Preference Defense
Preference Elements

Transfer (usually a payment) that is made:

(1) by an insolvent company;
(2) to or for the benefit of a party;
(3) on account of an existing debt;
(4) within 90 days (or a year, if the party is an insider of the company) of the filing of the bankruptcy case; and
(5) that allows the party to receive more than it would if the company were liquidated.
Go On, Take the Money and Run

- Dunning letters
- Worst that can happen is you have to give it back
- Recent Bankruptcy Code changes to protect the little guy
Ordinary Course Defense

- Transfer not avoidable if it was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee and was (1) made in the ordinary course of business or financial affairs of the debtor and the transferee or (2) made according to ordinary business terms
- Statistical analysis
- Method of payment/other factors
- Industry standard
Subsequent New Value Defense

• After preference payment was made, the defendant provided goods or services ("new value") to the company
• Available to offset any preceding preference payments
• Some courts require new value remain unpaid
• Timing of new value
Other Defenses/Arguments

• Statute of limitations
• Contemporaneous exchange for new value
• Resulting claim
• Contract assumed/creditors paid in full
Hypothetical (Part I)

• Bankruptcy case filed on February 18, 2008
• Pre-preference payment range of 30-40 days
• Preference period payments made 25 days ($10,000), 32 days $(15,000), 37 days $(5,000), and 42 days $(20,000), with unpaid invoices of $12,000, $3,000, and $6,000
## Hypothetical (Part II)

<table>
<thead>
<tr>
<th>Invoice Date</th>
<th>Payment Date</th>
<th>Amount</th>
<th>Lag Time</th>
<th>Preference Exposure (Cumulative)</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/30/07</td>
<td>N/A (New Value)</td>
<td>$12,000</td>
<td>N/A</td>
<td>$0</td>
</tr>
<tr>
<td>1/1/08</td>
<td>1/26/08</td>
<td>$10,000</td>
<td>25 days</td>
<td>$10,000</td>
</tr>
<tr>
<td>1/27/08</td>
<td>N/A (New Value)</td>
<td>$3,000</td>
<td>N/A</td>
<td>$7,000</td>
</tr>
<tr>
<td>1/3/08</td>
<td>2/4/08</td>
<td>$15,000</td>
<td>32 days</td>
<td>$7,000</td>
</tr>
<tr>
<td>1/3/08</td>
<td>2/9/08</td>
<td>$5,000</td>
<td>37 days</td>
<td>$7,000</td>
</tr>
<tr>
<td>1/3/08</td>
<td>2/14/08</td>
<td>$20,000</td>
<td>42 days</td>
<td>$27,000</td>
</tr>
<tr>
<td>2/15/08</td>
<td>N/A (New Value)</td>
<td>$6,000</td>
<td>N/A</td>
<td>$21,000</td>
</tr>
</tbody>
</table>
Small Business
Bankruptcy/Restructuring Issues
The Small Business Debtor

- 70-80% of all Chapter 11 cases
- Small business debtor has $2 million or less in debts, with certain exceptions
Surprise, Landlord!

- Tenant on brink of eviction
- Lease is one of most valuable assets
- Automatic stay
- Post-petition rent
- Narrower timeframe to assume non-residential real property leases
Advantages of Being a Small Business Debtor

• Expedited plan/disclosure statement process
• Often avoid creditors committee
Disadvantages of Being a Small Business Debtor

• Additional reporting requirements
• Earlier plan deadlines
• Limits on automatic stay
Alternatives to Chapter 11

- Financing (Yeah, right)
- Workout with creditors
- Liquidation alternatives
Purchasing Distressed Assets
363 Asset Sale Advantages to the Buyer

- “Stalking horse” protections
- Sell property “free and clear of any interest in such property”
Drafting a Buyer-Friendly Sale Order (Part 1)

• Expansive “free and clear” language
• No liabilities are assumed by the purchaser other than those expressly identified
• Any future plan of reorganization must incorporate key sale transaction terms
• Retention of jurisdiction to enforce sale order
Drafting a Buyer-Friendly Sale Order (Part 2)

• Reasonably equivalent value/fair consideration was provided for the assets sold
• Notice was proper, adequate, and sufficient
• Sale price was not controlled by an agreement among potential bidders at the sale
• Purchase was made in good faith, which means that the reversal or modification of sale on appeal does not effect its validity unless there is stay pending appeal
• No stay of sale pending appeal
363 Asset Sale Disadvantages

- Risk of being “outbid”
- Delay
- Cost
Sales Under a Plan of Reorganization

- More complicated/delay
- Potential increased cost
- Avoid the auction process
- Possibility of additional/broader buyer releases
- Avoid transfer taxes
Sales Outside of Bankruptcy

- Non-bankruptcy risks
- Post-sale bankruptcy risks
- Fewer costs
- Faster
- Less competition