverable preference would be \$130, while in those jurisdictions in which the transfers of new value do not have to remain unpaid, such as Delaware, the recoverable transfer would be \$80. A quick review of the two results in this example illustrates the difference in recovery that would depend on whether transfers of new value are required to remain unpaid.

B. Can a Creditor's Proof of Claim Constitute New Value?

Before a creditor can receive a new value setoff, it must first establish when the services were performed or goods were provided.⁸⁸ If the creditor cannot prove to the court that the new value was provided after it received the preference payment, the creditor will not be able to apply the new value defense.

VII. Contemporaneous Exchange

Section 547(c)(1) of the Bankruptcy Code protects transfers constituting "contemporaneous exchanges." In order for a creditor to prove it received a contemporaneous exchange, it must first show that the parties actually intended the payments to be contemporaneous. Next, the creditor must prove that the payments received were in fact contemporaneous.⁸⁹ Both elements are required in order to use the defense. However, the "critical inquiry" for the court is whether the parties intended their transaction to be contemporaneous.⁹⁰

A. Intended To Be Contemporaneous

Even if a creditor provided goods or services on credit, payments for such goods may still constitute contemporaneous exchanges.⁹¹ Credit transactions, by design, include a delay between the time goods or services are provided, and when payment is received. Nevertheless, such goods may still constitute a contemporaneous exchange provided the parties intended it as such.⁹² The burden is on the creditor to present evidence sufficient to show that the parties intended the transaction to be contemporaneous.⁹³ Once this burden is met, however, a plaintiff's statement that there was no intent for the exchange to be substantially contemporaneous, by itself, is insufficient to rebut a creditor's evidence of contemporaneous exchange.⁹⁴



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - **Contemporaneous Exchange**
 - Other Defenses
- Limiting Preference Exposure
- References

In deciding whether a transfer constitutes a contemporaneous exchange, courts often apply a “flexible approach” that looks at the amount of time between when the debtor received the relevant goods or services, and when the debtor’s check was delivered to the creditor.⁹⁵ The defense is not defeated simply because time passed between the time the debt was incurred and the time payment was received.⁹⁶



An example of a contemporaneous exchange includes a debtor paying a creditor after the creditor shipped the goods, but before or at the time the shipments arrived at the debtor’s facility.⁹⁷ “Destination contracts,” or contracts where the creditor could refuse to deliver goods if the debtor failed to pay prior to delivery, are another example of contemporaneous exchange.⁹⁸ The defense has been extended to a creditor who refused to ship goods without assurance that the debtor would pay.⁹⁹

Transactions without any delay between when the debt arises and the payment of the obligation are the best example of contemporaneous exchanges.¹⁰⁰ Nevertheless, there are many court cases where a delay existed between providing goods or services and the debtor’s payment, yet the parties were still found to have engaged in contemporaneous exchanges. For example:

- The debtor paid the creditor’s invoices seven to eleven days after the shipment of goods, but prior to receipt of the creditor’s invoice.¹⁰¹
- The debtor agreed to pay the creditor within one business day of receipt of its invoice for services provided the previous week.¹⁰²
- The creditor submitted proof that the parties intended payment to be due upon delivery of the creditor’s product.¹⁰³

B. Substantially Contemporaneous

Although courts tend to focus more on whether the parties intended the transaction to be contemporaneous, the Bankruptcy Code requires that the creditor also prove that the transaction was indeed contemporaneous. In Delaware, whether a transaction is substantially contemporaneous depends on the “totality of the circumstances” of that particular transaction.¹⁰⁴ Applying this standard, courts have considered the following factors when deciding whether a transaction was substantially contemporaneous:

- The length of delay between providing goods and services and the time payment was received.
- The reason for the delay.
- The nature of the transaction.
- The intention of the parties.
- The possible risk of fraud.¹⁰⁵

