

THE SOURCE

Keep The Payment Received: *Nine Things You Can do to Prevent A Preference Action*

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Everyone in a business knows they are financially vulnerable when a customer has not yet paid a bill. After all, what if the bill is never paid? And these days, we are cynically mindful that the only definitive safety is after the check has cleared.

But how may business people realize they still have an area of vulnerability after a bill has been paid and the check has cleared?

If you want to know if you are at risk, simply ask yourself if it is at all plausible that any of your clients or customers could declare bankruptcy. In the current financial climate, there would be few businesses in any industry that could answer "no" to that question with any comfort.

Thus, the risk exists for all. The fact is that the U.S. Bankruptcy Code, Section 547 called "Preference", allows the Debtor-in-Possession or Trustee to regain payments made within 90 days prior to the filing of Bankruptcy. (That's three months worth of vulnerability after each check has cleared!) This is done to ensure that all creditors are treated alike, preventing the debtor from showing preference for some suppliers at the expense of others.

You could either receive a phone call from the trustee or the trustee's attorney, followed up by a letter of demand, or you may just receive the letter. Should you ever just return the money? Never! These matters are negotiable, especially if the amount is not very large. Although the trustee may file, suit, negotiation is still the bottom line.

Whichever way it goes, your preference should be to avoid the problem altogether. Here are nine procedures you can turn into standard practices to either prevent the situation altogether or be able to defend yourself quite tangibly:

1. **When possible, transform your receivable into a secured debt.** Secured creditors cannot not be sued for Preference.
2. **Be aware of each customer's payment patterns.** If a pattern changes, pursue the reason aggressively. Thus, if a customer always pays slightly late, don't allow them to slip into paying very late. A long-term pattern of slightly late payments may create an "ordinary course of business" defense.
3. **If your customer is seriously late, force collection with partial payments, but be clear that full payment is for current deliveries.** Preferences are only for old debts, not current payables.
4. **Require payment before delivery of more goods, and put this in writing.** This creates a "new value" defense.

5. **If your customer refuses to pay COD, and you are confident he will pay new shipments in a timely manner, make sure that his checks reference the newest invoice.** Additional payment sums can be referenced to older invoices.
6. **Go consignment.** Record a consignment agreement and collect promptly per contract. This demonstrates that the payment is not for a debt and not subject to a Preference action.
7. **Have someone trained in collection techniques who will be firm, friendly and persistent, thus increasing the odds that your customers will pay you as quickly as possible.** Remember: a trustee can go after money received 90 days prior to a bankruptcy filing. Time is always of the essence, and it's the squeaky wheel that gets the payment.
8. **Get a personal guaranty for payment.** Then, if you do have to return the payment, you can collect from the guarantor.
9. **Keep your ears open.** Try to know someone who can tip you off to impending trouble, so you can take early action. Sometimes you can be "in the grapevine" by joining a local chamber of commerce or industry trade association.

If you follow such procedures, you may avoid being involved in a Preference suit. However, if it does happen, you'll want to decide if the amount at issue is large enough to warrant bringing in an attorney. If it is, then these procedures will enable your attorney to have excellent grounds to resist payment or, at the very least, negotiate out of strength for you to return as little of the money as possible.

Don't allow yourself to remain vulnerable; make some changes in your receivable procedures. Remember, the fact that the check has cleared no longer means you're safe.