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A U.S. Circuit Court of Appeals Sweetens Creditors' New Value Preference Defense

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As originally published in the Credit Research Foundation 3Q 2018 CRF News

Creditors dread spending the time and expense necessary to defend preference claims. Fortunately, creditors can take solace from the array of defenses that can reduce their preference liability. One of the more frequently invoked preference defenses is the new value defense in Bankruptcy Code Section 547(c)(4). A hotly contested issue is whether the new value defense includes both paid and unpaid new value, or is limited to just unpaid new value?

On August 14, 2018, the United States Court of Appeals for the Eleventh Circuit, in *William S. Kaye, Trustee of BFW Liquidating Trust v. Blue Bell Creameries Inc.*, joined four other U.S. Circuit Courts of Appeal in ruling that the new value defense includes both paid and unpaid new value. This issue is critically important to trade creditors as their ability to include paid, as well as unpaid, new value in support of their new value defense can significantly reduce their preference liability.

Preference Claims and the New Value Defense

A trustee may avoid a transfer under Bankruptcy Code Section 547(b) by proving all of the following elements of a preference claim: (1) the debtor transferred its property, such as by making a payment, to or for the benefit of a creditor; (2) the transfer was made on account of antecedent or existing debt that the debtor owed the creditor; (3) the transfer was made when the debtor was insolvent, based on a balance sheet definition of liabilities exceeding assets (a debtor is statutorily presumed to have been insolvent during the 90-day period prior to the debtor's bankruptcy filing date); (4) the transfer was made during the 90-day preference period with respect to a transfer made to a non-insider creditor of the debtor, such as a trade creditor; and (5) the transfer enabled the creditor to receive more from the transfer than the creditor would have received in a Chapter 7 liquidation of the debtor's assets.

Once a trustee proves all of the above preference elements, the creditor then has the burden of proving one or more of the preference defenses contained in Section 547(c) to reduce or eliminate preference liability. The new value defense, contained

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in Section 547(c)(4), is a frequently invoked preference defense. Section 547(c)(4) states:

[t]he trustee may not avoid under this section a transfer . . . 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 - . . . *on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor* (emphasis added).

The new value defense reduces a creditor's preference liability to the extent the creditor replenished a debtor's bankruptcy estate by providing new goods and/or services on credit terms subsequent to receiving a preference payment. The defense is premised on the lack of any harm to a debtor's unsecured creditors when a preference payment is followed by the preference recipient's delivery of goods and/or provision of services on credit terms to the debtor. The new value defense, like other preference defenses, is also supposed to encourage creditors to continue doing business with and extending credit to their financially distressed customers and thereby reduce the risk of the customers' bankruptcy filing.

The courts have reached conflicting holdings on whether the new value defense includes paid, as well as unpaid new value, or is limited to only new value that remains unpaid as of the bankruptcy filing date. The United States Courts of Appeal for the Fourth Circuit (covering Maryland, North and South Carolina, Virginia and West Virginia), the Fifth Circuit (covering Louisiana, Mississippi

and Texas), the Eighth Circuit (covering Arkansas, Iowa, Minnesota, Missouri, Nebraska and North and South Dakota) and the Ninth Circuit (covering Arizona, California, Idaho, Montana, Nevada, Oregon and Washington), now joined by the Eleventh Circuit (covering Alabama, Florida and Georgia), have held that the new value defense includes paid new value that was not paid by an "otherwise unavoidable transfer", as well as unpaid new value. The United States Courts of Appeal for the Seventh Circuit (covering Illinois, Indiana and Wisconsin), and according to prior court decisions and commentators prior to its recent decision, the Eleventh Circuit, had reached the contrary holding that new value must remain unpaid on the bankruptcy filing date in order to

be included as part of a creditor's new value defense.

Background

The Debtor, Bruno's Supermarkets ("Debtor"), was a grocery store chain with more than 60 stores in Alabama and Florida. Blue Bell Creameries, Inc. ("Blue Bell") had sold ice cream and related products on credit terms to the Debtor. The Debtor had historically been current in its obligations to Blue Bell, paying Blue Bell twice per week.

As a result of its deteriorating liquidity position, the Debtor began slowing down payments to its creditors in August, 2018. That included stretching out payments to Blue Bell to just once per week. The Debtor

also cut checks and then held them for a period of time prior to delivering them to creditors. As a result of this new "slow pay" policy, the Debtor took a longer time to pay Blue Bell and Blue Bell received payments from the Debtor at irregular intervals, particularly during the 90-day period from November 7, 2008 through February 5, 2009 ("the Preference Period").

