Section 547(c)(4) New Value in the 11th Circuit after *Auriga Polymers, Inc.* and *In re BFW Liquidation*

Section 547(c) of the Bankruptcy Code details nine defenses to a trustee's ability to avoid a prepetition transfer as a preference. One of those defenses allows an entity "who provides new value after receiving a preferential transfer [to] use that new value[1] to offset its preference liability."[2] The defense—sometimes called the "subsequent new value" defense—is fairly easy to apply. Consider the following example:

> Creditor receives a $50,000 payment from Debtor as to goods Creditor previously supplied to Debtor on credit. The $50,000 payment is made by Debtor within 90 days of Debtor's petition date, and the payment otherwise meets the requirements detailed in § 547(b). Two weeks after Debtor's payment, but before Debtor's petition date, Debtor orders an additional $25,000 in goods from Creditor (again on credit) and Creditor abides, delivering the goods the next day. Assuming no other transfers or payments are made between Debtor and Creditor prior to Debtor's bankruptcy filing, a trustee or debtor-in-possession can seek to unwind the $50,000 payment as a preference. But because of the subsequent new value defense, Creditor will be entitled to offset the $50,000 payment by the $25,000 in goods supplied to the Debtor after the payment was made.

Thus, the subsequent new value defense is pretty straightforward in most instances. Even so, aspects of § 547(c)(4)'s text have created some confusion. According to a recent Eleventh Circuit opinion, "[t]here are three elements to [the subsequent new value defense]: (1) the creditor must have given new value; (2) the new value was not secured by an otherwise unavoidable security interest; and (3) the debtor did not make an otherwise unavoidable transfer to or for the benefit of the creditor on account of the new value."[3] Confusion has arisen—mostly—because of the third requirement and the unfortunate phrase "otherwise unavoidable transfer." Two recent Eleventh

[1] As that term is defined in subsection (a) of § 547.

[2] *Auriga Polymers Inc. v. PMCM2, LLC*, No. 20-14647, 2022 WL 2800195 (11th Cir., July 17, 2022).

[3] (*Id.* at *5).

Circuit opinions (*In re BFW Liquidation, LLC*[4] and *Auriga Polymers Inc. v. PMCM2, LLC*[5]) illustrate some of the difficulties as to applying the third element. But, more importantly, the opinions settle two significant issues which will directly impact preference liability negotiations, at least in the Eleventh Circuit, going forward.

A. *In re BFW Liquidation, LLC* and Remains Unpaid

The issue in *In re BFW Liquidation* was whether a creditor's asserted new value must remain unpaid in order to successfully offset preference liability. The dispute arose as part of the Bruno's/Food World Chapter 11 case,[6] which is pending in the Northern District of Alabama. The liquidating trustee in the Bruno's case sought to avoid and recover as preferences a series of payments received by Blue Bell Creameries in the 90 days leading up to the Bruno's bankruptcy filing. In the aggregate, the payments totaled over $560,000, and Blue Bell asserted the subsequent new value defense in response to the trustee's claims. Blue Bell and the trustee stipulated that the payments were preferences, but disagreed as to Blue Bell's ability to rely on the new value defense.

Prior to Bruno's bankruptcy filing, Blue Bell was a significant supplier of ice cream and other merchandise which Bruno's resold to the public. In connection with their business arrangement, Blue Bell made almost daily deliveries of goods to Bruno's and Bruno's made regular payments to Blue Bell in response. But the regularity of Bruno's payments changed in late 2008 as it struggled with the cash flow issues which ultimately pushed it into bankruptcy. The payments at issue in the trustee's preference suit were made by Bruno's as to products Blue Bell delivered both during and prior to the 90-day preference period. And by the time Bruno's

[4] 899 F.3d 1178 (11th Cir. 2018).

[5] No. 20-14647, 2022 WL 2800195 (11th Cir., July 17, 2022).

[6] Bank N.D. Ala., Case No. 09-00634-TOM11.

bankruptcy case was filed, most of the goods supplied by Blue Bell during the 90-day period had been completely paid for by Bruno's.

