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Introduction

Thank you for reading our second issue of 2006 of the Preference Quarterly Law Journal. Also, be on the lookout for the Preference Quarterly's web site, coming soon!

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Customs Brokers and the “Conduit Defense” Under § 550 of the Bankruptcy Code

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Have you heard

In recent years, preference defendants have tried using the “Section 502(d) Defense.” This defense, based on 11 U.S.C. § 502(d) and first recognized in LaRoche Indus. v. Gen. Am. Transp. Corp. (In re LaRoche Indus.), 284 B.R. 406 (Bankr. D. Del. 2002), argued that if a debtor objects to a preference defendant’s claim, and the matter was resolved, the debtor could not pursue the defendant on a preference. The theory was rejected by other courts, e.g., Rhythms Netconn., Inc. v. Cisco Sys., Inc. (In re Rhythms Netconn.), 300 B.R. 404 (Bankr. S.D.N.Y. 2003), and even in subsequent Delaware decisions. See TWA Inc. Post Conf. Estate v. City & County of S.F. Airports Comm’n (In re TWA Inc. Post Conf. Estate), 305 B.R. 221 (Bankr. D. Del. 2004). Last month, the Delaware District Court rejected the Section 502(d) Defense. Caliolo v. Saginaw Bay Plas., Inc. (In re Cambridge Indus. Holdings, Inc.), 2006 U.S. Dist. LEXIS 7939 (D. Del. Mar. 2, 2006). Given the LaRoche’s unpopularity, the Section 502(d) Defense may have seen its last days.

Due to the complexities of international trade, importers and exporters often obtain the services of a customs broker to facilitate the transfer of goods. Customs brokers serve as the “middle men” between importers, exporters, purchasers and sellers of goods by assisting importers with shipment routes, carrier options, tariff schedules, customs regulations and the like. As the “middle man,” a critical service customs brokers offer to importers is the payment of fees, freight and shipping costs to the appropriate entities. Customs brokers achieve this by either (i) serving as an intermediary between the importer and those parties owed for these costs (the “agency approach”), or (ii) advancing funds on behalf of an importer to the parties owed these costs (the “advancement approach”).

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28 U.S.C. § 1409(b): How Do Recovery of Consumer Debts Relate to Recovery of Preferences?

By The Editors

Occasionally, we come across preference-related issues that are (somewhat) interesting but that do not warrant the kind of quality analysis and discussion typical of the Preference Quarterly. One such issue is the question of to what extent recovery of a consumer debt, as set forth in 28 U.S.C. § 1409(b), might include a preference recovery.

Section 1409 of title 28 governs venue of bankruptcy proceedings. Subsection (b) provides some protection to remote defendants by requiring the bankruptcy trustee to bring certain types of proceedings in the defendant's home district. Immediately prior to enactment of the BAPCPA, § 1409(b) provided, in part:

a trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover a money judgment of or property worth less than \$1,000 or a consumer debt of less than \$5,000 only in the district court for the district in which the defendant resides.

Accordingly, an action to recover a consumer debt of less than \$5,000 must be brought in the defendant's home court. A consumer debt is defined in 11 U.S.C. § 101(8) as a "debt incurred by an individual primarily for a personal, family, or household purpose." Without attempting to define the outer limits of consumer debts, the general nature of a consumer debt seems obvious. A good example of a consumer debt is provided in the Senate Report accompanying S. 2266 (S. Rep. No. 95-989 (1978)), which was substantially similar to H.R. 8200 that was codified as the Bankruptcy Reform Act of 1978. The Senate Report states that the purpose of the subsection

(b) of the proceeding venue statute is to protect "distant debtors of the estate."

For example, if a store doing a major part of its business through catalog sales took bankruptcy, the trustee could not file suit in the bankruptcy court in which the case is pending to collect from customers owing for merchandise ordered from catalogs. The debts owed by such customers generally speaking would be consumer debts.

S. Rep. No. 95-989, at 155 (1978).

This is straight-forward. A consumer incurs a consumer debt when it purchases goods for personal, family, or household purposes, such as those from a catalog, and any attempt to recover on that debt by a bankruptcy trustee runs afoul of the § 1409(b) floor. However, could "recovery of a consumer debt" be interpreted in a way that the \$5,000 consumer debt floor would apply to a preference action?

