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# Preference Clawbacks in the Staffing Industry



# Preferential Transfers



*Nathan & Miriam Barnert Mem. Hosp. Ass'n v. Onward Healthcare, Inc.*  
*(In re Nathan & Miriam Barnert Mem. Hosp. Ass'n),*

2009 Bankr. LEXIS 5569 (Bankr. D.N.J. Oct. 5, 2009)



## Facts:

- Debtor Nathan and Miriam Barnert Memorial Hospital Association and Defendant Onward Healthcare, Inc. began their business relationship when Onward acquired Health Staff Professions, Inc. and All Care Nursing Services, the two entities that provided nursing professionals to the Debtor.
- In 2007, Onward commenced an action in the Superior Court of New Jersey against the Debtor, alleging breach of contract for ninety-six unpaid invoices totaling \$367,850.38.
- The Debtor did not answer the State Court Complaint, and the state court entered a Default Judgment in the amount of \$451,009.89 against the Debtor.
- Subsequently, the county sheriff levied upon the Debtor's bank account. At the time of the levy, the account contained \$466,409.58.



## Facts:

- After Onward filed a Motion for Turnover of Funds, the parties entered into a Consent Order, which vacated the Default Judgment in exchange for \$192,398.69 from the Debtor's bank account.
- The Consent Order also provided that the Debtor was required to make monthly payments in the amount of \$25,351.43 for seven months.
- On the date on which the first monthly payment was due, the Debtor filed for bankruptcy.
- The Debtor filed a motion for summary judgment arguing that the wire transfer of \$192,398.69 to the Defendant constituted a voidable preferential transfer.



## Arguments:

- The Defendant argued that the issuance of the Bank Levy caused the Debtor to lose all interest in the funds in the bank account. Consequently, the Defendant asserted that the \$192,398.69 transferred by the Debtor to it from the bank account could not have been a transfer of "an interest of the debtor in property."
- The Debtor argued that the wire transfer constituted payment for the ninety-six unpaid invoices, and, thus, was made on account of an antecedent debt.
- The Defendant contended that upon issuance of the levy, the Debtor's obligations to the Defendant with respect to the invoices were satisfied and that there were no amounts due and owing to the Defendant before the Debtor made the allegedly preferential transfer.



## Arguments:

- Additionally, the Defendant asserted that as a fully secured creditor, it did not receive more than it would have received in a Chapter 7 liquidation.



## Issue:

- Was the property transferred by the Debtor property in which the Debtor possessed an interest?
- Was the wire transfer made on account of an antecedent debt?
- Did the transfer enable the Defendant to receive more than it would have received had the case been filed under Chapter 7 of the Code?



Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) Made—

a) on or within 90 days before the date of the filing of the petition; or

b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

a) the case were a case under chapter 7 of this title;

b) the transfer had not been made; and

c) such creditor received payment of such debt to the extent provided by the provisions of this title.



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b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that **enables such creditor to receive more than such creditor would receive** if—

a) the case were a case under chapter 7 of this title;

b) the transfer had not been made; and

c) such creditor received payment of such debt to the extent provided by the provisions of this title.



## Court's ruling:

- As to the “interest in the debtor in property” issue, the Court noted that several provisions in the bankruptcy code permit the Trustee to recover property which the debtor did not have possessory interest. Thus, the bankruptcy estate includes those interests recovered or recoverable through transfer and lien avoidance provisions.
- The Court found that, although the Debtor did not have control of the bank account at the date of the wire transfer, the Debtor nonetheless retained an interest because the levy depriving the Debtor of such control was executed within ninety days of the Debtor's petition and constituted an avoidable preference.
- As to the antecedent debt issue, the Debtor first became legally obligated to pay the Defendant on the payment date specified by the invoices. Consequently, the Court found that the wire transfer was clearly made in payment of that debt.



## Court's ruling:

- As to the “received more” issue, the Court noted that the Defendant only held an avoidable levy, which, upon exercise of the Trustee’s avoidance powers, would have left the Defendant a general unsecured creditor.
- Also, the Debtor’s liabilities exceeded its assets so the Defendant had received more in the wire transfer than it would have in a Chapter 7 proceeding.
- Therefore, the Court held that the wire transfer of \$192,398.69 to the Defendant constituted a voidable preferential transfer under section 547(b) and granted the Debtor’s motion for summary judgment.



## Conclusion:

- A debt is incurred on the date upon which the debtor first becomes legally bound to pay. A later compromise of a claim does not affect the time when the debt first arose.



