

# What Is the New Value Defense to a Preference Action?

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Creditors face many risks when a company files for bankruptcy. One such risk is preference exposure, which is where the company seeks to claw back funds paid to a creditor before the company files for bankruptcy. A general overview of preferences in bankruptcy can be found here<sup>1</sup>.

The Bankruptcy Code provides affirmative defenses that give a creditor an opportunity to reduce its preference exposure or liability. This article addresses the new value defense (sometimes called the subsequent new value defense). A discussion of the ordinary course of business defense, another important defense, can be found here<sup>2</sup>.

The new value defense is designed to encourage creditors to continue engaging with companies experiencing financial distress. The defense is contained in 11 U.S.C. § 547(c)(4), which provides the following:

The trustee may not avoid under this section a transfer — (4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor — (A) not secured by an otherwise unavoidable security interest; and (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

For this defense, a creditor generally should show (i) the debtor was given new value after the alleged preferential payment, (ii) the new value was not secured by an unavoidable security interest, and (iii) the new value provided remains unpaid as of the bankruptcy filing.

A short example may be instructive. A company pays a creditor \$20,000 on January 1. The creditor provides the company with goods totaling \$10,000 on January 10. On January 13, the company files for bankruptcy before it can pay the creditor \$10,000 for the goods it provided on January 10. If the company were to assert a preference for the \$20,000 payment it made to the creditor on January 1, the creditor could reduce its preference exposure by \$10,000 — the amount in goods it provided on January 10. The remaining \$10,000 reflects the new value the creditor provided after the preferential payment.

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<sup>1</sup> See How Can You Protect and Defend Your Business From Preference Actions? [tp\\_creditors-rights-toolkit\\_protect-and-defend-your-business.pdf](https://troutman.com/tp_creditors-rights-toolkit_protect-and-defend-your-business.pdf) (troutman.com)

<sup>2</sup> See Preference Actions: What Is the Ordinary Course of Business Defense? [tp\\_creditors-rights-toolkit\\_preference-actions.pdf](https://troutman.com/tp_creditors-rights-toolkit_preference-actions.pdf) (troutman.com)

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As is evident from the foregoing example, the new value defense can be a straightforward mathematical-type defense, which can be easier to prove than the more subjective ordinary course of business defense. Accordingly, the new value defense is often the first defense asserted in a preference action. However, in practice, the new value defense analysis is not always straightforward. Courts may disagree on the defense's application and other facts may affect the availability of the defense. The following are things to keep in mind:

- Some jurisdictions permit a creditor to offset its new value against only the immediately preceding preferential payment while some courts permit a creditor to offset the new value against all prior preference payments.
- Preference exposure can never go below zero. This means that, depending on the timing of the payments and new value, the new value a creditor provides may not reduce its overall preference exposure.
- Determining when new value was provided can be difficult. If a creditor provides services, new value was provided on the date the services were performed. If a creditor provides goods, however, the new value may have been provided on the date the goods were shipped or the date the goods were delivered depending on the terms of the contract between the parties.
- Courts have different views on the effect of events that occur after the petition date on the new value defense. For example, some courts have held that post-petition payment on account of goods delivered pre-petition pursuant to Section 503(b)(9) claim<sup>3</sup> prohibits the creditor from using the value of such goods as new value.

Though it may be easier to assert than other preference defenses, the new value defense does not come without its own complex analysis. Creditors should retain competent counsel to analyze whether the new value defense can be asserted. Retaining competent counsel will place a creditor in the best position to reduce or eliminate its preference liability.

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<sup>3</sup> See [What Is a Section 503\(B\)\(9\) Claim and How Can It Improve My Chances For Recovery?](https://www.troutman.com/insights/publications/2018/03/what-is-a-section-503(b)(9)-claim-and-how-can-it-improve-my-chances-for-recovery/) [tp\\_creditors-rights-toolkit\\_what-is-a-section-503b9-claim.pdf](https://www.troutman.com/insights/publications/2018/03/what-is-a-section-503(b)(9)-claim-and-how-can-it-improve-my-chances-for-recovery/) (troutman.com)