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Must New Value Remain Unpaid to Serve As a Defense to a Preference Action?

Are We Really Having This Discussion Again?

By Christopher Donoho and Shannon Lowry Nagle

Does subsequent new value need to be unpaid to constitute a defense to a preferential transfer under section 547(c)(4)? The issue arises when a creditor asserts the subsequent new value defense to a preference action, on the basis that additional credit (goods or services) was extended after the preferential transfer occurred, even if the subsequent new value was paid for by the debtor.

With every decade comes a new wrinkle in the discussion on whether the subsequent new value provided must remain unpaid. The issue has been resurrected recently due to the frequency of critical vendor orders authorizing the post-petition payment of pre-petition debt and debtors-in-possession agreeing to pay reclamation claims in exchange for keeping the goods. What was once previously unpaid "new value" has now been paid, albeit postpetition. Can the creditor still maintain the defense it provided subsequent new value when the new value has been repaid? Focusing on the plain language of the statute reveals the answer is yes. No matter how hard or how many times they try, courts cannot rewrite the precise language of the statute. Put simply, there is no requirement in section 547(c)(4) that in order to qualify for the subsequent new value exception the "new value" must remain unpaid.

Recognizing the inherent risk, one bankruptcy court early on admonished future courts from shorthandedly glossing over the requirements of section 547(c)(4). *See Valley Candle Mfg. Co. v. Stonitsch (In re Isis Foods, Inc.)*, 39 B.R. 645 (Bankr. W.D.Mo. 1984). Ten years later, apparently frustrated by the continued conflict in various circuits and attempting to highlight the error of many courts' ways in their repeated use of a shorthanded test to state the requirements of section 547(c)(4), one commentator summarized the entire body of case law and policy back to the Bankruptcy Act. *See* Quinn HP: The Subsequent New Value Exception under Section 547(c)(4) of the Bankruptcy Code-Judicial Gloss is Creditors' Loss. 24 *Mem. St.U.L. Rev.* 667, 695 (1994). Yet, despite admonitions and wishful thinking, some courts

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A Model for Canadian Cross-Border Insolvency

Core-Mark International, Inc.

By Jay A. Carfagnini, Shirley S. Cho, Brian F. Empey and Richard L. Wynne

The trend toward commercial globalization has led to an increase in the number and complexity of cross-border bankruptcy cases. The ability to overcome differences in legal systems, often through the cooperation and coordination of courts in different countries, can be a key factor in the success or failure of a restructuring.

A Successful Case

A recent successful case of harmonious cross-border insolvency was Core-Mark International, Inc. Core-Mark, a Delaware company, filed for Chapter 11 protection in the United States, simultaneously with its parent company, Fleming Companies, Inc., to restructure debt located at the parent level. The immediate concern for Core-Mark was the protection of its Canadian assets and a quick emergence from bankruptcy. At the time of its U.S. bankruptcy filing on April 1, 2003, Core-Mark had and still continues to carry on significant operations in Canada, with headquarters in Northern California as well as British Columbia. Fleming was the largest U.S. wholesale distributor of foods and Core-Mark was the third largest distributor of goods to convenience stores in the U.S.

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continue to ignore the plain language of section 547(c)(4) and instead rely on cases hiding behind the public policy concept that new value should replenish the debtor. In what appears to be a decennial debate, the defense has undergone recent, but conflicting, analysis in several courts. Are we really having this discussion, again?

ANALYZING SECTION 547(C)(4)

Section 547(c)(4) states that:

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[.]

11 U.S.C. §547(c)(4). Section 547(c)(4) represents a substantial revision of section 60(c) of the Bankruptcy Act. *See Thomas W. Garland, Inc. v. Union Elec. Co. (In re Thomas W. Garland, Inc.)*, 19 B.R. 920, 925 (Bankr. E.D. Mo. 1982). Significantly, section 547(c)(4) omits language from section 60(c) requiring that new value remain unpaid. *See Quinn,* 24 Mem. St. U.L. Rev. at 673. Despite these changes, the subsequent new value defense continues to promote the prime policy of the Bankruptcy Code — equality of distribution among creditors. The ability to avoid payments made by the debtor within the 90 days preceding the petition date discourages creditors from outmaneuvering each other by pressuring the insolvent debtor for payments, and prevents the debtor from making payments that prefer one creditor to the detriment of all others. Likewise, the new value defense allows a creditor to keep an otherwise preferential payment in recognition of the fact it continued doing business with the debtor in the ordinary course of business and used credit terms with an eye towards avoiding bankruptcy altogether. *See Chrysler Credit Corp. v. Hall*, 312 B.R. 797, 802 (E.D. Va. 2004); *Phoenix Rest. Group v. Ajilon Prof. Staffing LLC (In re Phoenix Rest. Group)*, 317 B.R. 491, 495 (Bankr. M.D.Tenn. 2004).