*Authentic Fitness Corp. v. Dobbs Temp. Help Servs., Inc. (In re Warnaco Group, Inc.),*

2006 U.S. Dist. LEXIS 4263, 97 A.F.T.R.2d (RIA) 958 (S.D.N.Y. 2006)



## Facts:

- Appellant Pro Staff Personal Services, Inc. (“Pro Staff”) was a staffing company that had provided temporary and permanent workers to Appellee Authentic Fitness Corporation (“AFC”).
- Pro Staff provided AFC’s predecessor with temporary workers. Pro Staff also performed related administrative duties for AFC, such as managing the temporary employees' withholding taxes.
- A usual transaction between Pro Staff and AFC would begin when AFC placed an order for a specific number of workers with particular skills or education levels.
- Pro Staff then sent workers who suited these needs to AFC, each with a Pro Staff time card to be completed and approved by AFC managers.



- Three days before filing for bankruptcy, AFC made four wire transfers to Pro Staff in the amount totaling \$532,142.47, which exceeded what was owed to Pro Staff by \$79,883.44 (“Overpayment”).
- After AFC filed the petition, Pro Staff continued to provide services and workers for them until August 21, 2001.
- As compensation for the post-petition services, Pro Staff filed an Administrative Claim Motion for \$ 164,907.55.
- AFC sought to avoid and recover as a preferential transfer the amount it owed Pro Staff for pre-petition services (\$452,259.03). AFC also sought to avoid and recover the Overpayment (\$79,883.44) as a fraudulent conveyance, or alternatively to reduce Pro Staff's \$164,907.55 administrative claim by \$79,883.44 under the recoupment doctrine.
- The bankruptcy court granted AFC’s partial summary judgment. Pro Staff appealed.



## Arguments:

- AFC argued that the pre-petition payments amounting to \$452,259.03 constituted preferential transfers, and the remaining Overpayment of \$ 79,883.44 was avoidable as a fraudulent transfer because Pro Staff received no "new value" for those services.
- AFC also argued that in the alternative the Overpayment should be recouped from Pro Staff's administrative claim against AFC.
- Pro Staff argued that the amount of AFC's payments representing the employees' withholding taxes was not recoverable because it was held in trust for the IRS and could not be an interest of the debtor in property.



## Arguments:

- Additionally, Pro Staff asserted that AFC could not avoid the pre-petition payments because, except as to its 4% commission and overhead, Pro Staff acted as a "mere conduit" of the funds received from AFC, not as an "initial transferee".
- Finally, Pro Staff asserted a new value defense by pointing to invoices on the record which purportedly charged AFC for temporary staffing services provided between the date of the transfers AFC sought to avoid and recover and the date AFC filed for bankruptcy.



## Issue:

- Were the pre-petition payments a transfer of an interest of the debtor in property?
- Was Pro Staff an “initial transferee” against whom a preferential transfer could be recovered?
- Whether Pro Staff furnished AFC with services amounting to new value.
- Were the transfers received in the ordinary course of business between AFC and Pro Staff?



Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) Made—

a) on or within 90 days before the date of the filing of the petition; or

b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

a) the case were a case under chapter 7 of this title;

b) the transfer had not been made; and

c) such creditor received payment of such debt to the extent provided by the provisions of this title.



Sec. 547 (b) : Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of **an interest of the debtor in property**—

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) Made—

a) on or within 90 days before the date of the filing of the petition; or

b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if—

a) the case were a case under chapter 7 of this title;

b) the transfer had not been made; and

c) such creditor received payment of such debt to the extent provided by the provisions of this title.



Section 547(c) The trustee may not avoid under this section a transfer—

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;



Section 547(c) The trustee may not avoid under this section a transfer—

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave **new value to or for the benefit of the debtor**—

- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the **ordinary course of business** or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



## Court's ruling:

- As to the “withholding taxes” issue, the Court noted that the money AFC had paid Pro Staff was reimbursement to Pro Staff for monies already paid by it to employees.
- Consequently, the employees were on the payroll of Pro Staff. Because the party responsible for paychecks is the party responsible for withholding income taxes from those paychecks, the Court found that AFC could not be said to have held withholding taxes in trust for the IRS since all AFC had done was to pay Pro Staff for the services Pro Staff had provided them.
- The Court concluded that AFC's pre-petition payments constituted a transfer of an "interest of the debtor" and were avoidable as preference payments.



## Court's ruling:

- As to the “initial transferee” issue, the Court noted that Pro Staff had a legal right to do anything it chose with AFC’s pre-petition payments. Additionally, Pro Staff had already paid its employees their salaries and had paid the taxes and insurance premiums out of its own funds before billing AFC for reimbursement of its expenditures.
- The Court found that this reimbursement made Pro Staff a creditor and not a conduit.
- As to the “new value” defense, the Court found that Pro Staff failed to show precisely how much work was performed by its employees between the date of the transfers AFC sought to avoid and the date AFC filed for bankruptcy. Because Pro Staff failed to meet its burden of proof, the Court rejected this defense.



