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Editors-in-Chief:

Byron C. Starcher
Nelson, Mullins, Riley & Scarborough, LLP
Suite 1400
999 Peachtree Street, NE
Atlanta, Georgia 30309-3964
404-817-6135
byron.starcher@nelsonmullins.com

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Mark I. Duedall
Alston & Bird LLP
One Atlantic Center
1201 West Peachtree Street
Atlanta, Georgia 30309-3424
404-881-7887
mduedall@alston.com

Introduction

Thank you for reading this, our second edition of the Preference Quarterly Law Journal. We were pleased with the notes some of you sent after our first edition. We hope to continue to use the Preference Quarterly to provide practical tips and commentary primarily on preferences under § 547 of the Bankruptcy Code. Believing that providing high-quality information to those in the field will improve the field as a whole, we will reach out to bankruptcy specialists, attorneys with only occasional exposure to preferences, and even non-attorneys with this publication.

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Did you know

Federal Rule 36(a), which applies to preference actions by Bankruptcy Rule 7036, allows you to seek the admission of not only facts, but also “the application of law to fact.” So, when litigating a preference action, consider serving requests for admission on the ordinary course of business standards; the other side will have to answer them, and if they are denied without having “reasonable grounds” for the denial, then you may be reimbursed for attorneys’ fees if you must prove the matter at trial. See F.R.C.P. 37(c)(2). An effort to shift your fees to the other side, when backed up with the teeth of Rule 37, may come in handy if you are trying to reach a settlement on the eve of trial.

The (Adverse?) Effect of the New Administrative Claim of Section 503(b)(9) on Preference Actions

By Mark I. Duedall

Trade creditors are taking delight in the new Bankruptcy Code § 503(b)(9), which grants administrative priority for the value of goods received by the debtor during the 20 days prior to the case, if the sale was in the ordinary course of the debtor’s business. 11 U.S.C. § 503(b)(9). But could this administrative claim be just a pig in a poke, due to its potential adverse effect on the trade creditor’s “new value” defense under 11 U.S.C. § 547(c)(4)? That is, if a debtor in possession or trustee (hereafter a “DIP”) pays a trade creditor postpetition under § 503(b)(9) for goods delivered before the bankruptcy case, could the DIP later assert that the goods, now paid for, do not provide a “new value” defense under § 547(c)(4)? If so, then § 503(b)(9) accomplishes little for most trade creditors that had a prepetition relationship with the DIP. Sure, the DIP might pay a trade creditor \$20,000, or \$200,000, or more, for goods delivered just before the case, but if the DIP can thereby eliminate the same amount of new value and increase the trade creditor’s preference liability by the amount paid, then why bother?

Luckily (for trade creditors), a careful reading of the statutes and cases likely prevents this *de facto* nullification of § 503(b)(9).

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The articles herein are intended as general information, and not legal advice or a legal opinion. Readers should consult with legal counsel to obtain legal advice based on their situations. Opinions expressed herein are only those of the authors, and not any other party.

Recent Updates to Delaware Practice for Preference Counsel

*By Paul J. Dougherty, III
Gebhardt & Smith LLP
901 Market Street
Suite 451
Wilmington, Delaware 19801
pdoug@gebsmith.com
302-656-9002*

Introduction

One result of the continued popularity of Delaware as a top bankruptcy forum is that preference litigation has become a fact of life for the Delaware practitioner. As of July 2004, the United States Bankruptcy Court for the District of Delaware was home to more than 15,000 pending adversary actions. To be sure, local debtors' and creditors' attorneys are well-versed in the area. Delaware lawyers in other practice areas have also become skilled in the field by representing existing non-bankruptcy clients that are preference defendants, or by acting as local counsel to out-of-state attorneys. Foreign attorneys navigating Delaware preference practice for the first time, however, may benefit from knowing certain procedural details prior to retaining the required local counsel. This contribution to the Preference Quarterly Law Journal is intended not to replace the expertise of a Delaware lawyer; rather, it is offered to highlight recent technical changes in local practice and procedures which might be of interest to the non-Delaware practitioner.

Admissions

Local Rule 9010-1 of the United States Bankruptcy Court for the District of Delaware adopts U.S. District Court Local Rule 83.5 allowing the admission, pro hac vice, of a non-Delaware attorney only when the attorney associates with a member of the bar of the U.S.

