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PRACTICAL LEGAL TIPS



HOW CAN YOU PROTECT YOURSELF WHEN A CUSTOMER GOES BANKRUPT

In the coming months, you may find your customers are having grave financial difficulty and may file for bankruptcy protection. It may shock you when you receive a letter from the bankruptcy court trustee demanding return of payments your customer had made to you within 90 days of their filing for bankruptcy.

WHAT IS A PREFERENCE

When you receive the demand for repayment you are the recipient of a preference action. The bankruptcy trustee has authority under the law to recover certain payments made to creditors within 90 days of the filing for bankruptcy provided the payment meets certain criteria. In essence, a bankruptcy trustee can sue your company to recover payments made by the bankrupt customer in the 90 period prior to the filing of the bankruptcy petition.

WHAT YOU CAN DO TO DEFEND AGAINST A PREFERENCE ACTION

The bankruptcy code provides defenses against a preference action. They include the following:

1. **Contemporaneous Exchange for New Value:** This means that if you hear a customer is having financial trouble you may require that they pay you at the time they purchase the goods or very shortly thereafter. If this is not practical, then understand you may run the risk of possibly having a trustee recover an eventual payment to you later.
2. **Ordinary Course of Business:** This defense is available if you can prove the credit transaction is recurring and is in the ordinary course of your business. You must bear in mind that a Bankruptcy Court's analysis of what is ordinary course will vary from industry to industry.
3. **New Value:** This defense is available when you provide additional products and services as a direct result of receiving payment for prior products and services.

Your business attorney can provide tremendous value to your business by helping you arrange your credit practices with customers so that you have defenses when that preference letter comes in the mail. That preparedness is far preferable to having to give back the payment you received and ultimately ending up with pennies on the dollar.

As always, your trusted legal resource for practical advice.

For more information about me, click below.

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