It is not enough that the transaction was set up so that it could have been a contemporaneous exchange.¹⁰⁶ The creditor must show that the payment was in fact contemporaneous with the receipt of goods or services by the debtor.¹⁰⁷



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

C. When Payment Occurs

Courts have found payment to occur, for purposes of determining the applicability of the contemporaneous exchange defense, on the date that the check is delivered.¹⁰⁸ This is important because courts, in deciding when a transfer was made under section 547(b), will look to when the check was honored by the bank of the party who issued the check (the debtor's bank in preference actions).¹⁰⁹

VIII. Other Defenses

A. Statutory Lien

A statutory lien is a property right given to a creditor under state law. This property right acts to secure payment for the creditor, making it a secured creditor to the extent of the lien, and possibly excusing any preference transfers that the creditor may have received. One of the more common statutory liens is the mechanic's lien. The easiest way to understand a mechanic's lien is to imagine you have taken your car to a mechanic. Until you pay the mechanic, you don't get your car back.

In a number of states, including California,¹¹⁰ Minnesota¹¹¹ and South Dakota,¹¹² subcontractors and material providers have a similar statutory right. Subcontractors and material providers in these states have the ability to place a lien on property they have improved. When creditors who have the ability to obtain these liens are paid to either release the lien, or not establish the lien at all, these payments are likely going to be protected from avoidance.¹¹³

Section 547(c) of the Bankruptcy Code provides: The trustee may not avoid under this section a transfer . . . (6) that is the fixing of a statutory lien.¹¹⁴ Courts have routinely held that a trustee in a preference action cannot avoid payments made on an otherwise perfectible statutory lien.¹¹⁵ The case law shows that courts have routinely found that payments made in satisfaction of a potential statutory lien do not constitute avoidable transfers.¹¹⁶ Additionally, several courts have found that payments to relinquish a statutory lien are given in exchange for new value and are therefore not avoidable preferences.¹¹⁷

B. Mere Conduit

The Bankruptcy Code carves out another exception to the trustee's ability to recover preference payments.¹¹⁸ A creditor who transfers an otherwise preferential transfer to a third party may be able to prove that it was a "mere conduit," and therefore not the ultimate recipient of a preferential transfer.¹¹⁹ In order for a creditor to prove it was a mere conduit, it must show that it lacked "dominion and control" over the payments received from the debtor.

In order for a creditor to prove it lacked dominion and control over preference payments, it must show that it lacked the capability to use the payments in any manner it chooses.¹²⁰ Evidence that a party is not a mere conduit includes a creditor's ability to deposit the funds into a general checking account.¹²¹ Therefore, where the creditor controls the direction and use of the payments, it does not serve as a conduit, or "pass through," for the preferential payments.

C. Critical Vendor

When a debtor files for bankruptcy, often it will seek an order from the court declaring that certain creditors are "critical vendors" of the debtor. The order allows the debtor to pay the critical vendor's pre-bankruptcy invoices in exchange for the vendor's agreement to continue to deal with the debtor after the commencement of



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

its bankruptcy. Usually, the critical vendor order requires the vendor to continue dealing with the debtor on pre-bankruptcy business terms.

Critical vendors who are later sued by the debtor under a preference claim may seek to raise their critical vendor status as a defense. Courts that have looked at this issue do not see the designation of “critical vendor” as a clear defense to the preference action.¹²² Instead, the court will look at whether the critical vendor order addresses preference claims.

D. Refunds

Plaintiffs may seek to recover payments that were refunded by the debtor during the preference period. Whether such payments constitute avoidable preferences depends on the creditor’s ability to show that the funds were refunded under what courts describe as ordinary circumstances. Assuming the refund payments satisfy the core elements of a preference claim (a transfer of property of the debtor during the 90 days preceding the filing for bankruptcy, etc.), the creditor receiving the refund must either prove that the refund complies with the objective ordinary course of business standard, or prove the following:

1. The debtor mistakenly paid the creditor the amount that was subsequently refunded by the debtor;
2. The mistaken refund was quickly discovered by the parties;
3. The creditor immediately requested a refund; and,
4. The refund was tendered within three (3) days.¹²³

Although these requirements seem rigid, courts have been flexible in their application. In one case, a court held that the refund was not a preference even though the refund was not tendered within the three day deadline.¹²⁴ Instead, the court found that the money returned to the creditor was not a preference as the refund was initiated promptly.