## Court's ruling:

- Finally, as to the “ordinary course” defense, the Court noted that Pro Staff provided no factual evidence indicating the ordinary business terms or the custom among the temporary staffing industry. Without this information, the Court stated that it was left without knowing what ordinary staffing agencies do.
- Thus, the Court rejected Pro Staff's ordinary course defense.
- Therefore, the Court reaffirmed the bankruptcy court's order, which held that AFC could recover the pre-petition payments as preference and the Overpayment under the doctrine of recoupment.



## Conclusion:

- The actual and agreed-upon payer of the wages is generally the actual and agreed-upon holder in trust of the withholding taxes.
- A mere conduit has no dominion or control over the asset; rather, it is a party with actual or constructive possession of the asset before transmitting it to someone else. Mere conduits can do no more than transmit a transferor-debtor's funds to a transferee.
- Under the “new value” defense, the claimant has the burden of proof, which usually requires a dollar amount for the services rendered.
- Coerced late payments are not automatically excluded from the ordinary course defense; however, those payments which have been delayed many days beyond the due date may not be in the ordinary course of business.



# Contemporaneous Exchange Defense



*Official Committee of Unsecured Creditors of 360networks (USA) Inc. v.  
U.S. Relocation Servs., Inc. (In re 360networks Inc.),*

338 B.R. 194, 2005 Bankr. LEXIS 2811 (Bankr. S.D.N.Y. 2005)



## Facts:

- The Debtors 360networks (USA), Inc. was a provider of telecommunications services.
- The Defendant U.S. Relocation Services, Inc. was a relocation management company that provided services to the Debtors.
- In September 2000, the Defendant and the Debtors entered into an Agreement for Relocation Services (the "Agreement") pursuant to which the Debtors retained the Defendant to administer their employee relocation benefits plan.
- Under the Agreement, the Defendant could not make any independent determinations as to the benefits an employee was entitled to receive or the nature of the services that the Debtors specified for their eligible employees.



## Facts:

- In furtherance of its obligations under the Agreement, the Defendant performed some of the services itself and hired vendors to carry out other aspects of the relocation process. It charged the Debtors service fees related to its subcontracts with these vendors.
- The terms of the Agreement provided that the Defendant could advance relocation benefits to the employees or pay vendors for the benefits, and then invoice the Debtors for reimbursement.
- During the 90 days preceding the Debtors' voluntary bankruptcy filing, the Debtors made six payments to the Defendant under the Agreement in the aggregate sum of \$1,836,014.09 (the “Payments”).
- The Debtors sought to avoid and recover the Payments as preferential transfers.
- The parties' cross-moved for summary judgment with regard to the Defendant's defenses under 11 U.S.C.S. § 547(c)(1), (2).



## Arguments:

- The Defendant argued that it was a “mere conduit” of funds intended to benefit the employees because it was reimbursed by the Debtors for providing advance relocation benefits.
- The Debtors argued that there was an obligation on the employees to work for the Debtors for a year in order to retain their relocation benefits. As such, the employees' failure to repudiate the contract would not have constituted new value because forbearance does not constitute new value.
- The Defendant also asserted that there was no requirement that a "contemporaneous exchange" had to be an instantaneous exchange, and performance on one side may have taken place at the end of a contractual period.



Issue:

- Was the Defendant acting as a mere conduit for the funds transferred by the Debtor?
- Did the Payments constitute a contemporaneous exchange for new value?



Sec. 547 (c) : The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;



Sec. 547 (c) : The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a **contemporaneous exchange for new value** given to the debtor; and

(B) **in fact a substantially contemporaneous exchange;**



## Court's ruling:

- As to the “mere conduit” issue, the Court noted that the Defendant had provided and paid for the relocation benefits *prior to* receiving the Payments and therefore had complete dominion and control over the Payments, and the right to apply them as it wished, upon receipt.
- Further, the Defendant was not under any contractual or other obligation to use them for the benefit of the Debtors' employees. Accordingly, the Court found that the conduit defense was not available to the Defendant with respect to the Payments it received from the Debtors as reimbursement.
- As to the contemporaneous exchange issue, the Court determined that the record was not sufficient to demonstrate whether the employees provided new value to the Debtors in exchange for the challenged Payments to the Defendant.



## Court's ruling:

- The Court noted that if the employees continued to provide services and to relocate, and as long as the Defendant continued to be paid, it might plausibly be argued that the employees' relocation constituted new value for the Payments.
- Moreover, even if there was new value, the record was not adequate to determine whether the challenged Payments were intended to be simultaneous with the employees' performance.
- Additionally, the record did not indicate whether the employees had any knowledge of the Debtors' Payments to the Defendant or whether the Payments relieved the employees of an obligation to reimburse the Defendant for the benefits.
- Therefore, the Court rejected the Defendant's motion as to the conduit defense and both parties' motions as to the contemporaneous exchange for new value defense.



