

When Dealing with Payments to Creditors Timing is Everything

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Scenario: A company files for bankruptcy protection. Prior to the bankruptcy filing, a creditor sued the company for monies owed. Less than one year and more than ninety days before the bankruptcy filing, the creditor obtained a judgment against the company and recorded it in the public records. Thereafter, in order to collect on the judgment, the creditor obtained a writ of garnishment and served it on the bank where the company has its bank account. Within the ninety day period prior to the bankruptcy filing (the "Preference Period"), the creditor seized money from the bank account, satisfying the judgment in full. Can the trustee in the bankruptcy case sue this creditor for a preference claim, under section 547 of the Bankruptcy Code?

Generally speaking, according to section 547 of the Bankruptcy Code, when a debtor makes a payment to a creditor during the Preference Period, while the debtor is insolvent, the trustee of the bankruptcy estate can bring a preference action against the creditor to avoid the debtor's payment. *See*, 11 U.S.C. § 547(b). The purpose of the trustee bringing such an action on behalf of the bankruptcy estate is to collect this money to pay the debtor's other creditors.

Under prior Florida law, a garnishment lien arose only upon the entry of a final judgment in favor of the garnishor. However, under current Florida law, Fla. Stat. § 77.06, the service of a writ of garnishment creates a lien on the garnished funds and that lien dates from the time of service of the writ. Therefore, in our scenario, the creditor's lien on the garnished funds was created outside the Preference Period, which is the date that the bank was served with the writ. *See*, In re Advantage One Mortgage Corp., 2008 WL 5170553, 2 (Bankr. S.D. Fla. 2008).

According to the applicable case law, funds collected by a creditor from a garnishee, within the Preference Period, does not constitute a preferential transfer where the writ of garnishment was served on the garnishee outside the Preference Period. *See*, In re Ryder, 59 B.R. 868 (Bankr. S.D. Fla. 1986).

Furthermore, the pertinent case law provides that if a creditor becomes secured by virtue of a lien prior to the Preference Period, a transfer to that secured creditor in satisfaction of the lien during the Preference Period does not constitute an avoidable preference because the creditor did not receive more by the delayed payment than it would have received in a Chapter 7 case. *See*, In re Daddy's Money of Clearwater, Inc., 155 B.R. 788 (Bankr. M.D. Fla. 1993).

In our scenario, the creditor obtained a lien on the garnished funds when the bank was served with the writ of garnishment, which was outside the Preference Period. At that time, the creditor became a secured creditor. Therefore, even though the creditor garnished funds from the debtor's bank account during the Preference Period, it does not constitute a preferential transfer. However, if the creditor had obtained the lien on the garnished funds during the Preference Period (and garnished the funds during the Preference Period), then the creditor would very likely be subject to a preference claim in the bankruptcy case.

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