E. Deficient Complaint

Once litigation commences, the plaintiff must include specific information regarding the transactions between the creditor and debtor, or else the complaint can be challenged and dismissed. Specifically, the complaint must include: (i) the amount of the debt; (ii) an identification of each transfer applied towards payment of the debt; (iii) the name of the debtor making the payment; (iv) the name of the creditor receiving the payment; and, (v) the date and amount of each individual payment.¹²⁵ It is not enough if the plaintiff includes in the complaint only the elements of a preference claim as spelled out in the Bankruptcy Code.¹²⁶

Courts do not like to dismiss cases on technicalities. If the court were to find that the plaintiff in a preference action filed a complaint lacking the necessary information, the plaintiff will likely receive an opportunity to amend the complaint to include the required information.¹²⁷

IX. Limiting Preference Exposure

Clients often ask how they can manage their business in a way that will limit their preference exposure. Below are some of the ways to reduce the risk of having to return a payment as a preference claim.¹²⁸



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

■ Introduction

■ Time Limitations For A Preference Claim

■ Elements Of A Preference Claim

■ Core Defenses To A Preference Claim

- Ordinary Course Of Business

- New Value

- Contemporaneous Exchange

- Other Defenses

■ Limiting Preference Exposure

■ References

A. Require Cash Transactions

By dealing with a debtor on a cash-only basis (i.e. cash, cashier's or certified check), you can avoid credit transactions and avoid credit exposure. Checks may not constitute a cash transaction, especially if there is a delay in cashing the check.

B. Deposit Checks Immediately

If you do accept an ordinary check, deposit it as quickly as possible. Courts will look at the date the check cleared the debtor's account to determine whether your company received a preference. The longer you hold a check, the greater the risk that the payment might fall within the ninety day preference period.



C. Consider Secured Transactions

Only unsecured transactions can give rise to a preference. Secured transactions are not preferences. Depending on the nature of your business, consider establishing a security interest in the goods sold to your customer.

D. Exercise Your Ability to Create a Lien

If you are in an industry that allows you to establish liens to enforce payment (typically subcontractors or raw material suppliers), consider establishing liens whenever possible. The specifics of establishing a lien vary from state to state, so it is important to consult resources addressing the specific laws of the state (or states) in which you operate.

E. Keep Your Transactions with Customers "Ordinary"

The ordinary course of business defense is the most common defense in preference litigation. Remember the examples of "non-ordinary" behavior and avoid engaging in such activity where possible. Such activity includes sending repeated dunning letters, making threats of litigation, or submitting calls to more senior personnel at the customer's office in an attempt to receive payment. A change in payments terms is also an indication of "non-ordinary" behavior.

It also helps if you can keep the customer on an "ordinary" payment history. The more sporadic the payment history, the more likely the court will find that your business received a preferential payment. Check to see whether the payment terms extended to your customer reflect what is ordinary in your industry. (The authors recognize that these suggestions may not be possible, or practical, when dealing with a slow paying customer).

F. Keep Good Books and Records

Unfortunately, the creditor has the burden of proving that the payments it received from a debtor do not constitute a preference. To provide an effective defense, whether during informal negotiations or during trial, it is imperative to have records showing the parties' prior dealings. Having such items as the account ledger, copies of cancelled checks, and any correspondence with the debtor will be invaluable in defending against preference claims.