District Court for the District of Delaware who also maintains an office within the district.¹

The process is no longer free, as the District Court now collects a \$25.00 fee once each calendar year for a lawyer's pro hac vice admissions. Counsel's first motion for admission pro hac vice in a calendar year must be accompanied by a check made payable to the U.S. District Court. Once paid, the District Court issues a receipt number used in docketing subsequent pro hac vice motions. A copy of the Court's standing order for this procedure is located at www.ded.uscourts.gov/StandingOrdersMain.htm. Pursuant to Local Form 105, which is required for all pro hac vice motions, the admittee must certify the fee has been paid or the motion will not be granted. Form 105 is at www.deb.uscourts.gov/Forms/localform105.pdf.

Telephonic Appearances

Until recently, telephonic appearances in the Delaware Bankruptcy Court were largely governed by the chambers procedures of each individual judge. Effective January 5, 2005, however, the Delaware Bankruptcy Court has consolidated the instructions for all telephonic appearances under the CourtCall system. The procedures for using CourtCall are located at

¹ Local Rule 9010-1(c) provides two exceptions to the requirement to associate with local counsel. First, local counsel is not required for "the filing or prosecution of a proof of claim or response to an objection to a proof of claim," although the Court may require association with local counsel "if the claim litigation will involve extensive discovery or trial time." Second, attorneys representing the United States of America (or any officer or agency thereof) admitted in another District Court may be admitted in Delaware if they file a certification indicating they are in good standing in the other court and agreeing to be bound by the local rules and disciplinary authority of the Delaware Court.

http://www.deb.uscourts.gov/Chambers/telephonic_procedures.pdf, and are summarized below.

CourtCall, an independent conference call provider, allows parties who have filed a pleading, application, objection, etc. to appear telephonically in the Court's proceedings, or to participate in "listen-only" mode if no such pleading has been filed in a particular case. Local counsel cannot use CourtCall, and CourtCall is not available for prosecuting trials or evidentiary hearings (although it is allowed for status conferences), or for parties objecting to Chapter 11 plan confirmation.

Counsel wishing to appear telephonically must notify CourtCall (tel: 866-582-6878, fax: 866-533-2946) of its intent to do so no later than 12:00 p.m. two business days prior to the hearing and provide: counsel's name, address, phone number and name of the party they represent; the case name and number, and the name of the judge conducting the hearing; the hearing date and time when they wish to appear; and the matter on which they wish to be heard, or whether counsel intends to monitor the proceeding in "listen-only" mode. If counsel wishes to be heard on a matter, it must also send written notification to counsel for the debtor and/or opposing counsel, providing the same information as above. The rules provide no guidance on how much notice the debtor and/or opposing counsel must be provided. After receiving fax confirmation and instructions from CourtCall, the participant must dial into the call no later than 10 minutes prior to the start of the hearing.

There are new costs for this procedure, regardless of whether a party intends to be heard or merely to listen. While there are no subscription fees or special equipment, CourtCall charges each participant an initial fee of \$50 at the time the notification to appear is

made, which covers the first 0-90 minutes of a party's appearance. The fee for the next 90 minutes is \$30 with each additional 90 minute increment costing \$40.

Finally, the Court has found it necessary to specifically ban the use of car phones, cell phones, speaker phones or public phones under the new system, and participants are forbidden from placing the call on hold at any time, or recording the call.

Adversary-Specific Updates

The changes above apply to all actions, and not only preference cases under § 547. The Delaware Bankruptcy Court has, however, enacted procedural changes expressly dealing with preference actions. All adversary proceedings filed on or after May 1, 2004, which include a claim to avoid a preference are subject to new streamlining procedures, found at <http://www.deb.uscourts.gov/advorder.pdf> and <http://www.deb.uscourts.gov/mediation/AmendmentGeneralOrder11april05.pdf>. The procedures include the following:

- No extensions of time to file a responsive pleading without a court order, and motions for such extensions may be made no later than ten days prior to the initial pretrial conference in an adversary proceeding;
- Rule 26(f) discovery planning conferences must occur within thirty days after the answer is filed, or sixty days after the adversary proceeding is commenced, whichever is earlier;
- Rule 26(a)(1) initial disclosures must be provided within fourteen days after the initial discovery planning conference;

***Delaware Practice Update, continued
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- Parties must file a Stipulation Regarding Appointment of Mediator no later than one hundred twenty days after an answer is filed, or the court itself will assign the action to a mediator; and
- Trial dates will be set for no more than ninety days after the entry of an order assigning the adversary proceeding to mediation.