Relying on the Eleventh Circuit's 1988 opinion in *In re Jet Florida System*,[7] the trustee argued that Blue Bell could not offset its preference liability by relying on new value which had otherwise been paid. In *Jet Florida*, the appeals court indicated that § 547(c)(4) "had generally been read to require: (1) that the creditor must have extended the new value after receiving the challenged payments, (2) that the new value must have been unsecured, and (3) that the new value must remain unpaid."[8] Though the issue in *Jet Florida* had nothing to do with paid new value, the Trustee seized on the third element recited by the Eleventh Circuit in support of his argument. At the time, a number of courts interpreted the *Jet Florida* decision to require that subsequent new value remain unpaid.[9] And the Trustee also found support for his argument in the Seventh Circuit which, to this day, requires new value to remain unsatisfied for § 547(c)(4) purposes.[10] In response, Blue Bell cited cases from other circuits as to the remains unpaid issue, and argued that the third element recited in *Jet Florida* was dictum. Believing itself bound by the Eleventh Circuit's statement in *Jet Florida* that new value must remain unpaid, the bankruptcy court ruled for the trustee and prevented Blue Bell from relying on its asserted, but paid, new value. Not long thereafter, the issue was sent to the Eleventh Circuit on a direct appeal.

On appeal, the Eleventh Circuit determined that the *Jet Florida* language requiring new value to "remain unpaid" was dictum. That conclusion allowed the court to review the "remains

[7] 841 F.2d 1082 (11th Cir. 1988).

[8] (*Id*. at 1083).

[9] *See In re Pillowtex Corp.*, 416 B.R. 123, 126-27 (Bankr. D. Del. 2009) (citing *Jet Florida* while including the Eleventh Circuit among those circuits which required new value to remain unpaid).

[10] *See In re Calumet Photographic, Inc.*, 594 B.R. 879, 882 (Bankr. N.D. Ill. 2019).

unpaid" issue anew. To do so, the court analyzed the plain language of the statute, finding it unambiguous. The court specifically indicated that "[n]othing in the language of § 547(c)(4) indicates that an offset to a creditor's § 547(b) preference liability is available only for new value that remains unpaid."[11] The court homed in on Section 547(c)(4)(B), which contains the unfortunate phrase "otherwise unavoidable transfer," and explained that "[b]y its plain terms … the statute only excludes 'paid' new value that is paid for with 'an otherwise unavoidable transfer."[12] Per the court, "so long as the transfer that pays for the new value is itself avoidable, that transfer is not a barrier to assertion of § 547(c)(4)'s subsequent-new-value-defense."[13]

Therefore, in the Eleventh Circuit—and in the Fourth, Fifth, Eighth, and Ninth Circuits—new value for 547(c)(4) purposes must not, in all circumstances, remain unpaid in order to count. Rather, the pertinent question is whether the payments made by the Debtor which ultimately satisfied the new value were otherwise avoidable.[14]

B. ***Auriga Polymers Inc. v. PMCM2, LLC*** **and 11 U.S.C. § 503(b)(9)**

Very recently, the Eleventh Circuit took up another issue related to the subsequent new value defense in *Auriga Polymers Inc. v. PMCM2, LLC.*[15] As in *BFW Liquidation*, the issue in *Auriga Polymers* was whether a creditor could rely upon a category of supplied goods as new value to offset its preference liability. But, unlike the *BFW Liquidation* case, the new value the creditor in *Auriga* sought to rely upon was to be paid post-petition as a § 503(b)(9) administrative expense. In the bankruptcy court, the liquidating trustee associated with the Debtor's liquidating trust

[11] *BFW Liquidation*, 899 F.3d at 1189.

[12] (*Id*.).

[13] (*Id*.).

[14] *See In re Jones Truck Lines, Inc.*, 130 F.3d 323, 329 (8th Cir. 1997).

[15] *Auriga Polymers Inc. v. PMCM2, LLC*, No. 20-14647, 2022 WL 2800195 (11th Cir., July 17, 2022).

successfully argued that the creditor, Auriga Polymers Inc. ("Auriga"), could not use the value of the goods it supplied to the Debtor during the 20 days leading up to the Debtor's bankruptcy to offset its preference liability while also receiving post-petition payment of those amounts under § 503(b)(9). As in *BFW Liquidation*, the creditor appealed, and the issue reached the Eleventh Circuit directly, bypassing the district court.