Date / Time Period	Invoices / Deliveries from Blue Bell to the Debtor	Payments the Debtor Made to Blue Bell
Nov. 7, 2008 – Nov. 11, 2008	\$24,271.70	
Nov. 12, 2008		\$43,924.47
Nov. 12, 2008 – Nov. 24, 2008	\$108,872.64	
Nov. 25, 2008		\$67,821.23
Nov. 25, 2008 – Dec. 1, 2008	\$42,858.51	
Dec. 2, 2008		\$55,149.91
Dec. 2, 2008 – Dec. 4, 2008	\$11,523.17	
Dec. 5, 2008		\$27,485.38
Dec. 5, 2008 – Dec. 8, 2008	\$13,783.29	
Dec. 9, 2008		\$33,320.61
Dec. 9, 2008 – Dec. 14, 2008	\$41,029.32	
Dec. 15, 2008		\$26,327.00
Dec. 15, 2008 – Jan. 4, 2009	\$101,670.75	
Jan. 5, 2009		\$59,980.15
Jan. 5, 2009	\$10,337.94	
Jan. 6, 2009		\$55,508.85
Jan. 6, 2009 – Jan. 12, 2009	\$39,041.37	
Jan. 13, 2009		\$47,162.09
Jan. 13, 2009 – Jan. 19, 2009	\$23,737.88	
Jan. 20, 2009		\$28,483.07
Jan. 20, 2009 – Jan. 29, 2009	\$10,297.79	
Jan. 30, 2009		\$33,186.46
Jan. 30, 2009		\$48,213.42
Jan. 30, 2009 – Feb. 2, 2009	\$7,246.81	
Feb. 3, 2009		\$37,306.73
Feb. 3, 2009	\$1,034.48	

During the Preference Period the Debtor made 13 separate payments, totaling \$563,869.37, to Blue Bell. At least \$250,000 of these payments were for goods that Blue Bell had delivered to the Debtor prior to the Preference Period. Blue Bell had delivered goods, invoiced at \$435,705.65 on a daily basis in 1,700 separate deliveries, to the Debtor's stores during the Preference Period. The Debtor's payments to Blue Bell and Blue Bell's deliveries to the Debtor are summarized in the chart on the previous page.

The Debtor's Bankruptcy Filing and Preference Action Against Blue Bell

On February 5, 2009, the ("Petition Date"), the Debtor filed a Chapter 11 petition with the United States Bankruptcy Court for the Northern District of Alabama. On September 25, 2009, the bankruptcy court confirmed the Debtor's Fourth Amended Plan of Liquidation. A Liquidating Trustee (the "Trustee") was appointed under the confirmed plan and was authorized to commence preference actions.

In January 2011, the Trustee commenced a preference lawsuit against Blue Bell. The Trustee had sought recovery of the \$563,869.37 that Blue Bell had received from the Debtor during the Preference Period. Blue Bell asserted the new value defense and sought to include both paid and unpaid new value to reduce its preference liability.

The bankruptcy court held that the trustee was entitled to recovery of \$438,496.47 of its \$563,869.37 preference claim. The bankruptcy court had excluded all of Blue Bell's asserted new value based on deliveries of goods on credit terms to the Debtor for which the Debtor had tendered payment during the Preference Period. The court limited Blue Bell's new value defense to only new value for Blue Bell's deliveries of goods during the Preference Period that remained unpaid on the Petition Date. The bankruptcy court relied on an earlier Eleventh Circuit decision, in *Charisma Investment Co., N.V. v. Airport Systems, Inc. (in re Jet Florida System, Inc.)*, to justify limiting Blue Bell's new value defense to only unpaid new value.

Blue Bell filed an appeal to the United States District Court for the Northern District of Alabama. In addition, Blue Bell, with the Trustee's consent, sought permission to appeal the bankruptcy court's decision to the Eleventh Circuit. The Eleventh Circuit granted this request and considered whether Blue Bell's new value

defense includes both paid and unpaid new value.