* * *

***Section 503(b)(9) and Preferences,
continued from page 1***

For purposes of this article, we'll use the following basic hypothetical. A supplier of goods to the debtor ("Supplier") sells \$50,000 in goods to the debtor 150 days before the bankruptcy case, on an open invoice with net 30 day terms. Supplier does not take a purchase money security interest in the goods, so it is an unsecured creditor of the debtor. 80 days before the case, the debtor pays Supplier \$50,000 for the goods. This creates a *prima facie* preference action under § 547(b): there was a transfer of an interest of the debtor to Supplier, which is a creditor, on account of an antecedent debt owed by the debtor before the transfer was made. 11 U.S.C. § 547(b)(1)-(2). The transfer was made during the 90 days before the bankruptcy case, and debtor is presumed insolvent under § 547(f), thus satisfying § 547(b)(3)-(4). Finally, because Supplier is an unsecured creditor that would likely receive pennies on the dollar in bankruptcy, the transfer enables Supplier to receive more than if the transfer had not been made and the case had been filed under Chapter 7, thus satisfying § 547(b)(5). As to preference defenses, given that the transfer took place well beyond invoice terms, Supplier will have a difficult time proving the transfer was a

contemporaneous exchange for value or that it was in the ordinary course of business (although I don't entirely discount the ordinary course defense, in light of the easing of that defense under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005; that is a matter for another article.)

Accordingly, absent any "new value defense" under § 547(c)(4), Supplier will be writing a check to the DIP for \$50,000 (or such smaller amount as it can negotiate, if other defenses exist) when Supplier is sued to recover the preferential transfer. But now assume that Supplier delivers \$40,000 worth of goods, once again on an unsecured basis, to the debtor 15 days before the bankruptcy filing. Under § 547(c)(4), Supplier has a new value defense because, after the transfer to Supplier, Supplier "gave new value to or for the benefit of the debtor." 11 U.S.C. § 547(c)(4). The \$40,000 worth of goods is "money's worth in goods" and so it falls within the definition of "new value" set forth in § 547(a)(2).¹ The \$40,000 worth of goods was given to the debtor, further satisfying the introductory language of § 547(c)(4). Now the question is whether § 547(c)(4)(A) and (B) are satisfied, establishing the \$40,000 new value defense.

¹ While it is beyond the scope of this article, practitioners should note that one bankruptcy court has held that "goods shipped on the eve of bankruptcy that are subject to reclamation are not the same 'money or money's worth' [under § 547(a)(2)] as goods shipped free of the seller's strings." Phoenix Restaurant Group v. Proficient Food Company (In re Phoenix Restaurant Group), 2004 Bankr. LEXIS 2186, *40 (Bankr. M.D. Tenn. Dec. 16, 2004). Accordingly, if Supplier could **reclaim** the goods in question, those goods may not serve as new value, at least according to this ruling. The author notes, in the interests of full disclosure, that he represents the defendant in this action, and so no commentary is presented on this decision other than to note its existence for the benefit of bankruptcy practitioners.

Both appear to be satisfied. First, § 547(c)(4)(A) is satisfied because the new value was not “secured by an otherwise unavoidable security interest.” Supplier was selling to debtor on an unsecured basis. Second, § 547(c)(4)(B) is satisfied because there was no “otherwise unavoidable transfer” made by the debtor on account of the \$40,000 in new value provided just before the bankruptcy filing. Accordingly, based on these facts, Supplier has a \$40,000 new value defense to the \$50,000 transfer, resulting in a net preference liability of \$10,000.

Any payment of the \$40,000 worth of new value **postpetition** by the DIP pursuant to § 503(b)(9) should not change the result at all. The \$40,000 delivery of goods still qualifies as new value under § 547(a)(2), and the delivery was still made to the debtor by Supplier. Accordingly, if the DIP is to argue that the new value defense no longer applies, it must show that either § 547(c)(4)(A) or (B) is not satisfied by virtue of the postpetition payment pursuant to § 503(b)(9).

Section 547(c)(4)(A) remains satisfied because the new value still was not “secured by an otherwise unavoidable security interest.” Section 503(b)(9) provides an administrative priority to certain prepetition claims. This new administrative priority in no way creates a “security interest”—it does not attach to any property, nor does it entitle Supplier to adequate protection under § 361 or any of the other benefits of a secured creditor. There are no indicia of a security interest in the new administrative priority of § 503(b)(9), and so any argument that § 547(c)(4)(A) is not satisfied where there is a payment pursuant to § 503(b)(9) should be rejected.

