LOFARO & REISER, LLP
55 HUDSON STREET
HACKENSACK, N.J. 07601
TEL: (201) 498-0400
WEB: www.njlawconnect.com

PREFERENCES AND FRAUDULENT CONVEYANCES: AN OVERVIEW

A. Preferences.

1) Defined: Preferences are transfers of a debtor's property to a creditor, or to benefit a creditor, for payment of a prior debt, which results in the creditor receiving more than the creditor would have received in a Chapter 7 Bankruptcy if the property had not been transferred.

2) Insolvency Presumed Within 90-days of Bankruptcy Filing.
The transfer must occur when the debtor is insolvent and, generally, within 90 days before the bankruptcy filing. For the purposes of this section, the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition. See Section 544 of the Bankruptcy Code.

3) 1-Year Period For Transfers to Insiders. Transfers to "insiders", which includes relatives, general partners, and directors or officers of the debtor, made up to one year prior to the filing of a bankruptcy, may be avoided or undone. In addition, the Trustee may be able to avoid transfers under applicable state law, which may provide longer time periods. See Section 547(b) of the Bankruptcy Code.

B. Exceptions to Preference Claims – Trade Creditors Defenses Under Section 547(c) of Bankruptcy Code

1) Contemporaneous Exchange for New Value. Trustee may not avoid a transfer if it is made for a substantially contemporaneous exchange for new value.

2) Ordinary Course of Business. Trustee may not avoid transfer if it represents a payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee.

3) Purchase Money Security Interest. Trustee may not avoid a transfer that creates a security interest in property acquired by the debtor:

a) given at or after the signing of a security agreement that contains a description of such property as collateral;

b) given by or on behalf of the secured party under such agreement;

c) given to enable the debtor to acquire such property; and

d) in fact used by the debtor to acquire such property, and perfected on or before 20 days after the debtor receives possession of such property

4) Subsequent Advance Rule. 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 -
a) not secured by an otherwise unavoidable security interest; and

b) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

NOTE: The subsequent advance rule may apply to a creditor who extends credit or ships goods, receives payments and subsequently makes new shipments or extensions of credit. The fact that the new shipment or extension of credit was part of a different transaction does not prevent a court from shielding the prior repayment. The majority of courts permit an extension of new value to be applied to set-off any preceding preferential payment.

5) Perfected Security Interest in Inventory or a Receivable or the Proceeds Thereof. The trustee may not avoid a transfer that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of –

a) (i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or (ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

b) the date on which new value was first given under the security agreement creating such security interest.

C. Fraudulent Transfers and Obligations.

1) Elements of Fraudulent Transfer Claim: Pursuant to Section 548 of the Bankruptcy Code, the trustee may avoid certain transfers of an interest of the debtor in property, or any obligation incurred by the debtor, that:

a) Was made or incurred on or within one year before the date of the filing of the petition.

b) Was voluntarily or involuntarily made such transfer or incurred such obligation with actual intent to hinder, delay, or defraud creditors, or, the debtor received less **than a** reasonably equivalent value in exchange for such transfer or obligation.

c) Was made when the debtor was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation.

2) Bankruptcy Court May Apply State Law Governing Fraudulent Conveyances.

a) Section 544 of the Bankruptcy Code permits the trustee to avoid any transfer of an interest of the debtor in property...that is voidable under applicable law. Thus, the trustee may rely upon state fraudulent conveyance statutes to avoid fraudulent transfers.
b) New Jersey Fraudulent Conveyance Laws. In New Jersey, two statutes exist that assist defrauded creditors in enforcing their rights against debtors.

i) The New Jersey Fraudulent Conveyance Act ("NJFCA"). This statute provides that "every conveyance… of real estate… contrived in fraud…with intent to hinder, delay or defraud creditors…shall be deemed utterly void…" (N.J.S.A. 25:2-1, et seq.). Prevailing under the NJFCA is difficult because of, among other things, the tough burden of proving the grantor's deceptive "intent". The NJFCA does not contain a specific time period to file an action to set aside a fraudulent conveyance, however a recent ruling suggested a 1-year time period from the date the creditor knew or should have discovered the transfer.

ii) The Uniform Fraudulent Transfer Act ("UFTA") found at N.J.S.A. 25:2-20, et seq. The definition under the UFTA broadens the scope of fraudulent conveyances to include present and future transfers and obligations incurred. In certain instances, the burden of proving "intent" under the UFTA is removed. In contrast to the NJFCA, the UFTA generally provides for a four (4) year limitation period (N.J.S.A. 25:2-31). Accordingly, in order to determine the full extent of creditors' rights, the NJFCA and UFTA must both be considered.