The National Bankruptcy Review Commission evidently believed it could. In its Final Report, the Commission suggested changes to § 1409(b) solely to address preference concerns. It recommended that the venue floor for *non*-consumer debts be raised to \$10,000 to "protect smaller trade creditors from certain preference litigation tactics." Nat'l Bankr. Rev. Comm'n, Bankruptcy: The Next Twenty Years 799 (1997). However, the Commission recommended that the \$5,000 floor remain with respect to consumer debts so that a "trustee for consumer cases will not have to litigate in the creditor's forum unless **the transfer** is for less than \$5,000." Id. (emphasis added). The burden of the split-floor amounts was to fall on business debtors "and not on those seeking to recover on consumer debts (mostly consumer debtors)." Id. at 800. Apparently, the Commission believed that recovery of a preferential transfer made on account of a consumer debt represented an

effort to “recover a consumer debt” and thus subject to the § 1409(b) floor.

Congress either disagreed with this assessment or was not thinking when it enacted its amendments to § 1409(b) in BAPCPA. Either or both are strong possibilities. In BAPCPA, Congress not only raised the consumer debt floor in § 1409(b) counter to the Commission’s recommendations, but it raised the floor to \$15,000 – well beyond the \$10,000 non-consumer floor recommended by the Commission and enacted in BAPCPA. Why such a discrepancy?

Giving credit to Congress, the substantial increase in the floor provides additional protections to consumers when they are sued by debtors to collect on the types of debts described in the Senate Report. Under BAPCPA, debtor Catalog Co. must clearly sue to collect on Mr. Smith’s fishing pole and DVD purchases in Mr. Smith’s home court unless his debt is \$15,000 or more. But do the changes to § 1409(b) mean that a **consumer** trustee, seeking to recover a preferential transfer made on account of a consumer debt, must bring the action in the defendant’s home court unless the preference is \$15,000 or more?

Now that the floor has been raised to such a high level, the issue is worth litigating. Our admittedly perfunctory search failed to find any cases discussing this question. However, we note that the Commission’s interpretation, which has the consumer as plaintiff and bankruptcy debtor, places the parties in almost the exact opposite roles as that envisioned by the Senate Report, which has the consumer as defendant and a debtor of the estate. According to the Commission, the recovery of a preference may be the recovery of a consumer debt - presumably because the transfer in question was made on account of a consumer debt. The consumer trustee is recovering consumer debt payments that happened to be preferential. But recovering consumer debt payments may not be the same as recovering a

consumer debt itself. The debt being recovered by a consumer trustee is the debt owed (or incurred) by the preference defendant to the estate. Referring to the definition of consumer debt, the debt in question – the obligation to return avoided transfers – would not seem to be incurred by the preference defendant primarily for a personal, family, or household purpose. Upon avoidance, the debt owed by the preference defendant to the estate might be “incurred” solely for the public policy purposes found within § 547. In short: does the debt obligation “incurred” by a preference defendant upon avoidance meet the definition set forth in § 101(8)?

While we have our suspicions, we do not take a firm stand on this issue. The new \$15,000 floor makes the issue more interesting, and we would welcome any comments our readers might provide. However, this discussion may be mooted by an even more fundamental question: do **any** of the venue provisions in § 1409(b) apply to preferences at all? This we address in our next issue.

* * *

Customs Brokers and the “Conduit Defense,” continued from page 1

Under the agency approach, the customs broker collects funds from the importer and transmits them to the appropriate entities. Under this approach, as the customs broker is transmitting funds on the importer’s behalf, the broker is merely acting as a transfer agent for the importer. While this approach minimizes the agent’s role, it is not the most efficient method, as it causes payment delays that can inconvenience the client and ultimate payee. As a result, most customs brokers and their customers prefer the advancement approach.

The advancement approach is different in that the customs broker pays the fees, freight and shipping costs up front for the importer as they come due, and then turns to the importer

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for repayment. In essence, the advancement of funds is a short-term loan by the customs broker to the importer. Under the advancement approach, the customs broker takes the risk that the importer will not repay the advancement.

Upon an importer's bankruptcy, the broker who was paid for previously advanced funds by the importer debtor faces preference liability. Section 547(b) of the Bankruptcy Code permits the trustee (or a DIP) to avoid a transfer of property by the debtor made: (i) to or for the benefit of a creditor; (ii) for or on account of an antecedent debt; (iii) while the debtor was insolvent; (iv) on or within 90 days before the bankruptcy petition was filed (the "Preference Period"); (v) which enabled the creditor to receive more than it would if the case was filed under chapter 7 and the transfer had not been made. 11 U.S.C. § 547(b).