Section 547(c)(4)(B) presents a more complicated analysis, but a careful reading shows that this part of the new value defense

also remains satisfied, despite any postpetition payment of the new value under § 503(b)(9). First, § 547(c)(4)(B) only allows a new value defense if “the debtor **did not make** an otherwise unavoidable transfer” thereafter to Supplier. 11 U.S.C. § 547(c)(4)(B) (emphasis added). “Did not make” is past tense, i.e., referring to payments that must have been made prepetition. If § 547(c)(4)(B) would allow future payments to eliminate the new value defense, then the statute could easily have been reworded to read “on account of which new value the debtor did not *or does not* make an otherwise unavoidable transfer to or for the benefit of such creditor.” As taught by U.S. v. Ron Pair Enters., 489 U.S. 235 (1989), grammar counts when reading statutes, and this includes the tense of verbs. See, e.g., In re Kerner Printing Co., 178 B.R. 363, 370 (Bankr. S.D.N.Y. 1995) (tense of statute prevents interpretation suggested by one of the litigants).

Most cases are in accord with the view that the petition date fixes the preference claim and any preference defenses. Accordingly, those cases hold that postpetition payments do not reduce new value, although the reasoning and discussion is sparse in those opinions. See Grant v. Sun Bank (In re Thurmon Constr., Inc.), 189 B.R. 1004, 1014 (Bankr. M.D. Fla. 1995) (“[A]s of the date of the [bankruptcy] petition, the \$10,000 advance remained unpaid. Thus, the fact that [the preference defendant] received payment of the new value subsequent to the petition date is irrelevant to this discussion.”); see also New York City Shoes, Inc. v. Bentley Int’l, Inc. (In re New York City Shoes, Inc.), 880 F.2d 679, 680 (3d Cir. 1989) (“[T]he debtor must not have fully compensated the creditor for the ‘new value’ as of the date that it filed its bankruptcy petition” for the new value to qualify as a preference defense) (citing other cases in support); Energy Coop., Inc. v. Cities Serv. Co. (In re Energy Coop.), 130 B.R. 781, 789 (N.D. Ill. 1991) (same, and citing cases); cf. Regan v. Chicago

Tribune Co. (In re Homelife Corp.), 2005 Bankr. LEXIS 1542 (Bankr. D. Del. Aug. 15, 2005) (defendant/supplier's sale of all rights in claim against debtor did not divest defendant/supplier of new value defense; sale occurred after provision of new value, and thus was not relevant to defense).²

Moreover, it is well accepted that postpetition goods or services provided by a creditor do not enhance the creditor's new value defense. See, e.g., Field v. Md. Motor Truck Ass'n (In re George Transfer, Inc.), 259 B.R. 89, 95-96 (Bankr. D. Md. 2001) (citing cases). To allow postpetition payments to reduce a creditor's new value defense, while at the same time holding that postpetition provision of new value has no effect on the defense, is internally inconsistent and unfair. See also Phoenix Restaurant Group v. Proficient Food Company, *supra* footnote 1, at *28-*35.

As further support for this conclusion, § 547(c)(4)(B) only allows a new value defense if “**the debtor** did not make an otherwise unavoidable transfer” to or for the benefit of Supplier on account of the new value. 11 U.S.C. § 547(c)(4)(B) (emphasis added). But in the case of a postpetition payment, “**the debtor**” is not making any transfer—it is the

² While the “did not make” language in § 547(c)(4)(B) is undoubtedly past tense and thus refers to previous transfers, a preference plaintiff could argue that the point at which the inquiry should be made is when the preference action is filed, as opposed to the petition date. There seems to be little supporting such an argument, however. First, it runs counter to the cases cited above, holding that the bankruptcy petition fixes preference liability and defenses. Second, such a result would encourage preference plaintiffs to defer filing the lawsuit until after additional facts (such as the making of postpetition payments) have improved the plaintiffs' position.

