

Eleventh Circuit Bolsters Preference Defense by Holding That 503(b)(9) Claims Do Not Reduce the Subsequent New Value Defense

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Preference defense received an important boost this week when the Eleventh Circuit decided that invoices paid under 11 U.S.C. § 503(b)(9) can count as "new value" in defending against preference claims. It is the first circuit court to consider the question, making its decision in favor of creditors' rights that much more significant.

A brief review of two key points helps put the opinion in perspective. First, in 2005, section 503(b)(9) was added to the Bankruptcy Code. This section provides special treatment for goods delivered to a debtor within 20 days of the debtor's filing of a bankruptcy petition. Although there are some conditions and caveats, this section of the Bankruptcy Code often allows creditors to receive full payment in the debtor's bankruptcy case for goods they provided during this short window. Claims for payment for these goods are often referred to as "503(b)(9) claims."

Second, the Bankruptcy Code allows a bankruptcy debtor to file "preference" lawsuits, which are attempts to claw back funds paid to creditors in the 90 days preceding the filing of the debtor's bankruptcy petition. The Bankruptcy Code also provides creditors with defenses to these suits that may reduce or eliminate a creditor's liability. One such defense is the "Subsequent New Value" defense. This defense reduces a creditor's preference exposure by the amount of the "new value" the creditor provided to the estate after a preferential transfer (*i.e.*, a payment to the creditor) was made. Usually, new value takes the form of goods and services that the creditor provided to the debtor, and is documented by an invoice that was issued for those goods and services. The important point is that new value only counts as a defense in a preference action if "the debtor did not make an otherwise unavoidable transfer" on account of the new value provided.

The question that arises then is this: if a creditor is paid for an invoice under section 503(b)(9), is that payment an "otherwise unavoidable transfer" that prevents the creditor from counting the invoice as "new value" in defense of a preference claim? Debtors argue that it is, because they cannot "avoid" (*i.e.*, recover)[1] payments they make under section 503(b)(9). Further, allowing creditors both to be paid for an invoice and to use it to defend against a preference action feels like "double counting" to them. Creditors deny that it is double counting as they are not trying to get paid twice—they merely hope to retain money they rightfully earned. Further, there is no logical reason for providing creditors with special treatment under section 503(b)(9) only to have that treatment negated in a preference action.

Until now, no circuit court had weighed in on the question, and lower court decisions were split on the issue. Now, the Eleventh Circuit has held that the "otherwise unavoidable transfer" language in the law applies only to pre-petition transfers; it does not apply to post-petition payment of 503(b)(9) claims. Thus, an invoice that is paid for as a 503(b)(9) claim may also be used to help defend a preference lawsuit. Although this decision is only binding on bankruptcy courts in the Eleventh Circuit (Alabama, Florida, and Georgia), it likely will have persuasive value nationwide as courts continue to wrestle with the issue.

Miller Canfield regularly assists clients in navigating the Bankruptcy Code and is a leader in preference defense. Should you have any questions or need assistance, please contact us.

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[1] Preference actions themselves are referred to as "avoidance" actions because debtors use them to avoid and recover money they previously paid to creditors.