

What's Up

In the World of Collections

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DEFENSES TO PREFERENCE PAYMENTS

You have just learned that one of your larger customers has filed a Chapter 11 petition in Bankruptcy Court, leaving you with about \$50,000 in unpaid invoices. So, you file your Proof of Claim and try to figure out how to make up this loss. To compound matters, about a year later, you receive a summons and complaint from either the lawyers for your debtor, or the bankruptcy trustee. The suit is for the recovery of payments received from the debtor within the 90 days prior to the bankruptcy. They are demanding the repayment based on the preference section of the United States Bankruptcy Code. What are your options?

First and foremost, do not pay the creditor or trustee back without examining the facts. The next thing you do is review the payments in question to determine your exposure. It is the plaintiff's burden to show that the payment was made on "account of an antecedent debt", which means that the payment had to be on the account of an outstanding account receivable or other old debt, as opposed to a Cash on Delivery or prepaid shipment. If the debtor can establish the elements of a preference, there are three typical statutory defenses available to the preference defendant.

The first and most common is that the challenged payment was made in the **ordinary course of business** between the debtor and the vendor creditor, according to ordinary business terms. Depending on the length of the vendor/customer relationship between the creditor and the debtor and the course of dealing between the two parties prior

to the bankruptcy, those two things will have a greater or lesser effect on the Court's decision as to what constitutes ordinary course of business. In other words, if there is a longstanding business relationship between the vendor and the customer,

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"Don't use time or words carelessly. Neither can be retrieved."

"Don't give up when you still have something to give. Nothing is really over until the moment you stop trying."

*Brian G. Dyson, Pres. & CEO
Coca-Cola Enterprises*

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there is a much better chance that the payment was made in the ordinary course of business. Courts will also look at ordinary course of business on an industry-wide basis. In all cases, the burden is on the defendant to show that the payments were within the ordinary course of business.

The second defense that is typically used is contemporaneous exchange for new value. This defense provides that the trustee or debtor can avoid as a preference a payment that was intended by both the debtor and creditor to be a payment made as "a **contemporaneous exchange for new value** given to the debtor" and was "in fact a substantially contemporaneous exchange". This basically means that where the vendor delivered goods or services to the debtor and received payment at the same time, the payment will be viewed as a COD exchange that will be immune from preference recovery. The idea is that the goods were not delivered and the customer invoiced for them. They were delivered and paid for at the same time.

The third commonly used defense is what is known as the **subsequent new value defense**. This particular defense provides that to the extent the creditor gave "new value" in the form of delivery of new goods or services after the date of any challenged transfer, the transfer is then sanitized to the extent of the new value. For example, if the debtor makes two \$500 payments on September 1st and September 15th on old invoices, and the payments are followed by a new sale of goods or services from the creditor to the debtor on September 25th of \$3000, the earlier payments by the debtor to the creditor are immune to attack as preferences because the creditor gave subsequent new value to the debtor. This defense is not as common as the first two mentioned.

Frank Vecchio, Legal Manager



Believe It or Not
NACM Credit Congress
is fast approaching.
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you an invitation to our
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May 18 - 21, 2008

Did You Know?

There are other defenses to preference payments but they typically do not fit the trade creditor's situation. The mere existence of the preference cause of action seems extremely unfair to creditors who have significant claims against a debtor that could very well go unpaid in the bankruptcy case. The purpose of this legislative policy, however, is to allow the bankruptcy estate to recover preferences and redistribute the same amount to all creditors so that all creditors are on equal ground to share in any dividend from the bankruptcy estate. You should also be aware that you cannot be sued for any amount under \$5000 in a preference action. Additionally, any amount between \$5001 and \$10,000, the debtor or trustee, if they choose to sue, has to sue the creditor in the creditor's jurisdiction. Lastly, any amount sued over \$10,001 will be sued in Federal Court. Remember that even when it seems you have no choice but to pay, negotiate. The debtor and/or trustee do not want to sue you to get paid and they want money fast.

Brain Teaser

Which is the odd one out?

Telephone
Limousine
Freighter
Driftwood

Winners of Last Drawing

1. Eileen Higney (Long Island City, NY)
2. Gail Smith (Cleveland, OH)
3. Carmen Ginter (Emigsville, PA)
4. Mary Joan Kevlin (Cooperstown, NY)
5. David Houts (Chicago, IL)

5 Fax-O-Grams will be pulled at random & sent a FREE gift.
All answers to be placed on enclosed Fax-O-Gram form.

Happy Birthday!!

Taurus

Born: April 20 - May 20
Element: Earth
Quality: Loyalty
Symbol: The Bull
Lucky Day: Wednesday
Lucky Numbers: 5, 7, 15, 21, 30
Special Color: Pink & Light Blue
Traits: warmhearted, loving, reliable

Gemini

Born: May 21 - June 20
Element: Air
Quality: Talkative, Flexible
Symbol: The Twins
Lucky Day: Sunday
Lucky Numbers: 3, 6, 18, 27, 29
Special Color: Green & Yellow
Traits: adaptable, versatile, witty

For more information or to place a claim, please contact Judy Mattioli at:

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