Since the customs broker becomes, in effect, a lender by advancing funds for an importer debtor, the customs broker becomes a creditor. Thus, repayment of advancements by the debtor during the Preference Period likely satisfies each part of § 547(b), and customs brokers run the risk of preference liability.¹

This article focuses on the advancement approach and the legal dilemmas faced by customs brokers using this method. It also considers the preference liability that customs brokers risk when advancing funds for an importer who later files bankruptcy, and summarizes the arguments available to them to

¹ Even though the customs broker faces less risk under the agency approach, that approach does not leave the customs broker without any risk. The importer debtor's payment to the customs broker for commissions or broker fees during the Preference Period still may be pursued as a preference. However, the risk is not as great since the payments, if timely made, are typically small, and may be protected from attack if shown to be in the ordinary course of business.

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avoid, or at least reduce, the risk of preference liability when advancing funds for importers.

Is the Customs Broker a "Creditor" Under § 547(b)?

A customs broker who advances funds for an importer and is then repaid during the Preference Period may contend that the transfer was not made "to or for the benefit of a creditor" because the customs broker merely is serving as an intermediary or transfer agent for the importer, not a creditor. Accordingly, the transfer should not qualify as a preference under § 547(b). Unfortunately, this argument most likely will fail. A "creditor" under the Bankruptcy Code is any entity that has a claim against the debtor that arose at or before the bankruptcy petition was filed. 11 U.S.C. § 101(10). The fact that a customs broker is serving as an intermediary or transfer agent for the importer does not preclude its status as a creditor, because by advancing funds for the importer debtor, it has engaged in a credit transaction.

In Fonda Group, Inc. v. Marcus Travel (In re Fonda Group, Inc.), 108 B.R. 956 (Bankr. D.N.J. 1989), the bankruptcy court reviewed a transaction analogous to the advancement approach. The debtor transacted business with the defendant, a travel agent. Prior to the debtor's bankruptcy filing, the defendant received several checks from the debtor for past travel arrangements furnished. Id. at 957-58. But as a prerequisite to selling airline tickets, the defendant travel agent had to open a special bank account separate from its operating account. Airline Reporting Corporation ("ARC"), a third-party owned by the major airlines, was granted authority to withdraw funds from the account once tickets were issued, to cover the ticket price. Id. at 960. ARC withdrew funds for tickets fees regardless of whether customers paid the defendant. This resulted in the defendant having to make advances into the account to cover ARC's withdrawals. Id. After the debtor has paid the

defendant for the purchase of tickets, it then filed for bankruptcy, and sought to recover the transfers. The defendant argued that it was merely an intermediary, as it used funds received from the debtor to repay its advances to the account. The bankruptcy court rejected this, and held that an intermediary advancing monies on behalf of another party has engaged in a credit transaction. *Id.* The court reasoned that because ARC's withdrawals from the defendant's account resulted in the ticket purchasers owing the defendant, the transfers were credit transactions regardless of the fact that defendant acted as intermediary between ARC and the client. *Id.*

When a customs broker advances funds to entities for an importer, courts are likely to follow *Fonda Group*, and view the relationship between the broker and importer as that of a debtor and creditor, not simply one of agency.

The "Conduit Defense" Under § 550 of the Bankruptcy Code

When a transfer is avoided, § 550 of the Bankruptcy Code allows recovery of the transferred property from the "initial transferee of such transfer or the entity for whose benefit such transfer was made" 11 U.S.C. § 550(a). However, the Bankruptcy Code does not define the term "initial transferee." As a result, issues arise as to whether an entity serving as an intermediary between the debtor and other parties is liable as an initial transferee.

To determine whether a party is a "transferee" under § 550, courts use the "dominion and control test" to determine whether the alleged "transferee" has ever maintained possession of the property subject to the preference claim. *Nordberg v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1199 (11th Cir. 1988). However, under the dominion and control test, courts are flexible and look beyond the transfer in question to consider all the circumstances

surrounding the transaction. *Id.* at 1200. This may avoid inequities that arise if recovery is allowed against a party solely because the party received the assets transferred, even if it never actually exercised control over such assets. *Id.* This is often referred to as the "conduit" defense.

