DEFENDING PRE-BANKRUPTCY CONTRACT PAYMENTS

BRENDON D. SINGH, *Houston*
Tran Singh

State Bar of Texas
CONTRACTING IN THE COVID AND POST-COVID WORLD
April 8, 2022
Austin

CHAPTER 8

Brendon D. Singh
Founding Partner

Brendon D. Singh is a founding partner of Tran Singh LLP and enjoys a successful practice focused on consumer protection and bankruptcy. Mr. Singh's experience includes representation in Chapter 7, Chapter 11 and Chapter 13 bankruptcies, mortgage loan modification, repossessions, foreclosures, credit card debt and medical debt. His experience also includes representing clients in other bankruptcy litigation matters. In the course of his years in practice, Mr. Singh has also assisted his business clients in general counsel matters.

Mr. Singh graduated *summa cum laude* from Texas Southern University, Thurgood Marshall School of Law in 2011. He earned his Bachelor of Science degree, graduating *cum laude*, from the University of Houston in 2007.

Mr. Singh is board certified in Consumer Bankruptcy by the Texas Board of Legal Specialization.

In 2020, Mr. Singh was appointed by the United States Trustee to serve as a Subchapter V Trustee in accordance with the Small Business Reorganization Act of 2019. Mr. Singh serves as a Subchapter V Trustee and is appointed to small business cases filed in the Southern District of Texas.

Mr. Singh is a member of the American Bankruptcy Institute, American Inns of Court, Asian American Bar Association, Houston Association of Young Bankruptcy Lawyers, also serving as Treasurer, State Bar of Texas, Bankruptcy Law Section, State Bar of Texas, Leadership SBOT and Texas Bar Fellow. He has been professionally recognized as a Texas Super Lawyer and Texas Rising Star by Thomson Reuters and a Top Lawyer by Houstonia Magazine, since 2018.

Mr. Singh's experience includes a variety of speaking engagements.

TABLE OF CONTENTS

TRANSINGH LLP

Defending Pre-Bankruptcy Contract Payments

TRANSINGH LLP

§547 — What is a Preference Claim?

The Elements of a Preference Claim

11 U.S. § 547(b)

1. To or for the benefit of a creditor § 547(b)(1);
2. For or on account of an antecedent debt owed by the debtor before such transfer was made § 547(b)(2);
3. Made while the debtor was insolvent § 547(b)(3);
4. On or within 90 days before the date of the filing of the petition or between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider § 547(b)(4); and
5. That enables such creditor to receive more than such creditor would receive if the case were a case under chapter 7 § 547(b)(5).

To or For the Benefit of a Creditor

§ 547(b)(2)

- To constitute a voidable preference, the transfer must have been a transfer "to or for the benefit of a creditor." A number of courts have held that "indirect transfers," or transfers made by someone other than the debtor or to someone other than the creditor, may constitute a voidable transfer under §§ 547(b) and 550. As the Supreme Court noted in a case decided under the Bankruptcy Act, to "constitute a preference, it is not necessary that the transfer be made directly to the creditor." *National Bank of Newport v. National Kerkimer County Bank of Little Falls*, 225 U.S. 178, 184, 32 S.Ct. 633 (1912).

For or on Account of an Antecedent Debt

§ 547(b)(2)

- Where a payment is made after a creditor provides goods or services, the payment is "for or on account of an antecedent debt."
- Unless one of the statutory defenses set forth in § 547(c)(3) and (c)(5) applies, where a debtor grants a lender a security interest in his assets to secure an existing debt, the security interest is a transfer of property "for or on account of an antecedent debt." In that case, the transfer in such a situation occurs when the security interest is perfected under applicable state law.
- If a payment is made before the creditor provides the services or supplies, the payment is not "for or on account of an antecedent debt." Where a creditor provides services or goods pursuant to a long-term contract, and the debtor is obligated to purchase a minimum amount of services or goods under that contract, an argument exists that the prepayment is "for or on account of an antecedent debt."