The Debtor in *Auriga Polymers*—Beaulieu Group, LLC—was a large carpeting manufacturing and distributing company based out of Dalton, Georgia. Several market factors—including a change in consumer preference to hardwood floors along with increased competition—pushed Beaulieu into bankruptcy, and ultimately liquidation. Prior to the filing of its case, and well prior to the appointment of a liquidating trustee, Beaulieu purchased "polyester resins and specialty polymers" from Auriga on credit. When Beaulieu's bankruptcy case was filed, Auriga was owed over $4 million related to goods it provided to Beaulieu. Significantly, some of those goods were supplied within the 90-day period leading up to Beaulieu's bankruptcy filing. And perhaps more significantly, at least $694,502 of the goods provided by Auriga were delivered within twenty-days of Beaulieu's petition date. Auriga filed a large proof of claim in Beaulieu's case and sought an administrative expense claim under § 503(b)(9) as to the goods it supplied within that final twenty-day period.

"Section 503(b)(9) of the Bankruptcy Code grants certain creditors administrative expense priority for 'the value of any goods received by the debtor within 20 days before the date of commencement of a case under [Title 11] in which the goods have been sold to the debtor in the ordinary course of such debtor's business."[16] The parties in *Auriga* didn't ultimately dispute Auriga's entitlement to a § 503(b)(9) claim. Rather, the ultimate issue came down to whether

[16] *Auriga Polymers Inc.*, 2022 WL 2800195, at *3.

Auriga could use amounts set aside to pay Auriga's admin claim as new value for § 547(c)(4) purposes.

On appeal, the trustee argued the funds that he set aside post-petition to satisfy Auriga's § 503(b)(9) claim constituted an "otherwise unavoidable transfer" which could not be used as subsequent new value. In support, the Trustee pointed to the statutory language of § 547(c)(4)(B) which clearly states that a preference defendant cannot rely upon new value "on account of which" the debtor made an "otherwise unavoidable transfer to or for the benefit of such creditor."[17] And per the trustee, it did not matter that the "otherwise unavoidable transfer" was made post-petition because the statute did not make such a distinction. In analyzing the question, the Eleventh Circuit noted that only three courts had addressed the precise issue before the court, but that more courts had considered "the broader issue of whether *any* post-petition payments affect a creditor's subsequent new value defense."[18] In one of those cases (*In re Friedman's Inc.*[19]), the Third Circuit held that only *pre-petition* "otherwise unavoidable transfers can offset a creditor's subsequent new value.[20]

Because the question in *Auriga* required interpretation of a statutory provision, the Eleventh Circuit's analysis focused on the plain meaning of § 547(c)(4)(B). And its analysis looked not only to the language of the statute itself, but also to the broader context of the statute as a whole. The court's ultimate holding is simple—the phrase "'otherwise unavoidable transfers' means prepetition transfers."[21] Thus, Auriga could rely upon its post-petition § 503(b)(9) amounts

[17] (*Id*. at *5).

[18] (*Id*. at *6).

[19] 738 F.3d 547, 549 (3d Cir. 2013).

[20] *Auriga Polymers Inc.*, 2022 WL 2800195, at *6.

[21] (*Id*. at *8).

as new value to offset its preference liability. But to get to that conclusion, the court had to refute several counterarguments. First, the court determined that the word "transfer", which is used three times in § 547(c)(4), has the same meaning throughout the entire Code Section. And, when looking at all three uses, the court indicated that it was clear that the word "transfer" in § 547(c)(4) means "transfers that qualify as preferences." Second, the court reasoned that since the two-year statute of limitations as to a trustee's ability to assert preference claims runs from the petition date, then it wouldn't make sense to look to post-petition transfers as part of the analysis. In the court's estimation, if post-petition payments could defeat a new value defense, then "the calculation of preference liability could change depending on when the preference avoidance action was filed."[22] Finally the court determined that policy considerations supported its interpretation. In particular, the court noted that its decision did not sanction "double payment" of Auriga's invoices. Instead, per the court, "asserting a new value defense does not result in any payment to the creditor; it merely prevents disgorgement of monies previously paid."[23]

Final Thoughts

The subsequent new value defense is one of the most often utilized preference defenses. The first issue discussed in many preference negotiations between trustees and trade creditors is new value and whether a demand reduction is warranted. And many preference demand letters that are sent out these days include a preliminary new value analysis. Needless to say, it's an important defense in preference litigation. Thus, the Eleventh Circuit's opinions in *In re BFW Liquidation* and *Auriga Polymers*, provide immense value to practitioners in the circuit in terms of predictability. It is good to know—rather than guess—that paid new value is not categorically

[22] *Auriga Polymers Inc.*, 2022 WL 2800195, at *9.

[23] (*Id*. at *11).

excluded from the defense. It is also useful, for trustee and preference defendants, to know that post-petition transfers do not impact the § 547(c)(4) analysis.

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