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

- Introduction
- Time Limitations For A Preference Claim
- Elements Of A Preference Claim
- Core Defenses To A Preference Claim
 - Ordinary Course Of Business
 - New Value
 - Contemporaneous Exchange
 - Other Defenses
- Limiting Preference Exposure
- References

Recognize also that many debtors have poor books and records (hence, they are in bankruptcy). Having a well documented file places a creditor at an advantage over a debtor whose operations may have ceased months, or years, prior to the commencement of preference litigation.

G. Don't Wait

Typically, a debtor will send a letter to each of its creditors demanding repayment of any alleged preference payments before it files a lawsuit. This is the best time to get legal counsel involved. Once litigation is underway, there are numerous required filings that will take time for both you and your attorney. If, however, you can negotiate a settlement before a lawsuit is filed, or convince the debtor not to file suit, you can save significant time and money.

X. References

- ¹ 11 U.S.C. § 546(a).
- ² Fed. R. Civ. P. 4(m) made applicable in bankruptcy proceedings pursuant to Fed. R. Bankr. P. 7004.
- ³ 11 U.S.C. § 547(b), (b)(1) and (b)(2).
- ⁴ 11 U.S.C. § 547(b)(3), (b)(4) and (b)(5).
- ⁵ 11 U.S.C. § 547(b).
- ⁶ *Hayes Lemmerz Int'l v. Hyundai Motor Co. (In re Hayes Lemmerz Int'l)*, 329 B.R. 136, 141 (Bankr. D. Del. 2005), citing *Mktg Res. Int'l Corp. v. PTC Corp. (In re Mktg Res. Int'l Corp.)*, 41 B.R. 580, 581 (Bankr. E.D. Pa. 1984).
- ⁷ *Id.*, citing *Begier v. IRS*, 496 U.S. 53, 58, 110 S.Ct. 2258, 110 L.Ed.2d 46 (1990).
- ⁸ *Id.*
- ⁹ *Id.* at 142, citing *Hansen v. MacDonald Meat Co. (In re Kemp Pac. Fisheries, Inc.)*, 16 F.3d 313, 316 (9th Cir. 1994).
- ¹⁰ *U.S. Interactive v. Sampson Travel Agency, Inc. (In re U.S. Interactive)*, 321 B.R. 388, 395 (Bankr. D. Del. 2005), citing *Bonded Fin. Servs., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir. 1988).
- ¹¹ *Id.* ("To establish this defense, the defendant must show the payment merely slipped through his hands to another party.")
- ¹² *In re Futoran*, 76 F.3d 265, 267 (9th Cir. 1996).
- ¹³ *SEC v. First Jersey Securities, Inc. (In re First Jersey)*, 180 F.3d 504, 510 (3d Cir. 1999).
- ¹⁴ 11 U.S.C. § 101(12).
- ¹⁵ *In re First Jersey*, 180 F.3d at 510.
- ¹⁶ *Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 558, 110 S.Ct. 2126, 109 L.Ed.2d 588 (1990).
- ¹⁷ *In re Hayes Lemmerz*, 329 B.R. at 141, citing *The Fonda Group, Inc. v. Marcus Travel (In re The Fonda Group, Inc.)*, 108 B.R. 956, 959 (Bankr. D. N.J. 1989).
- ¹⁸ *Id.*, citing *Laws v. United Mo. Bank of Kansas City, N.A.*, 98 F.3d 1047, 1049-51 (8th Cir. 1996).
- ¹⁹ *Id.*, citing *Barnhill v. Johnson*, 503 U.S. 393, 394-95, 112 S.Ct. 1386, 118 L.Ed.2d 39 (1992).
- ²⁰ *Nelson Co. v. Counsel for the Official Comm. Of Unsecured Creditors (In re Nelson Co.)*, 959 F.2d 1260, 1267 (3d Cir. 1992).
- ²¹ 11 U.S.C. § 547(b)(3).
- ²² 11 U.S.C. § 101(32)(A).
- ²³ *Homeplace of America Inc. v. Salton, Inc. (In re Waccamaw's Homeplace)*, 325 B.R. 524, 529 (Bankr. D. Del. 2005).
- ²⁴ *See, e.g., Id.*
- ²⁵ 11 U.S.C. § 547(f); *see also Bros. Gourmet Coffees, Inc. v. Armenia Coffee Corp.*, 271 B.R. 456, 458 (Bankr. D.Del. 2002).
- ²⁶ *In re Waccamaw's Homeplace*, 325 B.R. at 528-29 (Holding that unless the defendant creditor can introduce evidence at trial showing that the debtor was solvent at the time the preferential transfers were made, the debtor's burden has been met under 11 U.S.C. § 547(b)(3)).
- ²⁷ 11 U.S.C. § 547(b)(5); *see also, Waslow v. Interpublic Group of Cos. (In re M Group, Inc.)*, 308 B.R. 697, 700 (Bankr. D. Del. 2004).
- ²⁸ *In re Waccamaw*, 325 B.R. at 530.
- ²⁹ *5 Collier on Bankruptcy*, 547-47.
- ³⁰ Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 § 1501(b), Pub.L. No. 109-8 Stat. 23; *see also, Miller v. Westfield Steel, Inc. (In re Elrod Holdings Corp.)*, 426 B.R. 106, 112 (Bankr. D. Del. 2010).
- ³¹ 11 U.S.C. § 547(c)(4).
- ³² *Claybrook v. SOL Building Materials Corporation (In re U.S. Wood Products, Inc.)*, 2004 WL 870830, *2-3 (Bankr. D. Del. April 22, 2004).
- ³³ 11 U.S.C. § 547(c)(1).
- ³⁴ *In re Elrod Holdings*, 426 B.R. at 110.
- ³⁵ The ordinary course defense is an affirmative defense, meaning the creditor must prove it. *HLI v. Metal Technologies Inc. (In re Hayes Lemmerz Int'l, Inc.)*, 337 B.R. 49, 56-57 (Bankr. D. Del. 2006).
- ³⁶ *Roberts v. Broyhill Furniture (In re Roberts)*, 315 B.R. 443, 454-55 (Bankr. S.D. Ohio 2004).
- ³⁷ *In re Elrod Holdings*, 426 B.R. at 111.