Bonded Financial Services, Inc. v. European American Bank, 838 F.2d 890, 893 (7th Cir. 1988), first set forth the conduit defense, holding that where an intermediary receives property of the debtor but exercises no dominion over it, the intermediary is not a transferee subject to preference liability, but a "mere conduit" of the transferred funds. *Id.* All of the circuits that have addressed this issue have generally followed *Bonded Financial*, denying recovery from an entity receiving the transfer when it simply acted as a conduit. See *Christy v. Alexander & Alexander of N.Y., Inc. (In re Finley, Kumble, Wagner, Heine, Underburg, Manley, Myerson & Casey)*, 130 F.3d 52, 56 (2d Cir. 1997); *Rupp v. Markgraf (In re Rupp)*, 95 F.3d 936, 942 (10th Cir. 1996); *Coutee v. Brunson (In re Coutee)*, 984 F.2d 138, 140-141 (5th Cir. 1993); *First National Bank of Barnesville v. Rafoth (In re Baker & Getty Fin. Servs., Inc.)*, 974 F.2d 712, 722 (6th Cir. 1992); *Chase & Sanborn Corp v. Societe Generale (In re Chase & Sanborn Corp.)*, 848 F.2d 1196, 1199-1200 (11th Cir. 1988); *Richardson v. United States (In re Anton Noll, Inc.)*, 277 B.R. 875, 878-79 (BAP 1st Cir. 2002). In each case, the court makes an important distinction between the "initial recipient," or the first entity to touch the disputed funds, and the initial transferee under § 550.

In *Bonded Financial*, the debtor corporation, Bonded Financial, sent a check to the bank of its principal with a note directing the bank to deposit the check into the principal's account at the bank. *Bonded Financial*, 838 F.2d at 891. Ten days later, the principal instructed the bank to debit his

account and apply the funds to an outstanding personal loan the principal owed the bank. Id. When Bonded Financial filed for bankruptcy, the trustee sought recovery of the transferred funds from the bank as the initial transferee, since it was the payee of the check from Bonded Financial. Id. at 893. In an opinion by Justice Easterbrook, the Seventh Circuit held that the bank was not the initial transferee: it only became a transferee under § 550 when the principal's account was debited to pay off the bank's loan, *not* when the funds were deposited by the debtor. Id. Since the principal had the funds in a personal account for ten days before transferring them to the bank, the principal had discretion and dominion over the funds to put them to his own use. Id. The principal was "free to invest the whole in lottery tickets or uranium stocks," and the bank was not the initial transferee. Id. at 894. In other words, the bank merely acted as a transfer agent between parties, and as such, should not be subject to preference liability arising from the transfer. Id.

Although the conduit defense has been accepted, some courts limit the defense to cases where the transfer in dispute is a "two-step transaction." Specifically, some courts have held that for the conduit defense to apply, the facts must be akin to those of Bonded Financial, with A giving funds to B as an agent for C. See In re Incomnet, Inc., 299 B.R. 574, 579 (BAP 9th Cir. 2003); In re Larison, 2005 WL 2179060, *8 (Bankr. D. Idaho 2005) (citing Incomnet).

In Incomnet, the debtor was a telecommunication provider who transferred funds to Universal Service Administrative Company ("USAC"). USAC was a nonprofit corporation that collected, managed, invested and disbursed funds for the Federal Communication Commission through the "universal service" program established by the Telecommunications Act of 1996. Incomnet, 299 B.R. at 575-76. Under the program, the

USAC disbursed funds collected by telecommunication providers to schools, libraries, health care providers, low-income customers and the like to subsidize the cost of telecommunication services. Id. at 576. During the preference period, the debtor transferred \$470,000 of contributions to USAC. Id. The creditors' committee filed a suit to avoid the \$470,000 in transfers, but the bankruptcy court granted summary judgment in favor of USAC. The bankruptcy court reasoned that since USAC lacked the requisite degree of dominion or control over the transferred funds, it was not a "transferee" and the conduit defense precluded liability. Id. The creditors committee appealed.

On appeal, the Bankruptcy Appellate Panel ("BAP") reversed. The BAP noted that the transfer at issue was not a two-step transaction, as USAC did not collect the funds as an agent for a third party. Id. at 580. Further, while it disbursed funds to various entities, USAC did not act on behalf of those entities when it collected the funds. The BAP reasoned that, by applying the dominion and control test to a one-step transaction, the bankruptcy court had expanded the dominion and control test beyond the realm of conduit cases for which it was created. Id. It further noted that if the conduit defense applied to one-step transactions, it would create a new class of entities that could be exempt from § 550. Id. Thus, an intermediary seeking to use the conduit defense should be aware that some jurisdictions may limit its applicability, depending upon the structure of the transaction at issue.

Can Customs Brokers Take Advantage of the Conduit Defense?

