

What To Expect, and What To Do, Throughout the Preference Litigation Process

Presented by:

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Preference Claim “Life Cycle”

1. Initial indications of customer distress.
2. Bankruptcy filed.
3. Wait.... (as long as 2 years).
4. Demand letter received.
5. Lawsuit filed.
6. Trial.

Customer in Distress

- Investigate exposure.
- Take action to protect and/or enforce rights.
- Continue to do work?
- They want to pay on old invoices, should we take the payment?

Tips for Limiting Preference Exposure

1. Require cash/wire or deposit checks immediately.
2. Get liens (either consensual or statutory).
3. Require payment by a third party.
4. Keep transactions “ordinary”
 - maintain established and consistent invoice and payment/collection policy.
 - require compliance with terms.
 - limit “threats” and dunning letters.
5. If any disputes, consider “settlement”.
6. Keep good books and records.

Should I Accept Payment?

- Permian King, Inc. owes you \$100,000.
- Assume (1) recovery to GUC's is 5% in eventual Permian King bankruptcy, and (2) "strike" demand is 85%.
- Your recoveries:

\$0 paid in 90-day period

\$5,000 (some-time in the distant future)

\$100,000 paid in 90-day period

\$15,000 (assumes you "accept" strike demand and pay back \$85,000 well into the future; might also retain right to assert "bounce-back" claim and recover 5% of the \$85,000, or an additional \$4,250)

Total \$19,250

\$50,000 paid in 90-day period

\$7,500 (return \$42,500)

+

\$2,500 (5% of the \$50,000 claim amount)

+

\$2,125 (5% of the returned \$42,500)

Total \$12,125

Demand Letter

- From “John Smith, Trustee of the Permian King Litigation Creditors’ Trust”.
- Will identify the payments/transfers that you allegedly received within 90 days of bankruptcy petition.
- Will threaten lawsuit.
- Usually will contain “offer” to settle for 85-90 cent payment by you.

What Do I Do?

- Engage counsel.
- Agree or disagree with factual accuracy?
- Gather evidence and support.
 - As to each alleged payment: When received? How paid? From whom? Applied to what?
 - Payment and shipment history to prepare assertion of defenses.
- Respond to demand.

Procedures Order

- Generally motion is filed well-prior to the filing of the preference lawsuits.
- Procedures that apply to ALL preference actions.
- Common provisions:
 - Response/answer extensions granted.
 - FRCP 26 disclosures and pretrial conference stayed.
 - Stay of discovery.
 - Mandatory mediation
 - ❖ within some fixed period of time
 - ❖ sharing of costs
 - ❖ conducted at Court location

Trustee Considerations and Motivations

- Time
- Cost
- Obtaining resolutions
- Avoiding trial
- Avoiding the unusual or novel issue

Trial Considerations

- Likely one day for trial.
- Plaintiff witnesses: trustee and possible expert.
- Defense witnesses: AR/credit rep, possible sales/shipping rep and possible expert.
- Issues:
 - Trustee's prima facie elements.
 - Your defenses, including establishment of any new value and billing/payment history.