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APPLYING THE 'PLAIN MEANING' OF SECTION 547(C)(4)

From the divergence of court decisions, it is clear that the arguably simple policy justifying the subsequent new value defense has proven less than simple in its application. Fortunately, some courts are getting it right. A good example is *Roberds, Inc. v. Broyhill Furntr. (In re Roberds, Inc.)*, 315 B.R. 443, 468-73 (Bankr. S.D. Ohio 2004), in which the Bankruptcy Court for the Southern District of Ohio summarized the current case law on the subject. In *Roberds,* the debtor brought an adversary proceeding to recover prepetition payments made to its supplier. The court stated that it was bound to follow the plain meaning of the statute unless the application would produce a result demonstrably at odds with the purpose of the statute. *See Id.*, 315 B.R. at 468 *citing United States v. Ron Pair Enters, Inc.*, 489 I.S. 235, 242, 109 S.Ct. 1026, 1031, 103 L.Ed.2d 290 (1989). The court noted that the word "paid" was not present in section 547(c)(4), and that decisions focusing on the narrow issue of whether the new value remains unpaid were incomplete and inaccurate. *See Roberds,* 315 B.R. at 469-70. According to the court, the proper inquiry is whether the subsequent new value has been repaid by an otherwise unavoidable transfer. *See Id.*; *Laker v. Vallette (In re Toyota of Jefferson, Inc.)*, 14 F.3d 1088, 1093 n.2 (5th Cir 1994). This approach, which tracks the language of section 547(c)(4)(B), allows a creditor to successfully assert the new value defense if the trustee can recover the repayment by some other means.

Similarly, the United States District Court for the Eastern District of

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'Practice By Ambush'

Rewriting the Code in Pleadings

**By David L. Buchbinder
and Kathleen A. Cashman-Kramer**

In their desire to zealously represent clients, practitioners may often attempt to rewrite the Bankruptcy Code or Rules in motions or reorganization plans. However, recent opinions have taken umbrage with these efforts to conduct "practice by ambush" that either propose provisions inconsistent with the Bankruptcy Code or seek to deprive parties in interest of due process, or both. After all, fundamental due process " ... is the cornerstone underpinning bankruptcy procedure...A creditor has the right to rely on the Bankruptcy Code and Rules and to expect to be accorded due process of law in accordance with the Bankruptcy Code and Rules, and the United States Constitution." *In re Whelton*, 299 B.R. 306, 318 (D. Vt. 2004).

When a motion or plan attempts to rewrite the Code or Rules, due process is abused when parties in interest are left to the vagaries of fine print inserted into lengthy plans or seemingly routine and innocuous motions. Courts are, however, becoming more vigilant in their efforts to prevent these abuses. Several recent opinions draw attention to this issue in the context of motion practice and in Chapter 11 and 13 plans. The decisions almost uniformly reject the notion that creative counsel may dispense with the Code or Rules simply by saying so in a pleading.

Chapter 11 Plans

In re Beyond.com

In *In re Beyond.com*, 289 B.R. 138 (Bankr. N.D. Ca. 2003), the court refused to approve a disclosure statement where the plan proposed provisions that included the appointment of debtor's former Chief Operating Officer pursuant to an undisclosed Liquidation Manager Agreement; authorizing the disposition of estate assets upon approval of a majority of the manager and a two person committee on 24 hours notice (which the plan "deemed" approved after the 24 hours notice); to retain and pay advisors without supervision or limitation; to retain professionals without court approval; to assert the estate's rights under Chapter 5 of the Code including potential claims against the former Chief Operating Officer acting in his role as Liquidation Manager; and, to amend the Plan after its Effective Date upon ten days notice to limited parties.

