

Five Quick Tips about Preference Lawsuits That In-House Counsel Should Know

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So your company has either been served with a preference lawsuit or a letter from counsel demanding the return of alleged preferential transfers has been received. There are numerous applicable defenses which could greatly lessen, if not eliminate any liability. However, in addition to the standard defenses that a company should consider, there are other factors and available information that could greatly assist you in settling or resolving a preference lawsuit.

1. What is it? Generally, a preference lawsuit is attempting to recover payments made by the debtor to a creditor within the 90 day period prior to the debtor's bankruptcy filing (the "Preference Period"). Specifically, the debtor may recover an interest of the debtor that was transferred to or for the benefit of a creditor made during the Preference Period while the debtor was insolvent and which allows the creditor to receive more than such creditor would receive if the case were a case under Chapter 7 of the Bankruptcy Code. 11 U.S.C. §547.

2. How do I respond to this demand letter? Usually, your company will receive a demand letter prior to the filing

of suit which will include a general introduction about the applicable bankruptcy case and the itemized amounts that the debtor contends were received by your company during the Preference Period. Within this letter, the debtor will probably offer to settle for 80-90% of the alleged amount. While a demand letter or lawsuit should never be ignored, be mindful that it is possible that the debtor may send out demand letters to see what kind of settlements can be garnered quickly and easily. This may be true even if actual complaints are not intended to be filed. This is especially true in smaller cases. The debtor may have a cutoff of \$10,000 or some other determined amount in which they will not file suit. However, they may send a demand letter to see if a settlement can be secured. 28 U.S.C. §1409(b) requires that an action to recover preferences in an amount less than \$11,725.00 be brought in the defendant's district. It is unlikely that the debtor or trustee will incur the expense to hire counsel in the foreign jurisdiction for these small amounts, but they may send a demand letter. Keep this in mind when determining your response to a demand letter.



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3. Who are you dealing with? It may be worthwhile to review the docket of the underlying bankruptcy case to see both who is pursuing the preference actions and how they have dealt with preference actions previously in this case. First, identify the counsel pursuing the preference case and review the docket. Professionals will most likely need to have court approval for their retention. It may be useful to see how they are being compensated for their work on the preference lawsuits—hourly or on a contingency fee basis. This may be helpful in determining your litigation strategy and when and if to make settlement offers. Further, in many bankruptcy cases, the settlement of preferences will require Court approval. These motions are filed pursuant to Rule 9019 of the Federal Rules of Bankruptcy Procedure and are commonly referred to as a “9019 Motion”. Pull a couple of 9019 Motions from the bankruptcy docket and you might be surprised at their content. The 9019 Motion may show how and for what amounts the debtor is settling other cases based on certain defenses or other circumstances. This information could be useful in determining your settlement strategy.

4. What if I can’t pay the demand? This is called pleading poverty and it is a very common plea by preference defendants. Essentially, if applicable, your company would say that regardless of the merits of the preference lawsuit, we could not pay a judgment even if you were successful. Be prepared for a request for balance sheets, operating reports, tax returns and other documentation to support your claim that you can not pay the demanded settlement amount or that any judgment taken would be uncollectible. Be sure to reach some sort of confidentiality understanding with opposing counsel prior to providing the documents. Also, upon resolution of the case, be sure to ask for the return of the documents and/or that they be destroyed. As a final point, it is better to plead poverty and couple such plea with a nominal offer, as opposed to simply saying we have no money to pay at all. Of course, if the latter option is actually the case, this may mean your company is nearing its own bankruptcy proceeding which may lead to another round of preference lawsuits!

5. What about an “informal exchange” of information? This can be a useful way to resolve a preference lawsuit quickly before incurring substantial litigation expense. Even before a suit is filed in response to a demand letter, you may be asked to provide information and documentation on your alleged defenses. Be sure to carefully review the information that is “informally provided” to the plaintiff’s counsel. By informally exchanging information, you are attempting to persuade plaintiff’s counsel as to the merits of your defenses for a lower settlement or dismissal. What you don’t want to happen is to provide information that could increase your company’s liability. For example, there are times when the preference lawsuit has failed to include all possible payments that could have been recovered in the lawsuit and your provision of information should strictly correspond to the payments actually at issue, the payments itemized in the complaint or demand letter. You do not want to provide information unnecessarily that may lead the plaintiff to amend its complaint or increase its demand. Yes, this information is discoverable and it may need to be disclosed eventually, but, initially, make sure your informal exchange of information is carefully reviewed and strictly in response to the payments made at issue by the plaintiff.

These quick tips are set forth as some general suggestions that may practically assist you in resolving a preference lawsuit or relevant demand. In addition to the above, there are numerous defenses that may be applicable to your preference case. Many of these cases are fact specific and will need analysis on a case by case basis. The attorneys at Ferry, Joseph & Pearce, P.A. are experienced at both prosecuting preference lawsuits and representing preference defendants in the United States Bankruptcy Court. Please do not hesitate to contact us if you should need assistance or to schedule a consultation.