

I was sued by a bankruptcy trustee for a preference, what is a preference and what should I do?

14 December 2010

It can be quite confusing when receiving a letter from a bankruptcy trustee demanding money from you. This is especially true when you simply received payment for a debt that was owed to you. You may wonder, is something wrong with getting paid for a legitimate debt? Understand that, although usually when someone is demanding you pay them money under the threat of legal action there is some allegation of wrongdoing, in this case there is none. But, you may still have to pay the money back — read on.

A preference under bankruptcy law is a power given to a bankruptcy trustee to “avoid” a transfer of an interest of a debtor that has filed bankruptcy that the debtor has recently given to a creditor. 11 U.S.C. § 547(b). Yes, even regular people and small businesses are creditors if they are owed a debt. A creditor does not need to be a big company.

The general rule is that if a debtor that was insolvent pays a creditor over \$600.00 (total of all payments) during the 90 days prior to the bankruptcy filing date for a prior debt that enables the creditor to make more than they would in the bankruptcy (through distributions of the debtor’s property in bankruptcy) then the amount paid by the debtor must be theoretically returned. In this case, returned to the trustee administering the debtor’s bankruptcy case. The bankruptcy trustee then distributes the funds according to a hierarchy of claims. The “look-back” period if you will, is longer (one year) for people who could be deemed an “insider.” Generally, these are people that are close to the debtor.

The idea is that debtors should not be able to “prefer” certain creditors over others by choosing to pay a creditor they prefer on the eve of bankruptcy and enter bankruptcy without those funds that would have been distributed to all the debtor’s creditors. This supports the idea of fair distribution of assets among creditors of the same class and is one of the two main policy goals of the bankruptcy system; the other more well known policy goal being the debtor’s “fresh start.”

What to do? Hire bankruptcy counsel to evaluate the allegation and to inform you how the law applies to your specific facts. (This is not a do-it-yourself task.) Do not bother with your family attorney, this is specialized subject matter and only an attorney well-versed and competent in bankruptcy matters is appropriate. Bankruptcy counsel can evaluate the strength of the allegation and also determine if you have any pertinent defenses. Unfortunately, you are the victim of your good fortune of getting paid; however, even if the payment fits the elements of the allegation, there still may be hope. There are defenses to the allegations that are listed in the code that may apply. In addition, bankruptcy counsel can negotiate with the bankruptcy trustee with more credibility.

If you have received a demand from a trustee or are considering bankruptcy and are concerned your filing may stimulate such demands from others, feel free to contact us.

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