## Conclusion:

- Generally, the minimum requirement of status as a transferee is dominion over the money or other asset, the right to put the money to one's own purposes.
- The Fourth Circuit has stated that when a creditor receives money from its debtor to pay a debt, the creditor is not a mere conduit.
- New value does not need to be provided to the debtor by the preference defendant; it may be provided by a third party.
- New value is not usually provided under 11 U.S.C.S. § 547(c)(1) if the contract party merely forbears from canceling or ceasing performance under a contract.



# Ordinary Course of Business Defense



*Prudential Real Estate & Relocation Servs. v. Burtch (In re AE  
Liquidation, Inc.),*

2015 U.S. Dist. LEXIS 120464, Bankr. L. Rep. (CCH) P82,868, 2015  
WL 5301553 (D. Del. Sept. 10, 2015)



## Facts:

- In May 2006, the Debtor Eclipse Aviation Corporation engaged Defendant Prudential Real Estate & Relocation Services to perform various relocation services for its employees.
- The agreement contemplated that the Debtor would pay Prudential for services within 30 days of receiving an invoice.
- During the first year and a half of the parties' agreement, the Debtor paid all invoices within the allotted time. Toward the end of 2007, however, the Debtor fell behind on payments.
- As a result, Prudential placed the Debtor on “billing review,” which required the Debtor to accept stricter payment terms in order to keep Prudential’s services (“First Payment Plan”).



## Facts:

- By January 18, 2008, the Debtor had complied with those terms and Prudential removed the Debtor from the First Payment Plan.
- A few months later, the Debtor again experienced financial difficulties, and Prudential again placed the Debtor on billing review due to late payments.
- In the 90 days prior to filing for bankruptcy, the Debtor had made 12 payments to Prudential totaling \$781,702.61.
- Following trial, the Bankruptcy Court entered its Opinion and Order awarding judgment in favor of the Trustee for \$653,323.20. This figure represented \$781,702.61 of preferential transfers, reduced by \$128,379.40 of "new value" that Prudential had provided.
- Both parties appealed the judgment.



## Arguments:

- The Defendant argued that the bankruptcy court erred by finding that the Debtor's faster payments during the preference period (roughly a 40% improvement) supported the finding that these transfers were not in the ordinary course of business.
- The Defendant also argued that when the Debtor began experiencing financial difficulties, it instituted the exact same actions that it had instituted earlier in their relationship. Thus, the stricter payment terms were ordinary.



Issue:

- Were the payments made in the ordinary course of business between the Debtor and the Defendant?



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



## Court's ruling:

- The Court noted that the bankruptcy court had reasoned that the decrease in the payment time from an average of 45.3 days to 28 days was significant, especially when coupled with the fact that Prudential had insisted on faster payments.
- As the timing of payments increased by 40%, the Court determined that the bankruptcy court had not erred in finding that the transfers occurred outside the ordinary course of business.
- Furthermore, the Court found that the bankruptcy court had not erred by finding that the stricter terms imposed by the Defendant onto the Debtor were not ordinary.



## Court's ruling:

- The parties had established a baseline relationship that continued for more than 18 months. Also, once the Debtor complied with the terms of the payment plan, Prudential reinstated the baseline payment terms.
- Therefore, the Court rejected Prudential's ordinary course of business defense and affirmed the bankruptcy court's judgment.



## Conclusion:

- Simply because a creditor has imposed stricter payment terms at some earlier point in its relationship with the debtor, does not dictate that those stricter terms were "ordinary."



*Sass v. Vector Consulting, Inc. (In re Am. Home Mortg. Holdings, Inc.),*  
476 B.R. 124, 2012 Bankr. LEXIS 2534, 2012 WL 2046829 (**Bankr. D.**  
**Del. 2012)**



## Facts:

- The Defendant Vector Consulting, Inc. was in the business of **staffing temporary information technology (IT) professionals.**
- Vector and the Debtor American Home Mortgage Holdings, Inc. entered into a professional service agreement (PSA) whereby Vector supplied the programming services of an individual to the Debtor for a period of three months. The PSA was extended for a total of eight months.
- During the preference period, the Defendant received a total of four checks totaling \$29,920.00.
- On behalf of the Debtor, the Official Committee of Unsecured Creditors (the “Committee”) sought to avoid and recover the four payments totaling \$29,920.00, alleging that the transfers were avoidable as preferential transfers.



## Facts:

- During the historical period, the payments made by the Debtor to Vector ranged from \$4,675.00 to \$12,240.00. These payments were made between 7 to 67 days after invoice.
- The payments made by the Debtor during the preference period ranged from \$5,440.00 to \$12,920.00. These payments were made between 34 to 62 days after invoice.



