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**BUSINESS RESTRUCTURING,
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Delaware Bankruptcy Court Clarifies Subsequent New Value Rules in Preference Actions

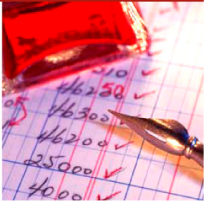
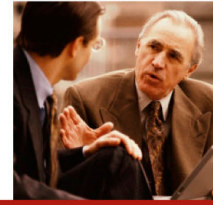
The Delaware Bankruptcy Court's recent decision in *Wahoski v. Efrid, Inc. (In re Pillowtex Corp.)*, expands the scope of the subsequent new value defense available to creditors facing preference avoidance actions brought by Chapter 11 debtors and Chapter 7 trustees.

Vendors and other creditors of bankrupt entities continue to face the possibility of litigation over so-called "preference avoidance actions," particularly in jurisdictions such as Delaware, where large numbers of bankruptcy cases are filed. A preference avoidance action allows a debtor or trustee to force creditors to disgorge payments received from an insolvent debtor in satisfaction of an antecedent debt within the 90 days prior to bankruptcy if such payment allowed the creditor to receive more than it would receive in a Chapter 7 liquidation.

One of the primary defenses to a creditor's preference exposure is the "subsequent new value" defense, which allows a creditor liable for a preferential payment to credit against the preferential payment the value of goods, services or credit (i.e., new value) the creditor provided to the debtor subsequent to the creditor's receipt of the preferential payment.

Until the bankruptcy court's decision in *Pillowtex*, many bankruptcy courts located in the Third Circuit, such as the Delaware bankruptcy courts, relying on what they believed was binding Third Circuit Court of Appeals precedent, strictly limited the use of the new value defense to those situations where that new value was unpaid as of the date of bankruptcy, even though the debtor's payment for the new value was itself subject to avoidance and recovery as a preference. In contrast to these decisions, the *Pillowtex* court determined that such an interpretation of the subsequent new value defense defied the plain meaning and legislative intent of the statute, holding that new value that was paid with a preferential payment would still qualify for the defense. The *Pillowtex* court explained that the Third Circuit opinion at issue had not directly addressed the question of paid new value, and, consequently, lower Third Circuit courts applying the strict new value rule had been improperly construing Third Circuit precedent.

This decision is good news for creditors finding themselves the victims of preference avoidance actions because it lends support to the more permissive and creditor-friendly view of new value that, until *Pillowtex*, had been mostly rejected in the Delaware bankruptcy courts. Any trade vendor faced with a preference claim should carefully consider, with the assistance of counsel, the availability of the "paid new value" defense.



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