For or on Account of an Antecedent Debt (cont'd)

§ 547(b)(2)

- The existence of a "debt" at the time of the transfer should be determined based on applicable non-bankruptcy law. *Ogden v. Big Sky Motors, Ltd. (In re Ogden)*, 314 F.3d 1190, 1200 (10th Cir. 2002) (citing *Raleigh v. Illinois Dept. of Revenue*, 530 U.S. 15, 20 (2000) (the "basic federal rule" in bankruptcy is that state law governs the substance of debts)).
- The Bankruptcy Code does not define a "debt," although a "claim" is broadly defined in §101(10)(A) to include any right to payment, whether reduced to judgment, liquidated, fixed, contingent, matured, disputed, legal, equitable, secured or unsecured.

When the Debtor was Insolvent

§ 547(b)(3)

- A debtor is presumed to be insolvent on and during the 90 days preceding its bankruptcy. § 547(i). Although a debtor has the ultimate burden of persuasion of all of the preference elements set forth in § 547(b), the creditor has the burden of producing evidence that the debtor was in fact solvent during the preference period to rebut the statutory presumption of insolvency. *Jones Truck Lines, Inc. v. Full Service Leasing Corp. (In re Jones Truck Lines, Inc.)*, 883 F.3d 253, 258 (8th Cir. 1996); *Official Unsecured Creditors' Committee v. Airport Aviation Services, Inc. (In re Arrow Air)*, 940 F.2d 1463, 1465 (11th Cir. 1991). In other words, the defendant in a preference action must produce evidence that the debtor was *not* insolvent to rebut the presumption of insolvency.
- An entity other than a partnership is insolvent when "the sum of such entity's debts is greater than all of such entity's property, *at a fair valuation*." § 101(32)(A) (emphasis added). A partnership is insolvent when the sum of the partnership's debts is greater than the aggregate of, at a fair valuation, (i) all of the partnership's property (with some exceptions) and (ii) the sum of the excess of the value of each general partner's nonpartnership property (with the same exceptions). § 101(32)(B).

When the Debtor was Insolvent (cont'd)

§ 547(b)(3)

- A person is insolvent under the Bankruptcy Code "if the sum of the debtor's debts is greater than all of the debtor's assets *at a fair valuation*." 5 Collier on Bankruptcy, ¶ 548.05, at 548-32 (15th ed.) ("Collier on Bankruptcy").
- For purposes of determining solvency, it is well established that contingent liabilities must be included to some extent. Rather than considering contingent liabilities at face value, the court should discount the liability "by the probability that the contingency will materialize." E.g., *WRT Creditors Liquidation Trust v. WRT Bankruptcy Litigation, Master File Defendants*, 282 B.R.343 (Bankr. W.D. La. 2001) (citing *Nordberg Arab Banking Corp. (In re Chase & Sanborn)*, 904 F.2d 588, 594 (11th Cir. 1990)). Indeed, as one court has noted, "[t]o correctly value the contingent liability it is necessary to discount it by the probability that the contingency will occur and the liability become real." *F.D.I.C. v. Bell*, 106 F.3d 258, 264 (8th Cir. 1997).

Made within the 90-Day or One Year Preference Period

§ 547(b)(4)