## Arguments:

- The Committee argued that the timing of the preference period checks were not sufficiently similar to the payments made during the historical period. **The average days between invoice and clear date increased from 24.7 days during the historical period to 57.4 days during the preference period.**
- The Defendant argued that the timing of the preference period checks were sufficiently similar to the payments made during the historical period as to be in the ordinary course of business.
- The Defendant also contended that, to the extent that it did not have a complete ordinary course of business defense, it had extended new value to the Debtor based upon the professional consulting services that it provided to the Debtor subsequent to the **May 7, 2007 payment of \$12,920.00.**



Issue:

- Were the transfers made in the ordinary course of business between the Debtor and the Defendant?



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the **ordinary course** of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the **ordinary course of business or financial affairs** of the debtor and the transferee; or
- (B) made according to ordinary business terms;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



Section 547(c) The trustee may not avoid under this section a transfer—

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave **new value** to or for the benefit of the debtor—

- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;



Section 547(c) The trustee may not avoid under this section a transfer—

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor **gave new value to or for the benefit of the debtor**—

- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;



## Court's ruling:

- The Court noted that, because the eight month relationship between the parties was relatively short, the Court had to look to the **industry standard** to determine whether the relationship was of sufficient length to be deemed ordinary.
- Relying on Vector's **experts' testimony**, the Court found that the average length of contracts in the IT staffing industry was six months. Because the parties' relationship was eight months, the Court concluded that this relationship was ordinary.
- The Court also noted that the preference period checks were received between 34 and 62 days after invoice, squarely within the historic range of 7 to 67 days.
- **Thus, the Court concluded that the payments made during the preference period were similar to those made during the historical period.**



## Court's ruling:

- Additionally, the Court found that each of the preference payments were made according to “ordinary business terms.”
- The Court noted that it was typical in the IT staffing industry for payments to be made after the due date (here, 30 days after invoice) and that the payments made during the preference period were made between 34 and 62 days after invoice.
- Finally, the Court concluded that the Debtor receive new value from the Defendant in the form of consulting services totaling \$5,440.00 between May 7, 2007 and May 17, 2007 on or after Vector received previous payment from the Debtor.
- Therefore, the Court held that the Defendant had satisfied its burden to prove its ordinary course of business defense and the transfers were not avoidable as preference.



## Conclusion:

- Where the parties have a relatively short history of dealings, the creditor is generally required to fill the "gap" by reference to a more extensive and exacting analysis of industry standards.
- Late payments do not preclude a finding that the payment occurred during the ordinary course of business; **in fact a pattern of late payments may establish an ordinary course between the parties.**
- The "ordinary business terms" test of section 547(c)(2)(B) is a broad one, and the evidentiary standard is not formidable.



*Continentalafa Liquidation Trust v Human Resource Staffing, (In re  
Continentalafa Dispensing Company),*

2011 Bankr. LEXIS 1743 (Bankr. E.D. Mo. May 9, 2011)



## Facts:

- Plaintiff Continentalafa Liquidation Trust sought to recover an alleged preferential payment of \$103,856.28 paid to creditor Human Resource Staffing
- Trustee contended that the transfer amounts were unusually large as compared to the payment amounts during the comparison period. The two transfers made during the preference period represented 419% and 211% increases as compared to the average base period payment amounts.
- The defendant counter argued that the alleged preferential payments were consistent with the payments in the base period as they were made within a period of 30-60 days which was the usual practice.



Defendant argued that the ordinary course of business defense applies because the Transfers were consistent with the past practice between Debtors and Defendant in that 90% of payments during the Pre-Preference Period were paid between 30 and 60 days of invoicing — the remaining 10% was paid between 15 and 30 days of invoicing — while 100% of the Transfers during the Preference Period were paid between 30 and 60 days of invoicing.



Issue:

- Were the transfers made in the ordinary course of business between the Debtors and the Defendant?



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



## Conclusion

- Given the nature of the services provided, and the nature of the business relationship between debtors and the agency, the court did not find the variation in the amount of invoices and thus variation in payment amounts to dispel the ordinary course of business defense.
- Payments came out to be consistent when calculated using the range of payments. The range of payment during preference period was similar to the range during the preference period.



*Official Committee of Unsecured Creditors of 360networks (USA) Inc. v.  
U.S. Relocation Servs., Inc. (In re 360networks Inc.),*

338 B.R. 194, 2005 Bankr. LEXIS 2811 (Bankr. S.D.N.Y. 2005)



## Facts:

- The Debtors 360networks (USA), Inc. was a provider of telecommunications services.
- The Defendant U.S. Relocation Services, Inc. was a relocation management company that provided services to the Debtors.
- In September 2000, the Defendant and the Debtors entered into an Agreement for Relocation Services (the "Agreement") pursuant to which the Debtors retained the Defendant to administer their employee relocation benefits plan.
- Under the Agreement, the Defendant could not make any independent determinations as to the benefits an employee was entitled to receive or the nature of the services that the Debtors specified for their eligible employees.



