By Jennifer M. McLemore and Eric J. Monzo

Blue Bell Creameries

Addressing the "Otherwise Unavoidable" Conundrum of the Plain Language in § 547(c)(4)(B)

Jennifer M. McLemore
Christian & Barton, LLP
Richmond, Va.

Eric J. Monzo
Morris James LLP
Wilmington, Del.

Jennifer McLemore is a partner with Christian & Barton, LLP in Richmond, Va. Eric Monzo is a partner with Morris James LLP in Wilmington, Del. Ms. McLemore is chair and Mr. Monzo is newsletter editor of ABI's Unsecured Trade Creditors Committee.

On Aug. 14, 2018, the Eleventh Circuit issued an opinion in *Kaye v. Blue Bell Creameries Inc. (In re BFW Liquidation LLC)*,[1] wherein the court reconsidered its prior decision as to whether the affirmative defense of subsequent new value, as preserved in § 547(c)(4), must remain unpaid to be used to set off preference liability under § 547(b).[2] The Eleventh Circuit's previous opinion considering this Bankruptcy Code section was addressed in *In re Jet Florida Systems*. While the issue as to "unpaid new value" was not germane to the question presented in *In re Jet Florida Systems*, nonetheless the Eleventh Circuit noted that in order to be used as a proper defense in the context of § 547(c)(4), subsequent new value must remain unpaid.[3]

In *Blue Bell*, the Eleventh Circuit analyzed the issue and determined that the statement in *In re Jet Florida Systems*, as it pertained to § 547(c)(4) issues, was *dictum*.[4] Upon reaching that conclusion, the *Blue Bell* opinion proceeded to analyze the "must remain unpaid" concept anew. The Eleventh Circuit's latest interpretation of the meaning of § 547(c)(4)(B) finds that subsequent new value does not have to remain unpaid to provide a defense to offset an avoidable transfer under § 547(b). With this new ruling, the Eleventh Circuit joins a majority of circuits[5] that have considered and ruled on the issue.[6] The Seventh Circuit remains in the minority in the "must remain unpaid" reading of § 547(c)(4)(B) with its opinions in *Sparrer Sausage*[7] and *In re Prescott*.[8]

Without revisiting those Seventh Circuit minority opinions, this article will explore how the *Blue Bell* opinion renders this positional change on the interpretation of § 547(c)(4)(B) and how the opinion's analysis might influence further erosion of the minority position in (yet unidentified) forthcoming holdings from the Third Circuit. The article also explores the means by which the other majority courts reasoned their conclusions on the meaning of § 547(c)(4)(B).

After examining the long-heeded *In re Jet Florida Systems*'s statement with regard to § 547(c)(4)(B), the *Blue Bell* opinion determined that the language in *In re Jet Florida Systems* was *dictum*, such that the court was "free to give ... fresh consideration" of the issue.[9] As such, the Eleventh Circuit carefully examined the actual of language of § 547(c)(4) in order to determine its meaning. The opinion explains first 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. Instead, the plain language of the statute requires only that (1) any new value given by the creditor must not be secured by an otherwise unavoidable security interest and (2) the debtor must not have made an otherwise unavoidable transfer to or for the benefit of the creditor on account of the new value given.[10]

While the *Blue Bell* opinion refers to this language of § 547(c)(4) as unambiguous,[11] some part of the circuit split may result from the differing opinions as to what the phrase "otherwise unavoidable" means. The *Blue Bell* opinion explains that in analyzing this phrase, courts make reference to the predecessor section of the Bankruptcy Act, § 60(c), which specifically required new value to remain unpaid in order to be utilized as a defense.[12] The *Blue Bell* opinion makes it clear that the lack of such a requirement in the specific language of § 547(c)(4) alone is sufficient to lead a court to find that there is no "remains unpaid" requirement in § 547(c)(4).[13] The opinion further explains that § 547(c)(4) was not a recodification of § 60(c), but instead a revision. This explanation further reinforces the conclu-