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

■ Introduction

■ Time Limitations For A Preference Claim

■ Elements Of A Preference Claim

■ Core Defenses To A Preference Claim

● Ordinary Course Of Business

● New Value

● Contemporaneous Exchange

● Other Defenses

■ Limiting Preference Exposure

■ References

38 *Id.*
39 *Id.*, citing *In re Forklift LP Corp.*, 340 B.R. 735, 738-39 (D. Del. 2006).
40 *Hechinger Inv. Co. v. Universal Forest Prods., Inc. (In re Hechinger)*, 489 F.3d 568, 577-78 (3d Cir. 2007).
41 *In re Hechinger*, 489 F.3d at 576-77.
42 *TWA, Inc. v. World Aviation Supply, Inc. (In re TWA)*, 327 B.R. 706, 709 (Bankr. D. Del. 2005).
43 *Id.*
44 *Id.* citing *Hechinger Liquidation Trust v. Universal Forest Prods., Inc. (In re Hechinger Inv. Co. of Delaware, Inc.)*, 326 B.R. 282, 285 (Bankr. D. Del. 2005), *aff'd* 339 B.R. 332 (D. Del. 2006) (additional citations omitted).
45 *Montgomery Ward v. OTC Int'l (In re Montgomery Ward)*, 348 B.R. 662, 675 (Bankr. D. Del. 2006), citing *In re Hechinger*, 326 B.R. at 285.
46 *Id.* at 676, citing *NSC Creditor Trust v. BSI Alloys, Inc., (In re National Steel Co.)*, 341 B.R. 229, 237-38 (Bankr. N.D. Ill. 2006).
47 *Id.*
48 *In re Hayes Lemmerz*, 337 B.R. at 56-57.
49 11 U.S.C. § 547(c)(2)(B).
50 *Fiber Lite Corp. v. Molded Acoustical Prods., Inc. (In re Molded Acoustical Prods. Inc.)*, 18 F.3d 217, 224 (3d Cir. 1994).
51 *In re U.S. Interactive*, 321 B.R. at 392-93.
52 *Id.* at 393-94.
53 *Pillowtex Corporation v. Classic Packaging (In re Pillowtex)*, 427 B.R. 301, 306 (Bankr. D. Del. 2010).
54 *In re U.S. Interactive*, 321 B.R. at 393-94.
55 *Id.* at 394, citing *McLaughlin v. Hoole Mach. & Engraving Corp. (In re Parkline Corp.)*, 185 B.R. 164, 169 (Bankr. D.N.J. 1994).
56 *In re Molded Acoustical*, 18 F.3d at 227.
57 *In re U.S. Interactive*, 321 B.R. at 393, citing *Hechinger Liquidation Trust v. Rager (In re Hechinger Invest. Co. of Del.)*, 298 B.R. 240, 242 (Bankr. D. Del. 2003) (rejecting hearsay statements generalizing about the industry standard).
58 *In re U.S. Interactive*, 321 B.R. at 393-94, citing *Harbour v. ABX Enters. (In re APS Holding Corp.)*, 282 B.R. 795, 803 (Bankr. D. Del. 2002) (stating that testimony where the witness "guessed" about what would comply with the standard was inconclusive).