## Facts:

- In furtherance of its obligations under the Agreement, the Defendant performed some of the services itself and hired vendors to carry out other aspects of the relocation process. **It charged the Debtors service fees related to its subcontracts with these vendors.**
- The terms of the Agreement provided that the **Defendant could advance relocation benefits to the employees or pay vendors for the benefits, and then invoice the Debtors for reimbursement.**
- During the 90 days preceding the Debtors' voluntary bankruptcy filing, the Debtors made six payments to the Defendant under the Agreement in the aggregate sum of \$1,836,014.09 (the “Payments”).
- The Debtors sought to avoid and recover the Payments as preferential transfers.
- The parties' cross-moved for summary judgment with regard to the Defendant's defenses under 11 U.S.C.S. § 547(c)(1), (2).



## Arguments:

- The Debtors argued that the Payments were not made in the ordinary course of business between the parties because the Defendant implemented various pressure tactics (i.e., requiring the payments to be made by wire transfer) to induce the transfers.
- The Defendant argued that its collection methods did not constitute payment pressure but rather were simply steps to protect its interest without harming the Debtors.



Issue:

- Were the Payments made in the ordinary course of business between the Debtors and the Defendant?



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



## Court's ruling:

- As to the ordinary course defense, the Court noted that the Defendant implemented various pressure tactics to induce the Debtors to pay invoices that were in some cases outstanding for considerable periods.
- **It was undisputed that the Defendant interrupted its efforts and suspended the relocation of the Debtors' employees as a result of the Debtors' failure to make timely payments under the Agreement.**
- Thus, the Court concluded that the Defendant's pressure tactics removed the Payments from the scope of the ordinary course of business defense.
- Therefore, the Debtors' motion for summary judgment was granted, and the Defendant's cross-motion was denied.



## Conclusion:

- Payments made as a consequence of economic distress and debt collection practices not common in the industry are not usually in the ordinary course of business.
- Lack of harm is not the standard for determining applicability of the ordinary course of business exception.



# New Value Defense



*Friedman's Liquidating Trust v. Roth Staffing Cos. LP (In re Friedman's Inc.),*

738 F.3d 547, 2013 U.S. App. LEXIS 25605, 70 Collier Bankr. Cas. 2d (MB) 1241, Bankr. L. Rep. (CCH) P82,568, 58 Bankr. Ct. Dec. 239, 2013 WL 6797958 (3d Cir. Del. 2013)



## Facts:

- The Debtor Friedman's, Inc. owned and operated fine jewelry specialty stores. On January 22, 2008, the Debtor filed for bankruptcy.
- In the 90-day preference period, the Debtor made payments for personnel to Appellee **Roth Staffing Companies**, LP ("Roth") totaling \$81,997.57.
- After these preferential transfers, but before the petition was filed, Roth provided services valued at \$100,660.88 to the Debtor. The money owed for these services remained unpaid as of the date the bankruptcy petition was filed.
- The Debtor filed a motion in the Bankruptcy Court seeking authority to pay its employees and independent contractors pre-petition wages, compensation, and related benefits.



## Facts:

- The Court granted the Debtor's motion (the "Wage Order"). Pursuant to the Wage Order, and after filing its bankruptcy petition, the Debtor paid \$72,412.71 to Roth on account of pre-petition staffing services.
- Appellant Friedman's Liquidating Trust ("FLT"), the successor in interest to the Debtor, sought to avoid and recover the transfers made to Roth as preferences.
- The Bankruptcy Court held that because FLT's payments made pursuant to the Wage Order had occurred after the bankruptcy petition was filed, those payments could not be entered into the preference calculation. The District Court affirmed, and FLT appealed the decision.



## Arguments:

- FLT argued that section 547(c)(4) plainly indicated that a debtor's payment offsetting new value may occur at any time, either pre- or post-petition, as long as it was a transfer made after the new value had been extended. **Because the drafters could have set forth a cutoff date, but did not, there was no limit.**
- Roth contended that the word "transfer" as used in § 547(c)(4) refers back to § 547(b), which states that in order for a transfer to be avoidable, it must have occurred within the 90 days preceding the petition date. **The later use of "transfer" must mean that the later word is also modified by the 90-day phrase.**
- Roth also argued that the use of the word "debtor" rather than "estate" or "debtor-in-possession" might have indicated that the provision only refers to pre-petition activity.



## Arguments:

- Finally, FLT argued that that the Debtor's estate was **not replenished** when the Debtor had made the transfer to Roth after the petition date, and that Roth unfairly received double payment.



Issue:

- Did the post-petition payment to the Creditor pursuant to a Wage Order entered at the Debtor's request reduce the Creditor's new value defense and thereby increase preference liability?