1 899 F.3d 1178 (11th Cir. 2018).
2 *Charisma Inv. Co. NV v. Airport Sys. Inc. (In re Jet Florida Sys. Inc.)*, 841 F.2d 1082 (11th Cir. 1988).
3 *Id.* at 1083 (section 547(c)(4) "ha[d] 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").
4 *Id.* at 1187.
5 The Fourth Circuit (*Hall v. Chrysler Credit Corp. (In re JKJ Chevrolet Inc.)*, 412 F.3d 545, 551-52 (4th Cir. 2005)); Fifth Circuit (*Laker v. Vallette (In re Toyota of Jefferson Inc.)*, 14 F.3d 1088, 1090-93 (5th Cir. 1994)); Eighth Circuit (*Jones Truck Lines Inc. v. Cent. States, Se. & Sw. Areas Pension Fund (In re Jones Truck Lines Inc.)*, 130 F.3d 323, 329 (8th Cir. 1997)); and Ninth Circuit (*Mosier v. Ever-Fresh Food Co. (In re IRFM Inc.)*, 52 F.3d 228, 231-33 (9th Cir. 1995)).
6 The First, Second, Tenth and D.C. Circuits have not yet issued an opinion on the issue.
7 *Unsecured Creditors Comm. of Sparrer Sausage Co. v. Jason's Foods Inc.*, 826 F.3d 388 (7th Cir. June 10, 2016).
8 *In re Prescott*, 805 F.2d 719, 727 (7th Cir. 1988). For a more detailed analysis of the *Sparrer Sausage* decision, *see* Frank W. DiCastri and Lindsey M. Greenawald, "Law and (Sparrer) Sausages: 'Remains Unpaid' Continues to Confound in Preference Cases," XXXV *ABI Journal* 11, 30-31, 72, November 2016, *available at* abi.org/abi-journal.
9 *Blue Bell*, 899 F.3d at 1186-87.
10 899 F.3d at 1189.
11 *Id.* at 1189-92.
12 1189 F.3d at 1190-91.
13 *Id.*

continued on page 89

from page 18

sion that § 547(c)(4)(B) includes different requirements than its predecessor.[14]

The court in *Blue Bell* next examined the policy consideration at issue. While acknowledging that statutory interpretation always trumps a policy argument, the *Blue Bell* opinion finds that the issues align, and both the policy argument and statute's plain meaning eliminate the need for new value to remain unpaid. The opinion's interpretation is that the statute, unlike its predecessor, § 60(c), is written to encourage creditors to work with financially troubled debtors.

The opinion then reexamines the most complicated part of the analysis: the meaning of the "otherwise unavoidable" language in § 547(c)(4) of the Bankruptcy Code. First, the opinion admits that "the double-negatives in the statutory language make for some difficult parsing,"[15] but then the opinion proceeds to unpack the meaning of § 547(c)(4)(B). The *Blue Bell* opinion explains that § 547(c)(4)(B) prevents

> the trustee from undoing (avoiding) a transfer of money from the debtor to a creditor to the extent that, after the transfer, the creditor gave new value to the debtor, unless the debtor made an "otherwise unavoidable transfer" to the creditor "on account of" that new value. So, if the debtor paid for the new value with an "otherwise unavoidable transfer," then the creditor cannot use new value as a defense against the trustee's attempt to avoid an earlier preference. Conversely, if the debtor makes a payment for the new value that is itself avoidable, then the creditor can avail itself of the new-value defense.[16]

As the opinion includes the very phrase that is the source of confusion within its explanation, it is helpful that the opinion goes on to provide specific examples for context. The opinion explains first what an avoidable transfer could be: fraudulent transfers or preferences that are not subject to affirmative defenses.[17] The opinion also describes a few transfers that typically are unavoidable by a trustee: Contemporaneous cash payments, debt incurred in the ordinary course of business and debts secured by a purchase-money security interest are all unavoidable transfers.[18] Perhaps the most succinct explanation contained in the opinion states that "if the debtor makes a payment for the new value that is itself avoidable, then the creditor can avail itself of the new value defense."[19]

The *Blue Bell* opinion reviewed and relied on the analysis of the opinions issued by the Fourth, Fifth, Eighth and Ninth Circuits that support the Eleventh Circuit's new decision. The Ninth and Fifth Circuit opinions use examples that shed meaningful light on the language of § 547(c)(4)(B). First, the Ninth Circuit's opinion in *IRFM v. Everfresh*[20] considers the "otherwise unavoidable" language in this way:

> If the debtor has made payments for goods or services that the creditor supplied on unsecured credit after an earlier preference, *and if these subsequent payments are themselves voidable as preferences* (or on any other ground), then under section 547(c)(4)(B) the creditor should be able to invoke those unsecured credit extensions as a defense to the recovery of the *earlier* voidable preference. On the other hand, the debtor's subsequent payments might not be voidable under section 547, because the goods and services were given C.O.D. rather than on credit, or because the creditor has a defense under section 547(c)(1), (2), or (3). In this situation, the creditor may keep his payments, but has no section 547(c)(4) defense.... In either event, the creditor gets credit only once for goods and services later supplied.[21]