59 *Id.*, at 394, citing *Sacred Heart Hosp. of Norristown v. E.B. O'Reilly Serv. Corp. (In re Sacred Heart Hosp. of Norristown)*, 200 B.R. 114, 119 (Bankr. E.D. Pa. 1996) ("the evidence presented by the Defendant was totally lacking in specificity, consisting merely of broad estimates of a wide range of delay time in payments").
60 *In re Pillowtex*, 427 B.R. at 309.
61 *Id.* citing *Troisio v. E.B., Eddy Forest Products (In re Global Tissue LLC)*, 106 Fed.Appx. 99, 103 (3d Cir. 2004).
62 *HLI v. Metal Technologies Inc. (In re Hayes Lemmerz Int'l, Inc.)*, 339 B.R. 97, 105 (Bankr. D. Del. 2006).
63 *Id.* at 102.
64 *Id.*
65 *Id.*
66 *Id.* at 102-03
67 *Id.* at 105.
68 *Id.*
69 *In re Elrod Holdings*, 426 B.R. at 111-12.
70 *Id.* at 111.
71 *Id.* at 112.
72 *Id.*
73 *In re U.S. Interactive*, 321 B.R. at 393
74 *Id.*
75 *Id.*
76 *Id.* citing *In re Molded Acoustical Prods.*, 18 F.3d at 226.
77 *Id.*
78 *In re U.S. Interactive*, 321 B.R. at 394.
79 11 U.S.C. § 547(c)(4). *See also, New York City Shoes, Inc. v. Bentley Int'l, Inc. (In re New York City Shoes, Inc.)*, 880 F.2d 679, 680 (3d Cir. 1989).
80 *TWA Inc. Post Confirmation Estate v. City and County of San Francisco Airports Comm'n (In re TWA Inc. Post Confirmation Estate)*, 305 B.R. 221, 228 (Bankr. D. Del. 2004), citing *In re New York City Shoes*, 880 F.2d at 680.
81 *In re Waccamaw*, 325 B.R. at 535 (holding that in order for a creditor to establish a new value defense, the debtor must not have fully compensated the creditor for the new value received). But see, *Hechinger Inv. Co. of Delaware Inc. v. Universal Forest Prods., Inc. (In re Hechinger Inv. Co.)*, No. 99-02261(PJW), 01-3170(PBL), 2004 WL 3113718, *5-6 (Bankr. D. Del. Dec. 14, 2004) (declining to follow decisions holding that new value must remain unpaid).
82 *In re New York City Shoes*, 880 F.2d at 680 (finding that the debtor must not have fully compensated the creditor for the new value as of the date the debtor filed for bankruptcy protection).
83 *In re Hechinger Inv. Co.*, 2004 WL 311378 at *5.
84 *Id.*, citing *Check Reporting Services v. The Water Doctor (In re Check Reporting Services, Inc.)*, 140 B.R. 425 (Bankr. W.D. Mich. 1992).
85 *Id.*
86 *Id.* at *6.
87 *Id.*
88 *In re U.S. Interactive*, 321 B.R. at 394.
89 *In re Hechinger*, 489 F.3d at 574, citing *In re Spada*, 903 F.2d 971, 974-75 (3d Cir. 1990).
90 *Id.*, citing *In re Spada*, 903 F.2d at 975.
91 *Id.* at 574-575.
92 *Id.*