DIP that is paying the claim. See also 11 U.S.C. § 363(b), 1107(a) (only a trustee, or a debtor in possession with the powers of a trustee, can use property of the estate).³ And § 547, as well as many other sections of the Bankruptcy Code, is very precise when it comes to distinctions between the debtor and the DIP. See, e.g., Phoenix Restaurant Group v. Ajilon Professional Staffing LLC (In re Phoenix Restaurant Group), 317 B.R. 491, 497 (Bankr. M.D. Tenn. 2004) (“Throughout § 547, ‘the debtor’ refers to the prepetition entity that transferred property or engaged in business with the preference defendant.”). For instance, § 547(b) refers to the “trustee’s” right to avoid a transfer, but the transfer must have been made by the “debtor.” This creates a clear distinction: only a trustee can avoid a transfer

³ This answer could be different in a Chapter 13 case, as there the debtor does have certain of the rights of a trustee, including the right to use property under § 363(b). Presumably, this right to use property would result in the debtor paying an administrative claim that arises under § 503(b)(9), to the extent the creditor has satisfied the terms of that section. Thus, in a Chapter 13 case, postpetition payments would be made by the debtor, potentially affecting the new value calculation under the plain language of § 547(c)(4)(B). On the other hand, the payments still would not have been made as of the petition date, and so the postpetition payment would still run afoul of the past tense, “did not make” language in § 547(c)(4)(B). Moreover, even where a creditor is paid postpetition by a Chapter 13 debtor, the creditor would have still complied with the overarching purpose of the new value defense: to “encourage[] creditors to continue their revolving credit arrangements with financially troubled debtors, potentially helping the debtor avoid bankruptcy altogether.” Laker v. Vallette (In re Toyota of Jefferson, Inc.), 14 F.3d 1088, 1091 (5th Cir. 1994). Accordingly, despite the slightly different analysis when a Chapter 13 debtor makes a postpetition payment, the result should be the same, and such payment should not affect the new value calculation.

(or the debtor in possession with the powers of a trustee, under § 1107(a)), but the transfer avoided must have been the debtor's property, i.e., prepetition property, and not property of the estate.⁴

Accordingly, a careful reading of § 547(c)(4)(B) shows it has no application to postpetition payments of any kind, which would include postpetition payments by a DIP of a prepetition claim entitled to priority under § 503(b)(9). This careful reading also avoids other absurd results. For instance, if postpetition payments could reduce new value, then fixing the proper amount of a new value defense would require the court to determine the creditor's potential distribution under a plan or a Chapter 7 liquidation, as such distribution

⁴ In one instance, however, the "debtor" does make postpetition payments, which could affect this analysis. Under § 1142, a debtor can carry out the provisions of a plan if so ordered by the court. Thus, if under a confirmed plan, a debtor makes post-petition payments to a creditor (by virtue of § 503(b)(9) or some other provision requiring payment), the preference plaintiff could argue that these "debtor" payments do affect the analysis under § 547(c)(4)(B). This argument should not succeed, however, as even where a debtor makes payments under a plan under § 1142, it is the debtor acting as successor to the DIP. Accordingly, the debtor should have the same rights (and limits on those rights) as the DIP, including limits on the ability of the DIP to reduce the new value defense through postpetition payments. See, e.g., Terry v. Fed. Ins. Co. (In re R.J. Reynolds - Patrick County Mem'l Hosp., Inc.), 315 B.R. 674 (Bankr. W.D. Va. 2003) (litigation trustee created by plan to bring causes of action was assignor of the estate; held, that an assignee steps into the shoes of the assignor and the assignee's situation is no better than that of the assignor, and thus the trustee did not have any different rights than the DIP); In re CSC Indus., Inc., 226 B.R. 402, 406 (Bankr. N.D. Ohio 1998) (liquidating trust established under a plan as the successor to the DIP was still subject to the DIP's obligations, such as payment of U.S. Trustee fees).

would be a potential postpetition payment the defendant would receive once it has dealt with its preference liability. No case suggests that this bizarre sort of calculus is required, but if postpetition payments reduce one's new value defense, it would be customary in all preference actions. See also Columbia Packing Co. v. Allied Container Corp. (In re Columbia Packing Co.), 44 B.R. 613 (Bankr. D. Mass. 1984) (rejecting the trustee's argument that once invoices have been used to establish a new value defense to a preference, the creditor has waived its right to assert a claim on account of those invoices). Indeed, the § 502(d) analysis would be equally complex if postpetition payments could reduce a creditor's new value defense. For instance, a creditor may have a complete new value defense to a preference, and thus its claim should not be disallowed by § 502(d). Yet once the creditor is paid on its allowed claim, if that payment reduces new value dollar-for-dollar, then perhaps the creditor no longer has a complete new value defense, and thus it should not have been paid in the first place under § 502(d). If postpetition payments reduced a creditor's new value defense, these circular calculations would be required in every case.

