## **Bankruptcy Law**



## A legal update from Shumaker, Loop & Kendrick, LLP

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## The Dreaded Preference Demand

you pay 80% today, it will all go away.

ou are in your office finishing your Starbucks when the mail comes. One letter is from what looks like a law firm...is it real or is it propaganda? You open it only to find a letter from counsel for a trustee in bankruptcy. Dear creditor, the Trustee demands you pay back the payments from the debtor (your customer) over 2 years ago...the dreaded preference demand. But, if

You pull out the file with all the bankruptcy notices you've received during the customer's bankruptcy case, making sure you filed the proof of claim. You recall that you shipped goods that your customer received within 20 days of its bankruptcy filing. So, your proof of claim also contains an administrative claim for those invoices. Your attorney has told you that the administrative claim will probably be paid, since it enjoys administrative priority. The attorney told me those claims are on parity with professional fees so maybe it will get paid.

Then you pull the invoices of shipments during the same period and analyze the payment history. Do I have a new value defense? Do I have the ordinary course of business defense? Looks pretty solid, so



David H. Conaway

time to call the trustee's counsel and put this to bed. After a few weeks of emails and phone calls, you finally get a response. Ok, send me your information on new value and payment history and I'll get back to you. Free discovery? Yes, but if I can bury this quickly, no worries so you email the PDF to the trustee's counsel. Depending on when the trustee's 2 year statute of limitations runs, you either hear from counsel quickly, or slowly. Eventually, you get a letter back saying, I've reviewed the information and agree to reduce the demand by the amount of the

new value shipments. But I don't buy your ordinary course defense...you have the burden of proof and I will make you prove it. Translated...I know you won't spend the money to come to court, so instead you will pay me more to settle.

Oh, and by the way, forget about the distribution on your unsecured claim. And forget about getting your 20 day administrative claim paid. Not until we resolve this preference. Translated...I'm using any leverage I can to get more money out of you. You didn't expect this curve ball. Better call counsel. Ok, click on "Contacts"...Shumaker.

What is the trustee saying and can he do this? Not pay my administrative claim? Not pay my unsecured claim? What gives?

The trustee is relying on Section 502(d) of the Bankruptcy Code. It

...the court shall disallow any claim of any entity...that is a transferee of a transfer avoidable under section....547, 548...unless such entity or transferee has paid the amount...for which such...transferee is liable....

The trustee says that "any claims"...my unsecured claim and my 20 day administrative claim...are toast until I pay back the alleged preference payment. Your response: have you read Judge Walrath's recent Delaware opinion in Giuliano v. Mitsubishi Electronics America, Inc. (dated May 1, 2012)? In that case, Mitsubishi timely filed a proof of claim that included a general unsecured claim of \$569,107 and a 20 day administrative claim for \$829,393. The debtor is "Ultimate Electronics" that operated 46 retail electronics stores, primarily in the mid-west and western states.

On July 19, 2011, the Trustee for Ultimate Electronics filed a preference action against Mitsubishi to recover \$4,744,787, and to also "disallow" Mitsubishi's general unsecured claim of \$569,107 and its 20 day administrative claim for \$829,393, both under Section 502(d) above. Mitsubishi filed a motion to dismiss the Trustee's complaint because the complaint didn't specify which debtor entity made the alleged preference payments to Mitsubishi, and because the Trustee's attempt to disallow Mitsubishi's claims was not proper.

Bottom line, the Delaware Court ruled in favor of Mitsubishi, and dismissed the preference action but gave the Trustee the right to amend its complaint to get the parties right. In doing so, the Court stated that Section 502(d) is not applicable unless and until there is a determination" on the preference complaint. "indicial Translated...the Trustee can't hold your claim(s) hostage until the Trustee gets a judgment on the complaint. Which almost never

With this case, the Delaware Court has turned the dial a bit in the preference wars...some leverage back to the creditor.

We hope you have found this useful and that it will be helpful to you in defending and resolving any preference claims you encounter. If you have questions about this issue or this decision, pick up the phone or shoot me an email.

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