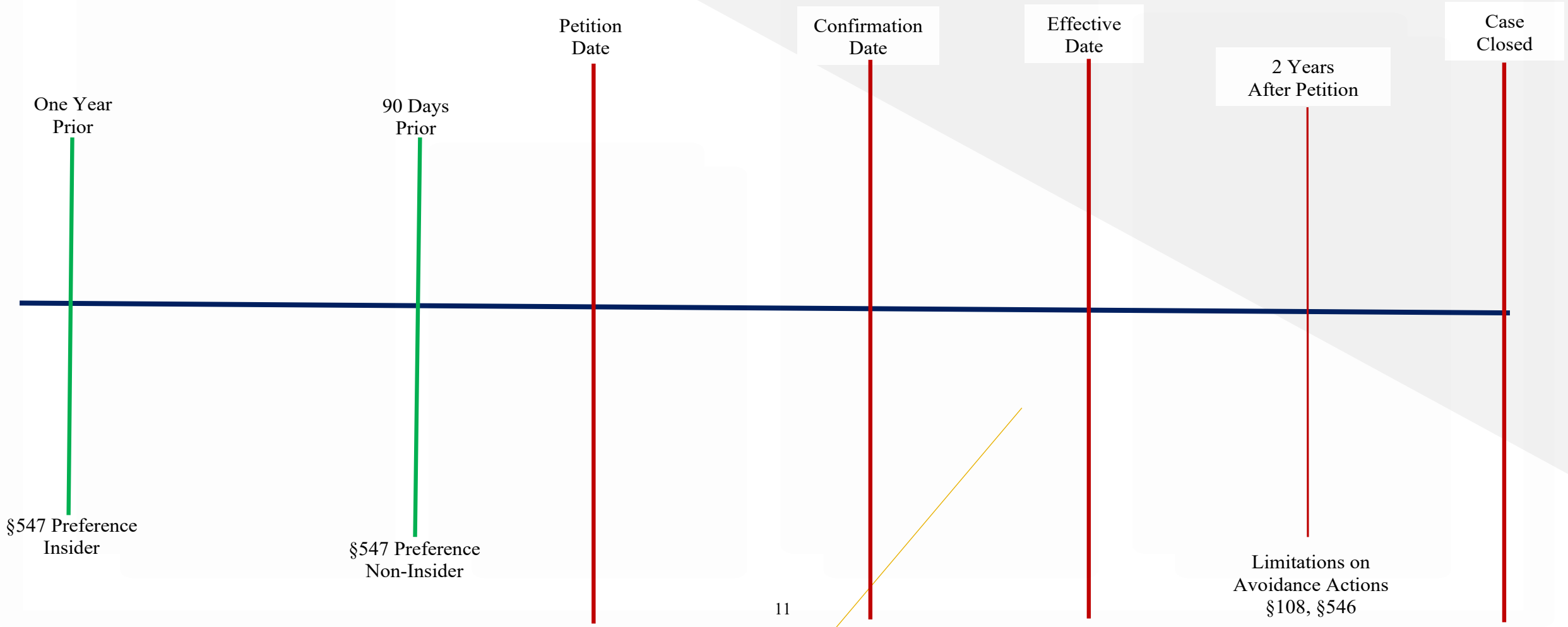
- "Insiders" is defined in § 101(32), and includes, by way of example, officers and directors of a corporation, or other person's in "control."
- For determining whether a payment is made within the applicable time, the preferential transfer is made when the check is paid, as opposed to when the check is delivered or mailed. *Barnhill v. Johnson*, 503 U.S. 393, 395, 113 S.Ct. 2141 (1992). Of course, if the check is a cashier's check, for calculation of the preference period, the transfer is complete when the check is delivered to the creditor.
- For purposes of the "subsequent new value" defense, the transfer may be treated as completed when the check is delivered. *E.g., Peltz v. Application Engineering Group, Inc. (In re Bridge Information Systems)*, 287 B.R. 258, 264 (Bankr. E.D. Mo.2002).

More than a Creditor would have received in a Chapter 7 Case

§ 547(b)(5)

- In essence, a fully secured creditor who receives payments within the preference period did not receive preferential payments because the creditor would have received at least the same amount payments in a Chapter 7 case on account of its security interests.
- Unlike the other elements of a preference, the pertinent determination is made at the time of the bankruptcy, rather than the time of the transfer. *E.g., Nueger v. United States (In re Tenna)*, 801 F.2d 819, 821 (5th Cir. 1986) (determined using hypothetical liquidation on date bankruptcy was commenced); *Seidle v. GATX Leasing Corp.*, 778 F.2d 659, 665 (11th Cir. 1985).

Preference Timeline



TRANSINGH LLP

Defenses to a Preference Claim

The Defenses

11 U.S. § 547(c)

- Contemporaneous Exchange of Value § 547(c)(1)
- Ordinary Course of Business § 547(c)(2)
- Subsequent New Value § 547(c)(4)

Contemporaneous Exchange of Value

§ 547(c)(1)

An otherwise preferential transfer is not avoidable to the extent such transfer was both intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor and was in fact a substantially contemporaneous exchange.

