

BACKGROUND: Bankruptcy Law as it relates to the Customs Broker

The Trustee: When an importer files for Chapter 7 bankruptcy, a Trustee is appointed. The Trustee's responsibilities include reviewing the debtor's petition and bringing actions against third parties to recover money and property for the benefit of the bankruptcy estate.

Preference Action: Section 547(b) of the Bankruptcy Code allows the Trustee to bring a preference action against any creditor who received money or property from the importer/debtor in the 90-day period prior to the filing of the bankruptcy petition, known as the "clawback" period. The purpose of this provision is to prevent the importer from showing preference to one creditor over another by paying them before he files for bankruptcy.

A preference action applies to any customs broker who either advanced duties to CBP on behalf of the importer/debtor or who collected the duties in advance and then paid money to CBP. If the money transfer from the importer to the broker occurred in the 90-days prior to the date the bankruptcy petition was filed, the broker may have to pay an equivalent sum to the bankruptcy estate – *even though the money was already used to pay duties to CBP!*

Example: During the 4th quarter of 2018, XYZ Customs Brokerage cleared shipments and paid duties totaling \$75,000 on behalf of Happy Importer, LLC. In October and November, Happy Importer paid XYZ a total of \$75,000 to repay the customs duties. On December 20, 2018, Happy Importer filed for bankruptcy. As the bankruptcy proceeding progressed, XYZ was served with a complaint from the Trustee claiming that a preferential payment had been made and demanding the \$75,000 be paid to the bankruptcy estate.

In some jurisdictions, the customs broker has successfully defended against such a claim based on defenses available under the Bankruptcy Code. However, in other jurisdictions, customs brokers were forced to repay the duties they had already paid to CBP.

Customs "Priority": The Bankruptcy Code (Section 507) sets out certain priorities for claims of creditors. These claims have greater priority than those of other unsecured creditors when the estate is liquidated. Moreover, having priority status gives an added layer of protection in a preference action – since if your claim will have priority status in the bankruptcy proceeding, a payment during the 90-day clawback period is not likely to be considered a "preferential" payment.

One such priority under Section 507 is for claims by Customs for duties arising out of the importation of merchandise. The irony, of course, is that customs brokers have already paid the duties to CBP, so the priority is rarely needed by the agency. Yet, the law does not allow customs brokers to avail themselves of Customs' statutory priority.

A Better Solution - Subrogation: Generally, when a creditor pays a debtor's debt owed to another creditor (for example, the US government), the paying creditor is *subrogated* to the rights of the creditor receiving payment. In effect, the paying creditor can "stand in the shoes"

of the receiving creditor. Since CBP is granted a "priority" under the Bankruptcy Code for claims against a bankrupt importer, any payment directly to the agency from the importer during the 90-day claw-back period would generally not be considered a preferential payment. If a customs broker could be subrogated to the priority rights of CBP, any payments from the importer to CBP *via the customs broker* during the 90-day period would likewise no longer be subject to a preference payment recovery action.

Subrogation rights are derived from common law and ordinarily would come into play, except for the fact that Section 507(d) of the Bankruptcy Code specifically disallows subrogation with respect to most of the enumerated priorities. Therefore, the best solution for customs brokers is a small change to Section 507(d) that, in effect, would allow subrogation for customs brokers who have paid duties to the government on behalf of a bankrupt importer.