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Client Alert: Breaking News – Shumaker Win: 11th Circuit Court of Appeals Issues a Significant Ruling in Favor of Chapter 11 Preference Defendants

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WE WON. WE MADE NEW LAW.

In the Chapter 11 case of Beaulieu Group, LLC (carpet industry in Dalton, Georgia) in the U.S. Bankruptcy Court for the Northern District of Georgia, we defended Auriga Polymers Inc. (a subsidiary of Indorama Ventures) in a preference claim filed by the Beaulieu Liquidating Trustee.

We successfully asserted Auriga's "subsequent new value" defense, that after preference payments were received, Auriga shipped more goods. A substantial portion of the goods were shipped within 20 days prior to the Chapter 11 filing, which provided Auriga a Bankruptcy Code Section 503(b)(9) administrative priority claim for the value of the goods shipped. The pivotal issue in this case, as in virtually every preference case, was whether Auriga could both be paid on its Section 503(b)(9) administrative expense priority claim (for goods shipped within 20 days prior to the Chapter 11 filing) and also reduce its preference liability based on the value of shipments that comprised such claim.

In the vast majority of Chapter 11 cases, after the "main event" (a Section 363 sale of all assets or a reorganization), the "residual" assets are transferred to a "creditor" trust to realize upon such assets. Ironically, the "residual" assets are mostly preference and other avoidance claims against creditors. In pursuing claims against creditors, the mop-up Liquidating Trustees throughout the U.S. have consistently asserted, and several bankruptcy courts have found, that a creditor may not both receive payment on its Section 503(b)(9) claim and also reduce its preference liability for 20-day shipments that were paid post-petition, as impermissible "double dipping."

Rejecting this “double dipping” theory, the United States 11th Circuit Court of Appeals, in a well-reasoned opinion, ruled that a creditor/preference defendant is entitled to both payment on its Section 503(b)(9) claim and a reduction of its preference liability by the value of such claim.

Bottom line: Auriga has zero preference liability and is entitled to receive 100% of its Section 503(b)(9) claim.

In so ruling, the 11th Circuit became the first U.S. Circuit Court to address whether post-petition payments on account of Section 503(b)(9) claims reduce the subsequent new value defense, and joins the 3rd Circuit Court of Appeals in ruling favorably for creditors that the subsequent new value defense is fixed at the petition date. There are no other U.S. Circuit Court of Appeals rulings on this issue.

This is one of the most significant rulings in a preference case. Though not controlling precedent in other circuits, the 11th Circuit ruling will likely materially improve creditors’/preference defendants’ position in defending preference cases. To quote a Kansas City colleague, “This case will definitely have implications beyond the boundaries of the 11th Circuit.”

Please let us know if you have any comments or questions about the 11th Circuit ruling or any other issue.

If you would like a copy of the 11th Circuit Opinion or our winning brief, please let me know.

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