

The Propriety of Monetizing Preference Claims: Another Circuit Court Weighs In

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Abstract

This article explains the impact of a recent decision by the Fifth Circuit Court of Appeals on the monetization of preferences that were sold to a third party. This court is now the third circuit to allow the sale of a preference of an insider to a non-estate representative. The decision provides lawyers across the country with more case law to maximize value in a case with limited resources. This ruling, relying on monetizing instead of dismissing or abandoning the claims, will likely add to the practice and we will see third parties engage in the purchase and pursuit of preferences that would otherwise have been likely abandoned or not pursued by the debtor.

The recent decision by the Fifth Circuit Court of Appeals (the “Fifth Circuit” or the “Court”) in *Matter of South Coast Supply Company*¹ adds to the growing list of circuit courts that have held that preference claims arising under Bankruptcy Code Section 547 can be sold and pursued by non-estate representative third parties. This trend, if it continues, could provide debtors, secured lenders, and creditors’ committees increased flexibility to monetize potentially valuable claims that a bankruptcy estate could not otherwise pursue due to a lack of estate resources in the first instance. Additionally, it could allow them to quickly monetize the last few pending preference actions and be able to close a bankruptcy case and stop incurring ongoing administrative costs that would otherwise accrue if those claims would continue to be pursued. Nonetheless, this decision is a significant development because the Fifth Circuit includes Texas, one of the most popular venues for the filing of large Chapter 11 cases. While the decision could be narrowly construed, as the Fifth Circuit was careful to state that the issue needed to be decided on a case-by-case basis, here, in connection with the sale of a single insider² preference action, the holding will undoubtedly be relied upon by stakeholders across the country.

The Elements of a Preference Claim

A preference action is a type of “avoidance” action arising under Sections 547 and 550 of the Bankruptcy Code.³ Avoidance actions are...

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¹ 91 F.4th 376 (5th Cir. 2024).

² While neither the Fifth Circuit nor the District Court (defined herein) opinion explicitly mention whether the Preference Claim (defined herein) was an insider claim, the plaintiff’s (Briar Capital) complaint in the District Court and the confirmed Plan (defined herein) referred to the Preference Claim as an insider preference claim and relied on a one-year lookback period.

³ While individual states have their own preference statutes, such statutes are beyond the scope of this article.