When the Fourth and Fifth Circuits examined this question, both cases involved floor-plan financing, numerous repayments and subsequent advances at automobile dealerships. In that context, the Fifth Circuit explained the "otherwise unavoidable" concept as "most obviously appl[ying] to revolving credit relationships."[22] The opinion elaborates beyond just the applicability of the concept to say:

> First, without the exception, a creditor who continues to extend credit to the debtor, perhaps in implicit reliance on prior payments, would merely be increasing his bankruptcy loss. Second, the limited protection provided by the subsequent advance rule encourages creditors to continue their revolving credit arrangements with financially troubled debtors, potentially helping the debtor avoid bankruptcy altogether. Protecting the creditor who extends "revolving credit" to the debtor is not unfair to the other creditors of the bankrupt debtor because the preferential payments are replenished by the preferred creditor's extensions of new value to the debtor.[23]

While the opinion in *Blue Bell* defines the term at issue and uses the term itself, in reviewing the other circuit opinions one can get a clear explanation of the meaning of "otherwise unavoidable." It is further benefited by helpful analogies from those opinions that give meaning to this perplexing phrase — particularly by those courts that revert back to Prof. Vern Countryman's reasoning and coupled with the Fifth Circuit's analysis in *Toyota of Jefferson*.

Indeed, even the Third Circuit (who historically supported the Seventh Circuit and minority view), which has not yet issued an opinion germane to the "remains unpaid" portion of its statement in *New York City Shoes Inc. v. Bentley International Inc. (New York City Shoes)*,[24] now considers

14 *Id.* at 1192.
15 *Id.* at 1196.
16 *Id.*
17 *Id.* at 1197.
18 *Id.*
19 *Id.*
20 52 F.3d 228, 231-32 (9th Cir. 1995) (quoting Vern Countryman, "The Concept of a Voidable Preference in Bankruptcy," 38 *Vand. L. Rev.* 713, 788 (1985)).
21 52 F.3d at 231-32 (emphasis in original).
22 *In re Toyota of Jefferson*, 14 F.3d at 1091.
23 *Id.* (internal citations omitted).
24 880 F.2d 679 (3d Cir. 1989); *see also In re Proliance Int'l Inc.*, 514 B.R. 426, 432 (Bankr. D. Del. 2014) ("To date, the Third Circuit has not issued an opinion germane to the 'remains unpaid' portion of its statement in *New York Shoes*. As such, the Third Circuit has not (yet) weighed in on the remains unpaid/subsequent advance dispute.").

continued on page 90

from page 89

the unpaid new value statement therein as *dictum*.[25] Courts within the Third Circuit, at least by inference, now readily recognize even paid subsequent advances as new value.[26]

The *Blue Bell* opinion reflects the reality that one more circuit has pivoted away from those requiring subsequent new value to remain unpaid. The decision is important from the standpoint of the ever-growing shift by circuit courts in their view of the new value defense provided by § 547(c)(4). On a practical level, the decision is a positive holding for service providers and trade creditors looking to minimize their exposure when their counterparty-turned-debtor is extended credit during the preference period. Protecting and promoting the extension of credit to debtors, notwithstanding the receipt of a preferential payment, should be encouraged. Now, the Eleventh Circuit Court of Appeals might be added to the growing list of circuit courts helping to protect the interests of the unsecured trade creditor. abi

Editor's Note: *For more on this topic, purchase* Preference Defense Handbook: The Circuits Compared, Third Edition, *now available in the ABI Store (store.abi.org). Members must log in first to obtain reduced pricing.*

25 *Blue Bell* at 1189; *see also In re Friedman's Inc.*, 738 F.3d 547, 552 (3d Cir. 2013).

26 *See, e.g., In re Dots LLC*, 562 B.R. 286 (Bankr. D.N.J. 2017); *In re Proliance Int'l*, 514 B.R. at 431-35 (reviewing circuit split, including review of use "otherwise" referring to transfers that are avoidable under § 574(c)(4) and not avoidable generally); *In re Frey Mech. Grp. Inc.*, 446 B.R. 208 (Bankr. E.D. Pa. 2011); *Wahoksi v. Am. & Efrid Inc. (In re Pillowtex Corp.)*, 416 B.R. 123, 126-27 (Bankr. D. Del. 2009).