In short, for the reasons set forth above, a **postpetition** payment by the DIP of a **prepetition** claim entitled to administrative priority under § 503(b)(9) does not affect the analysis under § 547(c)(4)(B).

There are cases holding to the contrary, mandating that postpetition payments of claims that provided a new value defense cause a dollar-for-dollar reduction in that new value. In Ringel Valuation Servs., Inc. v. Shamrock Foods Co. (In re Arizona Fast Foods, LLC), 299 B.R. 589 (Bankr. D. Ariz. 2003), the bankruptcy court held, with no citation to authority or any reasoning whatsoever, that postpetition payments by a non-debtor third party for goods delivered prepetition during the

reclamation period reduce the new value defense. *Id.* at 596-97. In that case, the debtor's supplier had asserted various claims against the debtor, including claims for goods it could reclaim. *Id.* at 591. The reclamation claim was allowed as an administrative claim through a stipulation, and paid in full by a non-debtor plan proponent pursuant to the debtor's confirmed plan. *Id.* at 592. Thereafter, the debtor sued the supplier to avoid prepetition transfers as preferences; when the supplier asserted its new value defense, the debtor filed a motion for summary judgment, arguing that as a matter of law, because the goods serving as new value had been paid for (albeit postpetition), those goods could no longer serve as new value.

The bankruptcy court focused on the language of § 547(c)(4)(B), but not in exactly the right way. The bankruptcy court noted correctly that § 547(c)(4)(B) requires an analysis of whether there was "an otherwise unavoidable transfer" on account of the new value. *In re Arizona Fast Foods, LLC*, 299 B.R. at 596 ("[W]here the repayment of the new value is unavoidable, the new value does not replenish the estate for prior preferential transfers, and those preferences may be avoided."). Payment of the reclamation claim was "an otherwise unavoidable transfer" as it was approved by stipulation and then paid under a plan, and could not be avoided. This is correct, but as noted above, it is only half of the analysis under § 547(c)(4)(B): the other part of the analysis must focus on **what entity** made the otherwise unavoidable transfer, as § 547(c)(4)(B) by its very terms refers only to transfers by the debtor. In *Arizona Fast Foods*, it was the co-proponent of the plan, a non-debtor, a fact that the bankruptcy court ignored. Accordingly, *Arizona Fast Foods* stands for the proposition that postpetition payments for goods reduce those goods' utility as new value, although in doing so the bankruptcy court disregarded the language of § 547(c)(4)(B) and

provided no reasoning or basis for doing so. *Arizona Fast Foods* should not be followed, and postpetition repayments of new value, whether pursuant to § 503(b)(9) or otherwise, should not reduce the availability of that new value to serve as a preference defense.

Before this article can conclude, one note to the "remains unpaid" crowd. Yes, some courts have held that new value must remain unpaid, relying on a very shorthand and cursory reading of § 547(c)(4)(B). *See, e.g., Kroh Bros. Dev. Co. v. Continental Constr. Engineers, Inc.*, 930 F.2d 648, 652-54 (8th Cir. 1991) (citing cases). But the "remains unpaid" shorthand is an incorrect reading of § 547(c)(4)(B): under the precise language of that section, the inquiry is not whether the new value "remains unpaid," but rather, whether the debtor made "an otherwise unavoidable transfer" on account of the new value. The difference is key, and most recent decisions agree with the reading dictated by the statute, as opposed to the "remains unpaid" formulation. *See, e.g., Hall v. Chrysler Credit Corp. (In re JKL Chevrolet, Inc.)*, 412 F.3d 545, 551-53 (4th Cir. 2005); *see also Intercontinental Polymers, Inc. v. Equistar Chems., LP (In re Intercontinental Polymers, Inc.)*, 2005 Bankr. LEXIS 997, at *33 (Bankr. E.D. Tenn. Mar. 31, 2005) (citing cases supporting and rejecting the "remains unpaid" shorthand, and holding "the 'emerging view' . . . is that the 'remain unpaid' approach is inconsistent with the plain language of the statute which only requires that the new value not be paid by 'an otherwise unavoidable transfer.'").

