

BY JEREMY R. FISCHER

Double-Dipping in Delaware

Friedman's, Quantum Foods and Beyond

Clients faced with preference suits in any bankruptcy court invariably lament what they view as the inherent unfairness of § 547 of the Bankruptcy Code. They will likely receive only a small dividend on their proofs of claim for unpaid pre-petition invoices, and, to add insult to injury, they are sued for avoidance and recovery of the few payments that they actually received during the preference period. Explaining the policy of “equality of distribution” generally falls on deaf ears in these situations, especially when the clients are summoned to an outside jurisdiction like the District of Delaware to defend the preference suits.

Yet two recent decisions may provide defendants with extraordinary protection from preference liability. The first decision allows defendants to assert undiminished “new value” defenses under § 547(c)(4), even when some or all of that pre-petition new value is paid post-petition under critical-vendor, shipper or wage orders.¹ The second — and related — decision provides that allowed, post-petition administrative expenses could be set off against preference liability and rejects the notion that such a setoff is a “disguised ... post-petition new value defense.”² Taken together and to their logical conclusion, these decisions may mean that (at least in Delaware) creditors are entitled to “double dip” — to receive payment (or setoff) based on § 503(b)(9) administrative expenses (the first dip), while also asserting undiminished new value defenses based on the very same transactions (the second dip).

In re Friedman's

In *Friedman's*, the debtor paid approximately \$82,000 to a creditor during the preference period; the creditor then provided additional services valued at approximately \$100,000 and was not paid pre-petition. However, the creditor was paid approximately \$72,000 post-petition under a critical-vendor order entered by the U.S. Bankruptcy Court for the District of Delaware.³

Subsequently, a liquidating trustee was appointed and sued the creditor for avoidance and recovery of the \$82,000 under § 547(b). The creditor asserted a full new-value defense under § 547(c)(4) based on \$100,000 of subsequent services that had

been rendered.⁴ The trustee objected, arguing that the defense must be reduced by the amount of the post-petition payment to prevent the creditor from double-dipping to the detriment of the estate and other creditors. The bankruptcy court ruled that the critical-vendor payments were made post-petition and thus did not diminish the new value defense.⁵

The district court and Third Circuit affirmed. The Third Circuit relied “primarily on the context and policy of the Code, rather than specific language.”⁶ As a matter of context, the Third Circuit reasoned that § 547

concerns transactions occurring during the preference period, which is by definition pre-petition.... It would make sense that the calculation of the amount of the preference, and the application of any new value reduced by subsequent transfers, would relate to that period.⁷

As a matter of policy, the panel rejected the trustee's argument that the bankruptcy court's decision undermined one of the basic purposes of the new value defense — to “treat fairly a creditor who has replenished the estate after having received a preference” — by allowing the creditor to “unfairly receive double payment, once post-petition, and once indirectly as an offset against its ... preference liability.”⁸ Instead, the panel noted that “even if a creditor is paid post-petition for new value [that] it provided pre-petition, the creditor still replenished the estate during the preference period, and therefore aided the debtor in avoiding bankruptcy to whatever extent possible.”⁹ Thus, as a matter of both context and policy, the Third Circuit held that where a payment “is made after the filing of a bankruptcy petition, it does not affect the new value defense.”¹⁰ The Third Circuit stated that the courts are “nearly equally divided” on whether a payment must be pre-petition to defeat a new-value defense.¹¹

4 Section 547(c)(4) states, “The trustee may not avoid under this section a transfer ... 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[.]”

5 *In re Friedman's*, 738 F.3d at 551.

6 *Id.* at 554.

7 *Id.* at 555.

8 *Id.* at 558–59 (quoting *N.Y. City Shoes Inc. v. Bentley Int'l Inc.* (In re *N.Y. City Shoes Inc.*), 880 F.2d 679, 680–81 (3d Cir. 1989) (internal quotation marks omitted)).

9 *Id.* at 559 (citing *Commissary Ops. Inc. v. Dot Foods Inc.* (In re *Commissary Ops. Inc.*), 421 B.R. 873, 878 (Bankr. M.D. Tenn. 2010) (“[T]he possibility that a debtor may pay a creditor's § 503(b)(9) claim post-petition does not negate the value represented by the claim that the creditor provided to the debtor. The deliveries benefit the estate ... regardless of whether the § 503(b)(9) claimants are paid at a later date for those deliveries.”)).

10 *Id.* at 549.

11 738 F.3d at 553–54.



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1 *Friedman's Liquidating Trust v. Roth Staffing Cos. LP* (In re *Friedman's Inc.*), 738 F.3d 547 (3d Cir. 2013).

2 *Official Comm. of Unsecured Creditors of Quantum Foods LLC v. Tyson Foods Inc.* (In re *Quantum Foods LLC*), — B.R. —, Adv. No. 15-50254 (KJC), 2016 WL 4011727, at *2 (Bankr. D. Del. July 25, 2016).

3 *In re Friedman's*, 738 F.3d at 549–50.