Section 547(c) The trustee may not avoid under this section a transfer—

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;



Section 547(c) The trustee may not avoid under this section a transfer—

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor—

- (A) not secured by an otherwise unavoidable security interest; and
- (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;



## Court's ruling:

- The Court opined that if section 547(c)(4) was read to contain no limit, then the time period involved would be totally open-ended such that any payment, at any time, could defeat a new value defense.
- Rather, in analyzing the provision in the context of the whole Bankruptcy Code, the Court found numerous contextual indicators that point to the **petition date as a cutoff for analysis of the new value defense.**
- For example, the Court noted that § 547 was titled "Preferences," and therefore suggested that it concerned transactions occurring **during the preference period**, which was by definition pre-petition.



## Court's ruling:

- As to whether the estate was replenished, the Court found that even if a creditor was paid post-petition for new value it provided pre-petition, the **creditor still had replenished the Debtor's estate during the preference period.**
- Lastly, the Court concluded that Roth was not unjustly enriched because it had provided **services on credit during the preference period**; all of the money Roth had received from the Debtor was for the services it had actually provided.
- Therefore, the Court held that were an otherwise unavoidable transfer was made after the filing of a bankruptcy petition, it did not affect the new value defense.
- FLT's post-petition payment pursuant to the Wage Order did not affect the calculation of Roth's preference liability.



## Conclusion:

- District and bankruptcy courts are divided on the issue of whether a payment must have been made before the petition date so as to defeat a creditor's new value defense.
- The **Third Circuit Court of Appeals** believes that the context of the Bankruptcy Code supports the conclusion that post-petition payments by a debtor do not affect a creditor's new value defense.



# Fraudulent Conveyance

*Tomsic v. Sales Consultants of Boston, Inc. (In re Saliency Assocs.),*

371 B.R. 578, 2007 Bankr. LEXIS 2251, 48 Bankr. Ct. Dec. 136 (Bankr.  
D. Mass. 2007)



## Facts:

- The Debtor Saliency Associates, Inc. was a professional **sales outsourcing company** that provided sales teams and market launching services to other companies.
- The Defendant Sales Consultants of Boston, Inc. (“SCB”) provided full-service **staffing** solutions for domestic and international companies.
- Robert G. Stockard served as the president of both SCB and the Debtor.
- SCB routinely procured employees for the Debtor in exchange for a fee, which was calculated as a **percentage of the annual salary of the placed employee.**



## Facts:

- **One year** prior to filing for bankruptcy, the Debtor made fifteen payments to SCB totaling approximately \$225,000 in commissions for services rendered (collectively, the “transfers”).
- The Trustee sought to recover and avoid each of the transfers as either preference payments or constructively fraudulent transfers.
- SCB filed a motion for summary judgment.



## Arguments:

- SCB argued that the contemporaneous exchange defense applied because it was the parties' intention that the **Debtor pay SCB for its staffing services contemporaneously with SCB's procurement of new employees for the Debtor.**
- Alternatively, SCB argued that the transfers were made according to the ordinary course of business between the parties. SCB placed over 100 employees with the Debtor over the course of five years and was paid a commission in each case, fifteen of which being the Transfers.
- The Trustee asserted that the Debtor should not have been obligated to pay full commissions to SCB for **long-term employees when their employment was known to be short-term** because, at a time of its insolvency, the Debtor failed to receive reasonably equivalent value for the Transfers - which renders them constructively fraudulent transfers recoverable pursuant to § 548(a)(1)(B).



## Issue:

- Did the transfers constitute a contemporaneous exchange for new value?
- Were the transfers made in the ordinary course of business between the Debtor and the Defendant?
- Did the Debtor receive reasonably equivalent value in exchange for the transfers?



Sec. 547 (c) : The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;



Sec. 547 (c) : The trustee may not avoid under this section a transfer—

(1) to the extent that such transfer was—

(A) intended by the debtor and the creditor to or for whose benefit such transfer was **made to be a contemporaneous exchange for new value** given to the debtor; and

(B) in fact a substantially contemporaneous exchange;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms;



§ 547 (c)- The trustee may not avoid under this section a transfer—

(2) to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was—

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to **ordinary business terms**;



Sec. 548 (a) (1): The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

**(B) (i)** received less than a reasonably equivalent value in exchange for such transfer or obligation; and

**(ii) (I)** was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;

**(II)** was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;

**(III)** intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or

**(IV)** made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.



Sec. 548 (a) (1): The trustee may avoid any transfer (including any transfer to or for the benefit of an insider under an employment contract) of an interest of the debtor in property, or any obligation (including any obligation to or for the benefit of an insider under an employment contract) incurred by the debtor, that was made or incurred on or within 2 years before the date of the filing of the petition, if the debtor voluntarily or involuntarily—

**(B) (i) received less than a reasonably equivalent value in exchange for such transfer or obligation; and**

**(ii) (I) was insolvent on the date that such transfer was made or such obligation was incurred, or became insolvent as a result of such transfer or obligation;**