Contemporaneous Exchange Defense

- For purposes of § 547, "new value" is defined as money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee in a transaction that is neither void nor voidable under any applicable law, including proceeds of such property. A creditor seeking to except a preferential transfer from avoidance under § 547(c)(1) must supply proof of the specific dollar value of any "new value" provided in exchange for the transfer. See *Jet Florida, Inc. v. American Airlines, Inc. (In re Jet Florida Systems, Inc.)*, 861 F.2d 1555, 1559 (11th Cir. 1988) ("*Jet Florida II*"). A creditor asserting a § 547(c)(1) defense must show that a preferential transfer conferred actual economic benefit upon a transferee/debtor, rather than merely showing that a transferee/debtor and creditor **intended** some hypothetical or ephemeral value to be conferred. *Jet Florida II*, 861 F.2d at 1558-59.

Contemporaneous Exchange Defense (cont'd)

- "New value" does not mean one obligation substituted for another obligation. § 547(a)(2). In *Babin v. Barry County Livestock Auction, Inc.*, 282 B.R. 871 (B.A.P. 8th Cir. 2002), the court found that cashier's checks delivered to the auction house two weeks after the debtor purchased cattle at an auction were not contemporaneous exchanges for new value. The auction house argued that the checks were not delivered to pay for the previously purchased cattle, but for the right to participate in auctions that were conducted on the dates that new auctions were conducted. The court first found that the debtor intended to satisfy its outstanding obligation to the auction house, and that the right to participate in future auctions was a mere consequence of the payment. Id. at 875. The court also found that the right to participate in new auctions did not constitute "new value" within the meaning of § 547(a)(2), because the right to participate did not constitute money, credit or "a good or service the value of which is qualified in the record." 282 B.R., at 875.

Ordinary Course of Business

§ 547(c)(2)

Under the ordinary course of business defense, a debtor in possession or trustee may not avoid a transfer to the extent that the transfer was (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, (B) made in the ordinary course of business or financial affairs of the debtor and the transferee, and (C) made "according to ordinary business terms."

Ordinary Course of Business Defense

- "In sum, the creditor must show that as between it and the debtor, the debt was both incurred and paid in the ordinary course of their business dealings and that the transfer of the debtor's funds to the creditor was made in an arrangement that conforms with ordinary business terms -- a determination that turns the focus away from the parties to the practices followed in the industry." *Gulf City Seafoods*, 296 F.3d at 369.
- In the typical preference case, there is no dispute that the debt was incurred in the ordinary course of the debtor's and creditor's business or financial affairs.

Ordinary Course of Business Defense (cont'd)

- According to the Eighth Circuit, the controlling factor under § 547(c)(2)(B) is whether the timing of the payments from the debtor to the creditor during the preference period were consistent with the timing of the payments before the preference period. *E.g., Peltz v. Bridge Information Systems, Inc. (In re Bridge Information Systems, Inc.)*, 287 B.R. 258, 264 (Bankr. E.D. Mo. 2002). The controlling factor in the analysis under § 547(c)(2)(B) is whether the timing of the payments from the debtor to the creditor during the preference period were consistent with the timing of the payments before the preference period. Thus, where the average payment outside the preference period was 56 days, and the average payment period within the preference period was 31 days, the payments were not made according to the ordinary business terms between the debtor and creditor, according to the court in Bridge. 287 B.R. at 264.

Subsequent New Value

§ 547(c)(4)

A trustee or debtor in possession may not avoid a transfer to or for the benefit of a creditor to the extent that, after such transfer, the creditor gave new value to or for the benefit of the debtor (A) not secured by an otherwise unavoidable security interest, and (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

Subsequent New Value Defense

- Because there is no question about the subjective intent of the parties, as in the case of the contemporaneous exchange defense, or the prevailing industry standards, as in the case of the ordinary course of business defense, the subsequent new value defense is the easiest to establish for settlement discussions, summary judgment or trial.

TRANSINGH LLP

Thank You.

Brendon Singh

832.975.7300

Bsingh@ts-llp.com

www.ts-llp.com