When determining if the customs broker has a conduit defense to a preference action for fees, freight and shipping costs paid on behalf of an importer, the method of payment seems to be a key factor. Under the agency approach, the customs broker is serving as an intermediary between the parties. Under those

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circumstances, a customs broker should be able to show that it lacks control over the funds at issue. See Salomon v. Nedlloyd, Inc. (In re Black & Geddes, Inc.), 59 B.R. 873, 875 (Bankr. S.D.N.Y. 1986) (holding that a steamship agent acting for a debtor, by collecting payment from the debtor for freight and then paying the funds to a carrier, was not the initial transferee); Trustee v. East Carolina Ship Agencies (In re Timber Line, Ltd.), 59 B.R. 728, 732 (Bankr. S.D.N.Y. 1986) (holding that funds given to a port agent by an owner to be used to pay the owner's obligation to a vendor was not a preference because there was no extension of credit made by the port agent).

The more difficult question is whether the conduit defense is available where the customs broker *advances* funds for an importer. In those cases, the customs broker essentially is entering into a credit transaction with the importer, and the transfer to be avoided is the importer's payment of the advance by the customs broker. Thus, the customs broker is serving as intermediary while also maintaining a credit relationship with the importer. On these facts, customs brokers have been less successful with the conduit defense, since they maintain dominion over the funds transferred to them as repayment by the importer debtors. However, in a recent case, Andreini & Co. v. Pony Express Delivery Servs., Inc. (In re Pony Express Delivery Servs., Inc.), No. 00-68309, 2006 WL 456361, *6 (11th Cir. Feb. 26, 2006), an insurance broker who advanced funds for a client who later filed bankruptcy was successful in asserting the conduit defense.²

In In re Pony Express, Andreini was an insurance broker who arranged insurance coverage for Pony Express and then billed Pony Express for premiums due on the policies.

² One of the authors of this article, Wendy Reiss, is part of the Alston & Bird team that defended the insurance broker on appeal in Pony Express.

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Under California law, payments from Pony Express to Andreini were deposited into a client trust account and then remitted to Pony Express' insurance carriers, less a commission for brokerage services. Pony Express sent Andreini a check for premiums, which Andreini deposited into the client trust account. The following day, Andreini issued several checks from the client trust account to Pony Express' insurance carriers. A few weeks later, the check from Pony Express was returned for insufficient funds. To resolve the deficiency, Pony Express wired the full amount of the check directly into Andreini's client trust account. Two days later, Pony Express filed for bankruptcy. Pony Express then filed a complaint against Andreini to recover the wire transfer as a preference, alleging that Andreini was an initial transferee under 11 U.S.C. § 550. Pony Express filed a summary judgment motion which the bankruptcy court granted and the district court affirmed. Id. at *1. Andreini appealed to the Eleventh Circuit.

The Eleventh Circuit reversed. Id. at *6. Relying upon its holding in In re Chase & Sanborn Corp., the Eleventh Circuit noted that under the control test, a court must "step back and evaluate a transaction in its entirety to make sure that their conclusions are logical and equitable. . . . [this] approach is consistent with the equitable concepts underlying bankruptcy law." Id. at *4 (quoting In re Chase & Sanborn Corp., 848 F.2d at 1199). In reversing the lower courts, the Eleventh Circuit focused on the following: (i) Andreini did not intend on being a creditor - Andreini's practice was not to wait for client checks to clear before paying premiums, to avoid lapses in its clients' insurance policies; (ii) accordingly, a deficiency created by a bounced check was inadvertent; (iii) Andreini expected that the funds would be forthcoming by Pony Express since all of Pony Express' previous checks had been promptly honored; (iv) Andreini did not charge the debtor interest or any additional "loan" fees; (v) the wire transfer was, in effect,

“earmarked” as a deposit to a client trust account for settlement of the inadvertent deficiency; (vi) the wire transfer was made within a reasonable time period and (vi) at no time were the transferred funds under the legal control of Andreini since they were wired to the client trust account, not an unrestricted business account. *Id.* at *4-5. Thus, the Eleventh Circuit concluded that there was no genuine debt between the parties, and Andreini was not an initial transferee under § 550. *Id.* at *6.

Given the *In re Pony Express* decision, customs brokers may have a better conduit defense where the customs broker advances funds on behalf of an importer debtor. However, as the Eleventh Circuit noted, the relevant inquiry is whether all the circumstances surrounding the parties’ dealings show (or don’t show) a credit transaction between the importer debtor and customs broker. Even under *In re Pony Express*, evaluating a customs broker’s conduit defense will be a fact-intensive inquiry.

Other Possible Defenses for a Customs Broker

i. Statutory Defenses under § 547(c) of the Bankruptcy Code

Section 547(c) of the Bankruptcy Code provides statutory defenses to preference liability. Two possible statutory defenses available to a customs broker who used the advancement approach are (i) the “ordinary course of business” defense; and (ii) the “new value” defense.

Under the ordinary course of business defense, a customs broker may argue that the advancement of the funds for the importer debtor to pay fees, freight and shipping costs were ordinary debts of the business, and either customary between the customs broker and the importer or customary in the importing

industry.³ The ordinary course of business defense will remain, as with all defendants, a fact intensive inquiry. As to the new value defense, it is limited to those circumstances where a customs broker can demonstrate that after it was repaid by the importer debtor, it provided new value to that debtor. Thus, the new value defense will be limited to those cases where the importer debtor and customs broker have an ongoing business relationship after the payment in question.

ii. Equitable Defenses under § 105 of the Bankruptcy Code

The dichotomy between the application of the conduit defense under the agency approach and under the advancement approach raises equitable concerns. If one goal of bankruptcy is foster equality in the distribution of assets among similarly situated creditors, one could argue that all customs brokers should be treated the same. However, it is difficult to argue that the customs broker who applies an agency approach to paying charges, fees and duties for an importer debtor is “similarly situated” to the customs broker that uses an advancement approach since the latter of these two is given the market advantage over the other. The customs broker who uses the advancement approach often provides faster service, and may obtain additional customers as a result. The financial risks of nonpayment, and recovery of payments as preferences, may be the cost the customs broker pays for this competitive advantage.

Another concern is that the priority structure in bankruptcy creates inequalities among customs brokers advancing funds for customs fees and duties. The bankruptcy laws currently give priority to the United States Customs Service over other creditors, for

³ Prior to the 2005 amendments to the Bankruptcy Code, defendants had to prove that the transfer was *both* customary between the parties *and* customary in the particular industry.

customs fees and duties owed to the federal government. In contrast, however, when customs brokers advance duty payments to the Customs Service on behalf of importers, customs brokers are not given priority claims, and those brokers are left in line with the other unsecured creditors of the importer debtor.

But there may be some hope for customs brokers who advance duty payments to the Customs Service on behalf of importer debtors. On March 15, 2005, Representative Henry Brown of South Carolina introduced House Resolution 1294, the Customs Business Fairness Act of 2005. This bill, if made law, would amend the Bankruptcy Code to establish a priority for the repayment of claims for duties paid to the United States by licensed customs brokers and sureties on behalf of a debtor. If enacted, this would protect brokers from not only the repayment risk for advancing customs duties, but also the preference risk, as the debtor may then be unable to prove that the priority claim for customs duties would not have been paid in a Chapter 7. See 11 U.S.C. § 547(b)(5). The resolution was referred to the Subcommittee on Commercial and Administrative Law in April 2005 and remains under review.⁴

Advice to Customs Brokers who Advance Monies on Behalf of Importers

Even if customs brokers are given priority for customs fees and duties advanced for an importer debtor in the future, as of now their transactions with importer debtors prior to an importer's bankruptcy filing remain vulnerable to attack. Further, the proposed legislation still leaves customs brokers at risk when advancing monies for freight and shipping costs. Thus,

the following are suggestions for customs brokers advancing funds on behalf of importers, to hedge some of these financial risks:

- Customs brokers should strictly define the terms of any relationship with an importer contractually, placing limitations on the customs brokers' authority to act and transfer funds on behalf of importers. The customs broker should make clear to others that it is at all times acting as an agent of the importer. One way in which the customs broker can accomplish this is to keep all monies given by clients in a separate account.
- If possible, customs brokers should ensure that transactions are structured as "two-step transactions" whereby an agency relationship is created. This could avoid issues in those jurisdictions where the conduit defense requires such two-step transactions.
- If a customs broker is subject to preference liability, it should consider other possible defenses to preference actions, such as the ordinary course of business defense, the new value defense or potential equitable arguments.
- Customs brokers should research and analyze the financial risks associated with an importer before entering into contractual or business relationships.

By taking the steps described above, a customs broker may not eliminate its risk altogether. However, it can allow for a stronger defense to a preference claim.

* * *

⁴ Customs duties are only one component of the funds advance by brokers. Because freight fees are not covered by Customs Business Fairness Act of 2005, this bill, if passed, will alleviate only some of the payment and preference risks faced by a customs broker.

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Introduction, continued from page 1

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