**(II) was engaged in business or a transaction, or was about to engage in business or a transaction, for which any property remaining with the debtor was an unreasonably small capital;**

**(III) intended to incur, or believed that the debtor would incur, debts that would be beyond the debtor's ability to pay as such debts matured; or**

**(IV) made such transfer to or for the benefit of an insider, or incurred such obligation to or for the benefit of an insider, under an employment contract and not in the ordinary course of business.**



## Court's ruling:

- As to the contemporaneous exchange defense, the Court noted that the invoices appeared to suggest the intention of a contemporaneous exchange with the terms: “**net due and payable on start date.**”
- However, the attached receipts revealed that payment had oftentimes not been made until **well after the specified start dates** of the new employees. The Court concluded that SCB had not established its contemporaneous exchange defense.
- Additionally, the Court found that SCB had not provided sufficient evidence of the **industry practice** to establish an ordinary course of business defense.
- The Court noted that SCB was not able to identify the standard timing of such payments **nor whether the industry standards dictated that full commission always be paid.**



## Court's ruling:

- Finally, the Court noted that valid questions existed concerning whether the Debtor had received received reasonably equivalent value in exchange for the transfers.
- Payment of **full commissions** for the placement of employees with a company that SCB, through Stockard, likely knew or had reason to believe was on the verge of bankruptcy would have had the favorable impact (for SCB) of drawing funds out of the Debtor's estate to the disadvantage of its other creditors.
- Therefore, the Court rejected SCB's motion for summary judgment as to its affirmative defenses and the Trustee's constructively fraudulent transfer claim.



## Conclusion:

- On a motion for summary judgment, a court views all facts and draws all reasonable inferences in favor of the nonmoving party (here, the Trustee).



# Conduit Defense



*Meininger v. TMG Staffing Servs. (In re Cypress Rests. of Ga., Inc.),*

332 B.R. 60, 2005 Bankr. LEXIS 1977, 45 Bankr. Ct. Dec. 142, 18 Fla.  
L. Weekly Fed. B 468 (Bankr. M.D. Fla. 2005)



## Facts:

- The Debtor Cypress Restaurants of Georgia, Inc. operated many family-style restaurants throughout the southeast.
- On September 18, 2001, the Debtor filed this Chapter 11 case.
- The next month, the Debtor and the Defendant TMG Staffing Services, Inc. entered into an agreement in which the Defendant would **lease employees** to the Debtor to staff the Debtor's operations.
- The agreement specified that the **Defendant would be responsible for wages and taxes due the employees**, regardless of whether the Debtor paid the Defendant for the employees' services.



## Facts:

- Because the Defendant was concerned about the debtor's pending bankruptcy and wanted to ensure prompt payment, the Defendant insisted on a provision that required the Debtor to make all payments via wire transfer.
- On May 2, 2002, the Debtor converted its Chapter 11 case to a case under Chapter 7.
- Subsequently, the Debtor made three unauthorized wire transfers to the Defendant totaling \$116,611.62.
- The Trustee sought to avoid and recover the wire transfers received by the Defendant and filed a motion for summary judgment on the issue.



## Arguments:

- The Defendant argued that the transfers should not be avoided because it was a mere conduit of the funds **as a result of its obligation to pay taxes and wages to the leased employees from the funds transferred by the Debtor.**



Issue:

- Was the Defendant acting as a mere conduit for the funds transferred by the Debtor?



## Court's ruling:

- As to the mere conduit issue, the Court stated that when the transferee is a creditor, or has a business relationship with the debtor, and it receives a transfer that is **applied to its own debt**, the transferee cannot be a conduit.
- The Court noted that the Defendant was a creditor of the Debtor and had supplied leased employees to the Debtor's restaurants in exchange for payment by the Debtor.
- Additionally, the **Defendant's financial obligations were not contingent upon receiving payments from the Debtor as the Defendant expressly assumed the obligation to pay the employees leased to the Debtor.**



## Court's ruling:

- Finally, the Court noted that if the Defendant had supplied other services or goods to the Debtor (instead of staffing services), the Defendant would have had an **obligation to pay suppliers and employees regardless of whether it had received payment from the Debtor.**
- Therefore, the Court held that the Defendant, as an initial transferee, had **dominion and control** over the post-conversion funds transferred from the Debtor and was not acting as a mere conduit.
- The Trustee's motion for summary judgment was granted and the Court ordered the Defendant to return the transferred funds to the estate.



## Conclusion:

- An entity does not have to be a financial institution to be a conduit where the entity receives transferred funds subject to precise disbursement instructions from the transferor.
- A true conduit's obligation to the transferee does not arise until the transferor pays the conduit and the amount of the obligation depends on the amount the transferor paid to the conduit.
- A party's duty to pay its own debts out of revenue does not make the party a mere conduit and applies even where the party's product is staffing and the party's debts are wages and employment taxes.



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