Fox Rothschild LLP
ATTORNEYS AT LAW

A Preference Reference: Common Issues that Arise in Delaware Preference Litigation

■ Introduction

■ Time Limitations For A Preference Claim

■ Elements Of A Preference Claim

■ Core Defenses To A Preference Claim

● Ordinary Course Of Business

● New Value

● Contemporaneous Exchange

● Other Defenses

■ Limiting Preference Exposure

■ References

- ⁹³ *In re APS Holding Corp.*, 282 B.R. at 800.
⁹⁴ *In re Hayes Lemmerz*, 329 B.R. at 140.
⁹⁵ *Id.*
⁹⁶ *In re Hechinger*, 489 F.3d at 575.
⁹⁷ *Id.* citing *In re Payless Cashways, Inc.*, 306 B.R. 243, 247 (8th Cir. BAP 2004).
⁹⁸ *Id.* citing *In re Payless Cashways, Inc.*, 306 B.R. at 250, 254.
⁹⁹ *Id.* citing *In re Anderson-Smith & Assoc., Inc.*, 188 B.R. 679, 689 (Bankr. N.D. Ala. 1995).
¹⁰⁰ *Id.* at 574.
¹⁰¹ *In re CCG 1355, Inc.*, 276 B.R. 377, 385-86 (Bankr. D.N.J. 2002).
¹⁰² *In re Bridge Inform. Sys., Inc.*, 321 B.R. 247, 256 (Bankr. E.D. Mo. 2005).
¹⁰³ *In re Hayes Lemmerz*, 329 B.R. at 140.
¹⁰⁴ *Id.*
¹⁰⁵ *Id.*, citing *Pine Top Ins. Co. v. Bank of Am. Nat'l Trust & Sav. Ass'n*, 969 F.2d 321, 328 (7th Cir. 1992).
¹⁰⁶ *Id.*
¹⁰⁷ *In re Hechinger*, 489 F.3d at 574.
¹⁰⁸ *Id.* at 140, n. 5, citing *Staff Builders of Phila., Inc. v. Koschitzki*, 989 F.2d 692, 695 (3d Cir. 1993).
¹⁰⁹ *Id.* at 141, citing *Barnhill v. Johnson*, 503 U.S. 393, 394-95, 112 S.Ct. 1386 (1992).
¹¹⁰ *See*, California Code of Civil Procedure, Title 11.7 § 1800(c)(7).
¹¹¹ *See*, Minnesota Statutes, § 514.05(1).
¹¹² *See*, South Dakota Codified Law § 44-9-1.
¹¹³ *See Cimmaron Oil Co., Inc., v. Cameron Consultants, Inc.*, 71 B.R. 1005, 1010 (D. Tex. 1987) (holding that debtor's payments, which resulted in creditor's taking no affirmative steps to perfect statutory lien rights, came within exception to avoidance statute for transfers that preclude imposition of true statutory liens).
¹¹⁴ 11 U.S.C. § 547(c)(6).
¹¹⁵ *Fredman v. Milchem, Inc. (In re NuCorp Energy, Inc.)*, 80 B.R. 517, 520 (Bankr. S.D. Cal. 1987).
¹¹⁶ *See In re White*, 64 B.R. 843, 851 (Bankr. E.D. Tenn. 1986) (finding that under § 547(c)(6), since attachment or perfection of a statutory lien during the preference period is not avoidable, payment to prevent attachment or perfection of a statutory lien is also not avoidable).
¹¹⁷ *Matter of Anderson Plumbing, Co.*, 71 B.R. 19, 20 (Bankr. E.D. Cal. 1986); *In re Mason and Dixon Lines*, 65 B.R. 973, 978-79 (Bankr. M.D.N.C. 1986); *In re Advanced Contractors*, 44 B.R. 239, 241 (Bankr. M.D. Fla. 1984); *In re Dick Henley, Inc.*, 38 B.R. 210, 213 (Bankr. M.D. La. 1984); *In re Johnson*, 25 B.R. 889, 892-94 (Bankr. E.D. Tenn. 1982).