In disapproving the proposed Disclosure Statement, the court initially observed the requirement of Bankruptcy Code Section 1129(a)(1) that the provisions of a Chapter 11 plan comply with all applicable provisions of the Bankruptcy Code. The proposed provisions would permit the debtor to simply ignore many provisions of the Code or Rules including abandonment (Section 554 and Rule 6007); the retention and compensation of professionals (Sections 327 and 330); amendments to plans (Section 1127); sale or use of estate assets (Section 363 and Rules 2002 and 2004); and rules regarding the settlement of controversies (Rule 9019). The court stated:

"The modifications to the applicable provisions of title 11 are not minor, ministerial or simply pragmatic. In effect, the plan affords the reorganized debtor the prerogative to comply selectively with the provisions of the Bankruptcy Code and Rules without judicial supervision. A more cynical view suggests that providing the least notice to the fewest people reduces oversight." 289 B.R. at 144.

The court further observed that the proposal that the Plan be able to be amended after becoming effective would run afoul of Section 1127 and also violate Section 1129(a)(11) because amendment implies the need for further reorganization. The court concluded: "In its exuberance rewriting provisions of the Code, the author of the proposed plan overlooked the requirements of §1129(a), which provide a framework ensuring the integrity of the system. These defects cannot be cured...Having sought bankruptcy's protections, it cannot now rewrite the Bankruptcy Code to suit its purposes." 289 B.R. at 146.

In re Consolidated Pioneer Entities

The effects of lack of oversight in a confirmed plan were dramatically illustrated by *In re Consolidated Pioneer Entities*, 264 F.3d 803 (Cir. 9 2001), where a granting of the United States Trustee's motion to convert was affirmed in a confirmed case where the liquidating corporation created by the plan failed to provide accountings, case information or anticipated distributions to creditors. The corporation contended that the Plan created an independent corporation which owed no specific duties to the investors or the estate, nor any reporting requirements to the bankruptcy court or anyone else.

The bankruptcy court found that: "... [the corporation's] failure to comply with its 'fundamental duty to provide an adequate accounting of financial activity constituted cause to convert." (264 F.3d at 806). As summed up by the BAP panel: "We adhere to the fundamental notion that the ... board of directors and its officers were working for the best interests of their constituency, and not for their own self interests." (248 Bankr. at 377). The Ninth Circuit concluded: "In light of [the corporation's] attempts to prevent the appointment of an examiner and otherwise eschew its duty to account, the bankruptcy court properly determined that conversion to Chapter 7 was necessary to ensure open and full financial disclosure." (264 F.3d at 809).

Daewoo International Corp. Creditor Trust v. SSTS America Corp.

On the other hand, in *Daewoo International Corp. Creditor Trust v. SSTS America Corp.*, 2003 WL 21355214, the court declined to set

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aside a plan provision that permanently enjoined creditors from asserting rights of setoff, subrogation or recoupment against the Debtor. When the defendant was sued and sought to assert its rights, the plaintiff asserted the provisions in the confirmed plan. The only notice had been publication of the confirmation hearing notice in *The Wall Street Journal*, which notice did not apparently disclose existence of the provision that would enjoin the creditor from asserting the noted claims. The court found that notice by publication was adequate constructive notice. The creditor should have obtained and read the Plan: " ... because SSTS was provided with sufficient notice to object to the plan's prohibition on recoupment and because it did not do so in a timely fashion before the Bankruptcy Court, we will not allow it to do so now." 2003 WL 21355214 at page 5.

This ruling suggests that every creditor of every plan read every line of every plan to make sure a plan does not affect the claims or defenses of a creditor. But query why creditors with minimal notice should be required to engage in such an undertaking when a reorganization plan is primarily about distributions to creditors and not about claims objections. After all, isn't a plan provision that purports to deprive creditors of defenses to claims objections effectively a claims objection? Claims objections, it should be noted, require 30 days notice to an affected creditor pursuant to Bankruptcy Rule 3007.

