

**ARE THE TIDES TURNING IN FAVOR  
OF LESSORS AND SECURED CREDITORS  
IN PREFERENCE BATTLES?**

One of the many frustrating issues a creditor can face in the bankruptcy world is a preference claim asserted against it by a trustee (or a debtor in possession). It is rare that the “preferential” payment received prior to the bankruptcy filing satisfied the indebtedness. Rather, for an equipment lessor, and most creditors facing this claim, there exists unpaid pre-petition and post-petition debt and the demand for payment of the alleged pre-bankruptcy preference adds salt to the proverbial wound. While there is some “preference planning” in which creditors can engage to structure workouts and forbearance agreements to minimize preference risk, in most cases the demand for return of payments received in the 90 day pre-bankruptcy filing period is a “shot-gun” effort by the trustee to capture any and all payments received during this heightened time period.

To briefly review the relevant statute, the Bankruptcy Code provides in Section 547(b) that the trustee (or debtor in possession) may recover, as an avoidable “preference”, transfers of property, including payments or granting of security interests, to a creditor made (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made on or within 90 days before the date of the filing of the (bankruptcy) petition; and (5) that such payment enables the creditor to receive more than it would upon a liquidation of the debtor’s estate (Chapter 7). The congressional purpose behind this enactment was to allow for all general unsecured creditors to equally bear the losses suffered by the bankrupt entity.

Several statutory defenses exist which may provide a creditor with the tools necessary to combat a preference claim. This Alert focuses on a recent case which arms lessors with support for a “new value” defense. Section 547(c)(4) of the Bankruptcy Code provides that the “trustee may not avoid...a transfer to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor.” Lessors are often confronted with the dilemma of receiving a payment prior to bankruptcy from a lessee and then the debtor/lessee fails to make subsequent payments. We have often argued that the subsequent lease to, and use by, the lessee of equipment should be “new value” that the lessor is giving to the lessee with the right to offset this new value against the preferential payments received. With this defense, a creditor is able to apply the amount of the alleged preference towards subsequent advances of new value until the preferential amount is depleted.

The critical inquiry by the court when deciding a preference action and, specifically, in determining if new value has been given by the creditor is whether the new value has replenished the estate. Often the plaintiff in a preference action will argue that no benefit was derived from the new value, no replenishment occurred and the defense should fail accordingly. Benefit to the estate is not always clear. In the often chaotic weeks and months leading up to the filing of a bankruptcy, benefit derived by an insolvent from new value may be difficult to ascertain and often even harder to prove.

A recent decision in the United States Bankruptcy Court for the Eastern District of Missouri, Omniplex Comm.Group, LLC v. GE Capital Corp., 297 B.R. 573 (Bankr. E.D. MO 2003), may indicate a shift in the courts from the strict adherence to the debtor protective requirement of “the replenishment of the estate”. In Omniplex, the trustee sought recovery of an alleged preferential payment made to GE Capital Corporation (“GE”) by the debtor. GE leased equipment to the debtor and the preferential payment at issue related to the monthly lease obligation. The leased equipment was delivered unassembled and remained in the same condition in a temporary staging area. At a future point in time, the leased equipment was to be moved to various locations where it would be installed. Although the debtor never used the leased equipment and despite the fact that the leased equipment would not be installed and working for some time, it agreed in the underlying lease agreement to immediately begin making monthly payments upon delivery.

The Omniplex court discussed and eventually applied the holdings of In re S. Technical College, 89 F.3d 1381(8th Cir. 1996) and In re Jet Florida Systems, Inc., 841 F.2d 1082 (11<sup>th</sup> Cir. 1988). In these two prior decisions, the courts held that a benefit must be derived by a debtor’s estate from the new value in order for the creditor to successfully defend a preference claim. In these cases, which dealt with rental payments for the occupancy of real property, the court only found new value where the debtor actually used and occupied the property.

Notwithstanding the fact that these prior rulings concentrated on “use” of the property, the Omniplex court nevertheless held, based on those very same rulings, that new value was given by GE. The trustee was not able to recover the payments made to GE during the 90 days before the bankruptcy to the extent that subsequent payments were not made. The court relaxed the requirement that the debtor actually use the equipment and stated that although the debtor did not actively use the leased equipment, its “opportunity and intent to use it provided a material benefit to the debtor.” A leasing company now has support for its claim that making equipment or property “available for use” can be a defense to a preference claim.

## CONCLUSION

The Omniplex decision may very well mark a shift in the way courts decide preference actions when creditors set forth a new value defense. The strict standard of “use”, which is often difficult to establish, has been eased to “opportunity and intent to use” and provides a new arsenal in the defense of preference claims. The shift is also consistent with the Code’s requirement that post-bankruptcy lease payments be made to real property and equipment lessors until rejection of the lease regardless of actual use of the property.

*Moritt Hock Hamroff & Horowitz LLP is a broad based corporate law firm with more than 25 lawyers and a staff of paralegals. The firm has extensive experience in litigation; creditors’ rights and bankruptcy; real estate law; tax & trusts and estate; direct marketing; advertising & new media; intellectual property & unfair competition; general corporate; financial services; secured lending & leasing.*

*This Alert was written by Marc L. Hamroff and Erica R. Feynman. Mr. Hamroff, a partner with the firm, heads up the firm’s financial services group which includes, among others, its creditors’ rights, secured lending, bankruptcy and equipment leasing practice areas. Ms. Feynman’s practice concentrates in commercial litigation, equipment leasing, creditors’ rights and bankruptcy.*

*Any questions concerning the matters raised in this Alert should be addressed to either Mr. Hamroff or Ms. Feynman. Mr. Hamroff and Ms. Feynman can be reached at (516) 873-2000 or by e-mail at mhamroff@moritthock.com and efeynman@moritthock.com.*