Despite this, "remains unpaid" cases still linger, and could result in the nullification of § 503(b)(9) by making each dollar paid postpetition reduce a dollar of new value defense. For instance, *Moglia v. Am. Psychological Ass'n (In re Login Bros. Book Co.)*, 294 B.R. 297 (Bankr. N.D. Ill. 2003) held that **postpetition** repayments of new value

By Byron C. Starcher

deplete that new value, since the new value must “remain unpaid.” But, as set forth above, Moglia mis-reads § 547(c)(4)(B) for two reasons: first, it ignores that § 547(c)(4)(B) excludes new value only when the debtor, and not the DIP or some third party, makes a transfer on account of the new value. Second, it ignores that § 547(c)(4)(B) focuses on whether new value was followed by an “otherwise unavoidable payment,” which is very different from whether the new value “remained unpaid.”

In conclusion, § 503(b)(9) will help many trade creditors by elevating the priority of their claims for goods delivered to the debtor during the 20 days before the bankruptcy case. In addition to an elevated priority, a careful reading of § 547(c)(4) would result in no impact on a trade creditor’s new value defense, despite that some or all of the goods comprising the new value defense may be paid for postpetition under § 503(b)(9). Some DIPs may complain that allowing payment of the claim **and** using the goods as new value is “double-dipping.” But at bottom, the Bankruptcy Code permits a trade creditor to use its claim for both purposes: to seek administrative priority within the confines of § 503(b)(9), and to protect against a subsequent preference action. Moreover, the enhanced benefits provided to creditors under § 503(b)(9) does not change the fact that such creditors complied with the policy behind § 547(c)(4): providing unsecured trade credit to a debtor in the hopes of keeping it out of bankruptcy. See supra footnote 3. Thus, § 503(b)(9) should provide substantial benefit to trade creditors without adversely affecting their potential preference liability.⁵

⁵ Another interesting issue raised by new § 503(b)(9), but which is outside the scope of this article, is whether an unpaid § 503(b)(9) priority claim can be used as a setoff against preference liability under § 547. As noted in our last issue of The articles herein are intended as general information, and not legal advice or a legal opinion. Readers should consult with legal counsel to obtain legal advice based on their situations. Opinions expressed herein are only those of the authors, and not any other party.

Mark and I have discussed the issues within this article at great length. As he has pointed out, the Code mandates his conclusions in most situations practitioners are likely to see. I am troubled, however, that the Code, which normally contains remarkably consistent logic, fails to provide a clear answer in all situations. A literal reading of the Code suggests that a Chapter 13 debtor and possibly a post-confirmation debtor could make postpetition transfers that would reduce the new value defense. See supra footnotes 3 and 4. This “problem” did not arise with the addition of § 503(b)(9) by the BAPCPA, but has always existed with respect to postpetition transfers, usually in the form of claims distributions made on account of prepetition new value. I believe Mark’s conclusions are correct; the results are bizarre otherwise. But I also believe the answer requires judge-made law, such as the Grant and New York City Shoes cases cited in

the Preference Quarterly, if a creditor/defendant argues that “a prepetition obligation of the debtor to the creditor should be setoff against the obligation of the creditor to disgorge a preference, this use of setoff should be prohibited by § 553 itself, which permits setoff only of mutual obligations. As the creditor’s obligation to disgorge a preference only arises postpetition, that obligation should never be mutual as to a prepetition obligation of the debtor.” Byron C. Starcher, Preference Actions and Kitchen Sink Affirmative Defenses, Pref. Q. L. J., Vol. 1, No. 1, at p. 4. Yet in the case of § 503(b)(9), the debtor’s prepetition obligation is elevated to administrative priority, and most cases have held that administrative claims can be setoff against preference liability. Id. at pp. 5-6 (citing cases). In this case, though, the § 503(b)(9) administrative claim still arose prepetition and is only artificially given postpetition administrative priority by Act of Congress, so mutuality may be lacking nonetheless. This issue will also require further exploration, either in the caselaw or commentary.

the article, to fill the logical gaps in the Code. Finding that § 547(c)(4)(B) requires the debtor's "otherwise unavoidable transfer" to have been made by the petition date is a sufficient and logical gap-filler, but is not required by the literal language of the Code. The fact that these cases address this important issue without much analysis is, in my mind, telling of the Code's inadequacy on this point.

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Feedback is also important to us. If we err, overlook a point, or if you are aware of caselaw or information to supplement a topic, please contact us so that we can issue an update in the next edition. Also, if you have any ideas on how we can improve the Preference Quarterly, let us know.

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