

CREDITOR'S RIGHTS TOOLKIT

What Is the Contemporaneous Exchange Defense to a Preference Action?

Preferences are a common issue in bankruptcy proceedings. A general overview of preferences in bankruptcy can be found [here](#)¹. The Bankruptcy Code provides several affirmative defenses to assist creditors in mitigating or eliminating their preference exposure. We have previously addressed the new value defense² and the ordinary course of business defense³. This article will briefly address another common affirmative defense: the contemporaneous exchange defense.

Just like the other affirmative defenses, the contemporaneous exchange defense encourages creditors to do business with companies that may otherwise face bankruptcy. Codified in 11 U.S.C. § 547(c)(1), the contemporaneous exchange defense protects transfers that both the debtor and creditor at the onset intended to be a contemporaneous exchange for new value given to the debtor. Specifically, to effectively utilize this defense, a creditor must show that (i) the transfer was intended as a contemporaneous exchange of new value given to the debtor, (ii) the transfer was, in fact, a substantially contemporaneous exchange of new value. An example of a contemporaneous exchange for new value is a cash-on-delivery exchange where the goods or service are provided at or about the same time as the payment.

Key Issues

When asserting this defense, there are at least three key things to keep in mind:

- **MUTUAL INTENT**

To successfully assert this defense, the creditor must show that the parties intended for the transfer to be contemporaneous. This determination is fact-intensive, and a creditor should provide any writings or communications between it and the debtor that establishes the requisite intent. The creditor could also point to any historical conduct or dealings between the parties to show intent. Failing to adequately show the existence of mutual intent will be fatal to the defense.

¹ See [How Can You Protect and Defend Your Business From Preference Actions? TPL_CreditorsRightsToolkit_ProtectAndDefendYourBusiness.pdf](#) (troutman.com)

² See [What Is the New Value Defense to a Preference Action? TPL_CreditorsRightsToolkit_WhatIsTheNewValueDefense.pdf](#) (troutman.com)

³ See [Preference Actions: What Is The Ordinary Course of Business Defense? TPL_CreditorsRightsToolkit_PreferenceActions.pdf](#) (troutman.com)

- **CONTEMPORANEOUS EXCHANGE**

As stated above, this affirmative defense requires that the exchange actually be contemporaneous. Therefore, the timing of the payment and exchange is important. Note that jurisdictions disagree on when a “contemporaneous” exchange occurs. Generally, cash provided on delivery of goods or services may be considered a contemporaneous exchange, while payments on credit may not. Payments by check may be contemporaneous even if they are not deposited immediately upon delivery. Courts may or may not find that deferred or delayed payments constitute contemporaneous exchanges. As a contemporaneous exchange is a required element for this defense, a creditor would be wise to figure out how the relevant jurisdiction views this issue.

- **NEW VALUE**

For this defense to be successful, new value must be provided to the debtor. What constitutes new value is flexible and broad, and may include goods, services, or a release of an interest or lien. Note that courts consistently hold that forbearance of a loan does not constitute new value.

Takeaway

In addition to the new value and ordinary course of business defenses, the contemporaneous exchange defense provides a path to circumvent or otherwise eliminate preference exposure. However, the applicability of the contemporaneous exchange defense, must be carefully reviewed to determine whether a creditor may assert this defense. Creditors should retain competent counsel to assist with this determination.