

**Q: "I am still working with customers that I know are in financial difficulty. If a customer files for bankruptcy, is there a risk that I may need to return any of the monies I've been paid?"**

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*Answered by Harold Israel and Sean Williams*

The COVID-19 epidemic has and will continue to cause financial distress across all industries. Almost all companies are facing a slowdown in collections, and bankruptcy filings are projected to increase. When a customer files for bankruptcy, there is a risk that funds received from that customer within the 90 days before the bankruptcy case will have to be returned to the bankrupt company. Why? Because these payments are deemed to be "preferences," allowing the creditor to receive the payment to be paid more than other creditors who did not get paid. The Bankruptcy Code provides certain defenses that allow companies to keep these so-called "preferential payments."

The following are things to consider to maximize your recovery and mitigate preference risk associated with dealing with a financially troubled company.

1. **Always take the money.** Even though a

bankruptcy trustee may want to pursue you for a preference claim in the future (seeking the return of monies paid to creditors pre-bankruptcy), it is always in your best interest to accept all payments. Given the number of defenses available to potential preference recipients, creditors rarely are required to give back all that they have been paid.

2. **Require cash in advance before shipping.** A payment can only be a preference if it is made on account of an "antecedent" debt (a debt that arises before its payment, *i.e.*, payments made on credit). There is no "antecedent" debt if payment is made in advance and you will not have to return the payment.
3. **Try and stay within the ordinary course.** The Bankruptcy Code provides that a potential preference may not be avoided if made in the "ordinary course of business." Bankruptcy courts usually look to the number of days between invoice issuance and invoice payment before the ninety-day period and compare it to each payment made during the ninety-day period. Payments made earlier or later than the average days-to-pay are susceptible to avoidance. Thus, you should work with your customers to ensure that payments continue to be made within the "ordinary course of

business."

4. **Apply payments to the oldest invoices first.** A creditor may "credit" the value of any goods or services provided to a debtor after the receipt of payment within the ninety days before a bankruptcy filing against its potential preference liability. In many cases, however, this defense is not available if payments are applied to the newest invoices issued. Therefore, we recommend applying payments to the oldest outstanding invoices first.
5. **Respond to the demand letter.** If you receive a message in advance of a lawsuit demanding repayment or are sued for a preference, your lawyer should be able to review the payments, determine which defenses may be available, and attempt to negotiate a settlement with the plaintiff's counsel. You will most likely obtain a more favorable settlement if you respond to the demand letter with knowledge of your defenses.