¹¹⁸ *In re U.S. Interactive*, 321 B.R. at 395.
¹¹⁹ *Id.*, citing *Christy v. Alexander & Alexander of New York Inc. (In re Finley, et al.)*, 130 F.3d 52, 58 (2d Cir. 1997).
¹²⁰ *Id.*, citing *Official Comm. of Unsecured Creditors v. Guardian Ins. k01 (In re Parcel Consultants, Inc.)*, 287 B.R. 41, 46 (Bankr. D.N.J. 2002).
¹²¹ *Id.* at 396.
¹²² *Compare, HLI Creditor Trust v. Export Corp. (In re Hayes Lemmerz Int'l, Inc.)* 313 B.R. 189, 193 (Bankr. D. Del. 2004) (holding that the absence of a release of preference claims in the critical vendor order prevented the critical vendor from using that order to protect preferential transfers) with, *Official Committee of Unsecured Creditors v. Medical Mutual of Ohio (In re Primary Health Systems, Inc.)*, 275 B.R. 709 (Bankr. D. Del. 2002), *aff'd*, C.A. No. 02-301 (D. Del. Feb. 27, 2003) (concluding that a creditor who received post-petition payment of pre-petition obligations under a Court Order was protected from a preference challenge.).
¹²³ *Safety-Kleen Creditor Trust v. Eimco Process Equipment Co. (In re Safety-Kleen Corp.)*, 331 B.R. 591, 596 (Bankr. D. Del. 2005).
¹²⁴ *Id.* at 597.
¹²⁵ *TWA v. Marsh USA, Inc. (In re TWA, Inc.)*, 305 B.R. 228, 232 (Bankr. D. Del. 2004).
¹²⁶ *Valley Media, Inc v. Borders, Inc. (In re Valley Media, Inc.)*, 288 B.R. 189, 192 (Bankr. D. Del. 2003).
¹²⁷ *TWA*, 305 B.R. at 233.
¹²⁸ This section includes advice from *How to Survive Your Customer's Bankruptcy*, T. Hurley, December 10, 2008.

For more information, please contact:

L. Jason Cornell, Esq.

302.252.5833

jcornell@foxrothschild.com

L. John Bird, Esq.

302.622.4263

jbird@foxrothschild.com



Fox Rothschild LLP
ATTORNEYS AT LAW

© 2012 Fox Rothschild LLP. All rights reserved. All content of this publication is the property and copyright of Fox Rothschild LLP and may not be reproduced in any format without prior express permission. Contact marketing@foxrothschild.com for more information or to seek permission to reproduce content. This publication is intended for general information purposes only. It does not constitute legal advice. The reader should consult with knowledgeable legal counsel to determine how applicable laws apply to specific facts and situations. This publication is based on the most current information at the time it was written. Since it is possible that the laws or other circumstances may have changed since publication, please call us to discuss any action you may be considering as a result of reading this publication.

Attorney Advertisement