The Eleventh Circuit Allows Paid New Value as Part of Blue Bell's New Value Defense

The Eleventh Circuit reversed and vacated the bankruptcy court's ruling, holding that Section 547(c)(4) allows both paid and unpaid new value. The court first noted that its statement in *Jet Florida System* that new value must remain unpaid on the bankruptcy filing date is *dictum* and not binding precedent. The Eleventh Circuit, in the *Jet Florida System* case, did not consider whether a creditor could include paid for new value as part of its new value defense or whether new value must remain unpaid. As a result, the Eleventh Circuit now could consider whether Section 547(c)(4) allows a creditor to assert both paid for new value, as well as unpaid new value, as part of the creditor's new value defense.

The Eleventh Circuit concluded that Section 547(c)'s text is clear that new value need not remain unpaid. The relevant portion of Section 547(c)(4) only excludes new value that is paid by "an otherwise unavoidable transfer". A creditor can include paid new value as part of its new value defense to reduce its preference liability, as long as the payment for the new value is itself avoidable.

The Eleventh Circuit also noted that the statutory history of Section 547(c)(4) supports its conclusion that new value need not remain unpaid. Section 60 of the Bankruptcy Act, the predecessor of Section 547(c)(4), limited the new value defense to only unpaid new value. Congress's enactment of 547(c)(4), that omitted section 60's unpaid new value requirement, showed Congress's intent to expand the new value defense to include paid, as well as unpaid, new value.

Finally, the Eleventh Circuit stated that limiting the new value defense to only unpaid new value hinders Section 547(c)'s policy objective of encouraging creditors, particularly vendors like Blue Bell extending short-term credit, to continue extending credit to financially distressed debtors, and thereby reduce the risk of the debtor's subsequent bankruptcy filing. The Eleventh Circuit pointed out the adverse impact of limiting the new value defense to only unpaid new value by presenting a hypothetical of a vendor/creditor shipping \$1,000 of goods to a debtor every other week and the debtor paying for these goods one week after delivery during the preference period.

In this hypothetical, the vendor reduced its preference liability by \$4,000 if the creditor's new value defense included goods the vendor had delivered to the debtor during the preference period that were thereafter paid. Counting paid new value reduces the vendor's preference liability from \$5,000 to the debtor's last payment of \$1,000, for which the creditor had not subsequently provided new value to the debtor. The vendor would have been subject to the full preference liability of \$5,000 and lose the benefit of \$4,000 of new value that the Debtor had subsequently repaid if the new value defense is limited to only unpaid new value.

	Transfer from Creditor to Debtor	Transfer from Debtor to Creditor
Transfer 1	\$1,000 in goods	
Transfer 2		\$1,000 in cash
Transfer 3	\$1,000 in goods	
Transfer 4		\$1,000 in cash
Transfer 5	\$1,000 in goods	
Transfer 6		\$1,000 in cash
Transfer 7	\$1,000 in goods	
Transfer 8		\$1,000 in cash
Transfer 9	\$1,000 in goods	
Transfer 10		\$1,000 in cash
Debtor's Bankruptcy Filing		

new value defense should significantly reduce the creditor's preference liability. The Eleventh Circuit joins other U.S. Circuit Courts of Appeal that have allowed paid for new value. Only the Seventh Circuit, "without much discussion" according to the Eleventh Circuit, rejects paid new value and limits the new value defense to unpaid new value. It will be interesting to see whether the Seventh Circuit eventually falls in

line with this emerging Circuit Court of Appeals consensus view, adopted most recently by the Eleventh Circuit, that the new value defense includes both paid and unpaid new value.

Finally, the Eleventh Circuit noted that a creditor cannot include paid new value as part of its new value defense where the payment for the new value is unavoidable for reasons other than Section 547(c)(4)'s new value defense. Where the new value is paid by a transfer that is subject to another preference defense, such as Section 547(c)(2)'s ordinary course of business defense, or Section 547(c)(1)'s contemporaneous exchange for new value defense, the payment for new value would be an unavoidable transfer that disqualifies the creditor from including that paid for new value as part of the creditor's new value defense.

What a way to start the fall of 2018 as we look forward to the holiday season!

Conclusion

The Eleventh Circuit's holding that a creditor can include paid new value as part of the creditor's



About the Author:

Bruce S. Nathan, Partner in the firm's Bankruptcy, Financial Reorganization & Creditors' Rights Department, has more than 30 years experience in the bankruptcy and insolvency field, and is a recognized national expert on trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters.