

# You Finally Got Paid But That's Certainly Not the End of the Story

By L. ALEXANDRA HOGAN

**W**hen your business finally receives payment of that long-overdue receivable, is that the end of the story? Not always, as recently learned by nearly 40 entities previously doing business with Northern Berkshire Healthcare Inc. or its affiliates.

Two years ago, Northern Berkshire Healthcare, a nonprofit healthcare corporation in Berkshire County, and its four affiliated entities (collectively Northern Berkshire) filed for Chapter 11 bankruptcy protection. On June 10, the trustee in Northern Berkshire's bankruptcy instituted almost 40 lawsuits in the bankruptcy court against entities that did business with the company because, simply put, those entities got paid prior to the bankruptcy filing.

Section 547(b) of the Bankruptcy Code authorizes a Chapter 11 debtor or trustee to recover 'preferential transfers.' These are certain payments made to creditors of the bankrupt company 90 days prior to the bankruptcy filing or made one year prior thereto if to an insider (e.g. an officer, director or affiliated entity.) In order to make a successful claim, the debtor or trustee must prove that the payment was made to the creditor on old debt while the debtor was insolvent, during the specified time period, and that the creditor received more than it would have if the case been filed under Chapter 7 of the Bankruptcy Code, as opposed to Chapter 11.

The prospect of a creditor losing its long-awaited payment appears fundamentally unfair. The social policy behind this law is actually to treat the bankrupt company's

creditors equally. In other words, the law should not permit the company to preferentially choose to pay one creditor over another. Money recovered under this law will be fairly distributed to all creditors under the scheme provided by the Bankruptcy Code. And, as with any cause of action, there are defenses — the contemporaneous-exchange defense, the ordinary-course-of-business defense, and new-value defense, to name a few.



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A transfer is not preferential if the creditor and soon-to-be bankrupt company intended and, in fact, made a substantially contemporaneous exchange of new goods or services for the payment in question. Cash on delivery and prepayment does not constitute a preferential transfer. In addition, if payment was made on a debt incurred in the ordinary course of business or the financial affairs of the parties, or according to ordinary business terms, the transaction is not preferential.

Some factors the court may consider in its analysis of this defense include the prior

course of dealings between the parties and the amount, timing, and circumstances surrounding the payment. Under the new-value defense, the practical result is that the preference amount is reduced by the amount of new value provided by the creditor following the payment in question. For example, the soon-to-be bankrupt company makes a payment to the creditor of \$5,000 on June 1 for goods delivered 30 days prior. Subsequently, on June 15, the creditor delivers another \$2,000 worth of goods before the company files Chapter 11 on June 30. The preference amount would rightfully be reduced to \$3,000.

This summary of the law is intended to provide a rudimentary understanding of the concepts at play. It goes without saying that any creditor faced with a preference lawsuit should immediately seek the advice of experienced counsel who understands the ins and outs of complex bankruptcy law. ■

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