

## **Bankruptcy Court Supports New Value Defense**

The United States Bankruptcy Court for the Middle District of Tennessee has ruled that goods supplied by a vendor within 20 days prior to bankruptcy qualify as “new value” in defending a preference claim.

In The Commissary Operations, Inc., the debtor filed numerous preference actions against vendors for payments made within 90 days prior to the bankruptcy filing. As it turns out, a number of those vendors had also filed administrative claims under Section 503(b)(9) of the Bankruptcy Code, asserting entitlement to “20 day administrative claim” status, for the value of goods shipped to and received by the debtor within 20 days prior to the bankruptcy filing. Absent an administrative insolvency of the debtor, administrative claims are usually paid in full, while general unsecured claims usually receive little recovery.

In the preference actions against numerous vendors, the debtor filed a declaratory judgment action seeking a ruling that goods shipped within the 20 day period prior to the bankruptcy filing (and thus qualifying for the 20 day administrative claim status), do not count as “new value” in support of the new value defense to preferential claims. The debtor argued that allowing creditors to include such shipments as new value would allow creditors to receive double value for their 20 day administrative claim invoices; specifically, the administrative claim status AND a reduction of preference liability. The creditors of course argued that they were entitled to the benefit of Section 503(b)(9) allowing sellers of goods an administrative priority claim for deliveries of goods within the 20 day period prior to the bankruptcy filing. After all, the delivery of goods enhanced the debtor’s estate in an amount equivalent to the value of the goods.

The Bankruptcy Court analogized 503(b)(9) claims (20 day administrative claims) to critical vendor claims. Bankruptcy Courts have often recognized that when a bankruptcy court approves payment of prepetition claims of suppliers pursuant to a “critical vendor” order, those payments do not deplete the new value defense. The Court saw no reason why critical vendors should be in a better position than 503(b)(9) claimants, given the Bankruptcy Code expressly provides for payment of their claims. The Court also distinguished 20 day administrative claims from reclamation claims by observing that delivery of goods subject to reclamation rights are somewhat conditional, while goods subject to a 20 day administrative claim are sold with no strings attached.

The Court also observed that to force a creditor to choose between asserting a Section 503(b)(9) claim and preserving its right to assert a subsequent new value defense that includes deliveries made to the debtor within 20 days prior to the bankruptcy filing would undermine Congress' policy of encouraging creditors to do business with troubled entities. To not allow creditors the full protection afforded by the Bankruptcy Code would in fact chill creditors' willingness to do business with failing companies.

Based on this reasoning, the Bankruptcy Court agreed with the creditors and allowed such creditors to include as part of their new value defense the value of goods shipped within 20 days prior to the bankruptcy filing, regardless of the fact that these creditors asserted claims for administrative priority status for the goods delivered in this window. The take away from this ruling is that creditors should vigorously assert their right to include goods shipped within the 20 days prior to the bankruptcy filing as part of their new value defense, and have a well-reasoned bankruptcy court decision to support that position.

We hope you found this useful and informative. Please contact us if you have any questions regarding this or any other matter.

©David H. Conaway, Shumaker, Loop & Kendrick, LLP  
704.375.0057 • [dconaway@slk-law.com](mailto:dconaway@slk-law.com)  
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