

BY-LINED ARTICLE

'Double Dipping' New Value Defense and Administrative Expense Claims

By Rudolph J. Di Massa Jr. and Laura D. Bonner

May 7, 2010

The Legal Intelligencer



In *Commissary Operations Inc. v. Dot Foods Inc.*, the U.S. Bankruptcy Court for the Middle District of Tennessee held that the value of goods delivered pre-petition to a debtor for which a creditor receives an administrative expense claim may also be applied in calculating credits under the "new value" defense to a preference action. Addressing a matter of apparent first impression, the court clarified and strengthened the new value defense available to preference defendants in bankruptcy cases, allowing preference defendants to benefit from the same shipment in these two ways.

Facts

According to the bankruptcy court's opinion, Commissary Operations Inc., a wholesale distributor of food products and related items to chain restaurants and restaurant franchisees, filed a petition under Chapter 11 of the Bankruptcy Code on July 22, 2008. During the course of the case, more than 200 creditors asserted claims in the bankruptcy for allowance of administrative expenses arising under Section 503(b)(9) of the code. The debtor initiated proceedings against several of these creditors, seeking the recovery of alleged preferential transfers made by the debtor within the 90 days before the debtor's filing. The creditors asserted a "new value" defense, including in that defense the amounts they were seeking to be paid as administrative expense claims. In response, the debtor sought a declaratory judgment that the creditors could not use the same invoices to support both an administrative claim under Section 503(b)(9) and a "new value" defense to a preference action under Section 547(c)(4).

Background

Section 547 of the Bankruptcy Code provides that a debtor may avoid preferential transfers, i.e., transfers of the debtor's property, on account of antecedent debt, made within 90 days before the bankruptcy filing. For purposes of Section 547, there is a presumption that the debtor was insolvent during the "preference period."

There are various statutory defenses to a preference action under Section 547, including that the transfer was in the ordinary course of the debtor's business with the creditor; that the transfer constituted a contemporaneous exchange of value between the debtor and the creditor; or that the creditor advanced new value to the debtor during the preference period. Under the new value defense of Section 547(c)(4), where a creditor who has received an otherwise preferential payment extends new value to the debtor (e.g., by shipping goods to the debtor) that is not secured by an otherwise

unavoidable security interest, the creditor may defend against a preference action to the extent of the new value furnished by the creditor to the debtor.

In establishing the new value defense, Congress intended to encourage creditors to continue to deal with struggling businesses in the hope that these businesses would become stronger with ongoing operations; obviously, the greater the number of creditors refusing to deal with these struggling businesses, the greater the likelihood that these struggling businesses would slide into bankruptcy. The new value defense, therefore, is intended to protect creditors from preference actions whenever these creditors provide businesses with new goods or services during the preference period.

In 2005, as part of the Bankruptcy Abuse and Consumer Protection Act, Congress enacted Section 503(b)(9), under which a creditor may assert its right to an administrative expense claim for the value of any goods received by the debtor within 20 days before the date that the bankruptcy petition is filed where those goods have been sold to the debtor in the ordinary course of the debtor's business. Administrative expense claims are given high priority under Section 507.

Arguments

The debtor argued simply that a creditor should not be allowed to receive "double value" by attaining administrative expense status for the value of goods delivered by the creditor and being permitted to offset that same value against a preference claim brought against the creditor. In response, the creditors asserted that the goods that comprise an administrative expense claim under Section 503(b)(9) benefit the pre-petition debtor and the debtor's estate upon the filing of the bankruptcy petition and, accordingly, the value of these goods should not be excluded from the new value defense described in Section 547(c)(4). The creditors advanced five arguments in support of their position.

First, the creditors pointed out that unlike a reclamation claim (whereby a creditor may seek return of the goods it delivered to a debtor), an administrative expense claim only affords a creditor the right to seek administrative expense status. Therefore, the debtor does not lose the value of goods delivered to it; it simply must pay for those goods at a higher priority level.

Second, the creditors reasoned that post-petition payments to a creditor may not be used to deplete new value, and any payment on an administrative expense claim necessarily occurs after the bankruptcy filing. Third, the creditors argued that their interpretation furthers the policy behind sections 503(b)(9) and 547(c)(4) of encouraging creditors to continue to do business with a troubled company.

Fourth, the creditors maintained that forcing a creditor to choose between submitting an administrative expense claim and asserting a new value defense conflicts with the bankruptcy courts' interpretation and treatment of the new value defense. Finally, the creditors asserted that the plain language of the statute supported their position.

The Court's Analysis

The court first distinguished a 503(b)(9) administrative expense claim from a reclamation claim. It considered the decision in *Phoenix Restaurant Group Inc. v. Proficient Food Co.*, which provided that goods subject to a reclamation claim could not qualify as new value for 547(c)(4) purposes. Reclamation is a state law claim recognized under the Uniform Commercial Code that is preserved in bankruptcy by Section 546(c).

The court noted that administrative expense claims and reclamation claims are fundamentally different. Unlike a reclamation claim where the debtor is obligated to segregate and return the reclaimed goods, an administrative expense claim does not limit the debtor's use of the subject goods. Furthermore, an administrative expense claim only arises after the filing of the bankruptcy petition, and the holder of an administrative expense claim is not entitled to a lien on the goods subject to the claim. For these reasons, the court determined that the considerations driving the decision in *Phoenix Restaurant Group* did not apply to the case at hand.

The court also looked at the congressional policy behind Section 503(b)(9). The court found that the policy behind sections 503(b)(9) and 547(c)(4) is to encourage creditors to do business with troubled companies. The court determined that forcing a creditor to choose between asserting an administrative expense claim and preserving its right to assert a new value defense would likely chill the creditor's willingness to continue doing business with a troubled company. Further, the court found forcing a creditor to make such a choice deprives it of the benefits conferred by Congress in enacting Section 503(b)(9).

Finally, the court looked at the plain language of sections 503(b)(9) and 547(c)(4). The court noted that when Congress enacted Section 503(b)(9) in 2005, it did not amend Section 547(c)(4). Moreover, the court noted there is nothing in the plain language of the statute suggesting that Congress intended to offset the benefits of Section 503(b)(9) through a corresponding reduction in the new value defense available to preference defendants.

In short, the court agreed with the creditors. It held that invoices giving rise to a claim for administrative expense status under Section 503(b)(9) may also be used to support a new value defense under Section 547(c)(4).

Conclusion

The decision in *Commissary Operations* provides creditors with more ammunition in their arsenal of weapons to defend against preference actions. The *Commissary Operations* court gave great weight to the policy objectives behind the Bankruptcy Code, emphasizing the importance of encouraging creditors to continue to deal with struggling businesses. In our current economic environment, the importance of these policy objectives becomes even clearer.

Rudolph J. Di Massa, Jr., a partner at Duane Morris, is a member of the [business reorganization and financial restructuring practice group](#). He concentrates his practice in the areas of [commercial litigation](#) and [creditors' rights](#). He is a member of the American Bankruptcy Institute, the American Bar Association and its business law section, the Commercial Law League of America, the Pennsylvania Bar Association and the business law section of the Philadelphia Bar Association.

Laura D. Bonner is an associate with the firm and practices in the area of business reorganization and financial restructuring.

This article originally appeared in The Legal Intelligencer and is republished here with permission from [law.com](#).