MOTION PRACTICE

Bankruptcy Code Section 1111(a) provides in Chapter 11 cases that claims scheduled as undisputed are "deemed filed", dispensing with the necessity for undisputed creditors to file claims. Bankruptcy Rule 3003(b) is consistent with this provision. In *In re ATD Corporation*, 352 F.3d 1062 (Cir. 6 2003), the Debtor proposed in a routine *ex parte* motion for a claims bar date that creditors scheduled as undisputed in the schedules would be required to file a proof of claim or be barred from later asserting a claim. The Bar Date notice did not set forth this requirement, but merely referred to Bankruptcy Rule 3001. Two undisputed creditors who did not file claims were required to bring motions before the court seeking their distribution after the plan was confirmed. The bankruptcy court granted the creditors' motion because the bar date order allowed the debtor to ignore Section 1111(a), Rule 3003 and "...permits debtor to avoid constitutionally required due process notice of objections to the scheduled claims." The district court affirmed and added that Section 105(a), a provision that permits the court to enter orders " ... necessary or appropriate to carry out the provisions of ... " the Bankruptcy Code did not give the debtor the power to contravene Section 1111(a). The Sixth Circuit, in affirming these rulings, concluded that there had been no due process: "We find no error in the bankruptcy court's determination that to construe the Bar Date Order as debtor urges would 'run afoul' of the due process rights of these creditors to receive adequate and meaningful notice that they were required to physically file a proof of claim before the bar date." 352 F.3d at 1066.

The Seventh Circuit, in its recent opinion of *In re Kmart*, 359 F.3d 866(2004), concerning payment of pre-petition debt to critical vendors at the inception of a case, further stated of Section 105(a): "This does not create discretion to set aside the Code's rules about priority and distribution; the power conferred by §105(a) is one to implement rather than override."

CHAPTER 13 CASES

In Chapter 13 cases, counsel have attempted to craft plan provisions purporting to discharge student loan obligations upon completing performance of the plan, without the necessity to file an adversary proceeding to determine dischargeability of the debt. The courts have rejected these efforts as inappropriate, notwithstanding the existence of case law upholding the finality of confirmed plans.

In *In re Lemons*, 285 B.R. 327 (Bankr. W.D. Ok. 2002), the plan attempted to discharge post-petition interest and collection expenses. The court rejected the proposed provision, along with other similar plan provisions that are designed to thwart the rights of creditors without due process, as "gamesmanship."

In *In re Whelton*, 312 B.R. 508 (D. Vt. 2004), the District Court affirmed the bankruptcy court rejection of a plan provision that would have discharged over $100,000 of student loan obligations without any due process to the creditor. The discharge provision was contained in a portion of the plan entitled "Other Provisions" and was inconspicuous in the fine print. The plan was confirmed without any objection by the creditor.

The creditor later commenced an adversary proceeding to determine that the plan provision could not act to discharge the student loan. In affirming the bankruptcy court's ruling to set aside the provision, the district court found and held that: "A bankruptcy court lacks the authority to confirm a plan unless it complies with the provisions of Chapter 13 and with other applicable provisions of the Bankruptcy Code." 312 B.R. at 514. Since the discharge provision did not comply with Section 523(a)(8) nor with the Bankruptcy Rule 7001(6) requiring a determination of dischargeability to proceed by adversary proceeding, confirmation was nugatory. In rejecting the plan provision that actively defies the Code, the Court reconciled its holding with circuit level opinions regarding the finality of confirmed plans because the provisions involved " ... a provision in a confirmation order that one-sidedly purports to resolve an issue that may only be resolved in an adversary proceeding is not entitled to preclusive effect." 312 B.R. at 516. The court noted that notices of confirmation hearings do not provide creditors with notice of any specific plan provisions that may affect it, or which may place specific rights in jeopardy.

DUE PROCESS

At the core of these cases is a lack of due process by the moving party or plan proponent. As succinctly stated by the bankruptcy court in *Whelton*, *supra*, "Sneaking a provision in a plan, hoping no one will notice it, and then reaping the benefits of its inclusion violates the fundamental principles of due process and fair play, and threatens the heart of

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Virginia held the proper inquiry was not whether the creditor asserting the new value defense had been paid for the new value but whether it had been paid by a transfer not subject to avoidance by the trustee or debtor-in-possession. *See Chrysler Credit*, 312 B.R. at 803. The court found the plain meaning of the section was coherent, and, by adhering to the plain meaning, promotes the policy of encouraging creditors to do business with financially troubled debtors. *See Id.* at 805. According to the court, if it were to require that new value remain unpaid, creditors would be discouraged from supplying new value. If creditors were not entitled to receive some benefit from supplying new value, those that did supply new value would be penalized and in a worse position than those who did not. *See Id.*; *Mosier v. Ever-Fresh Food Co. (In re IRFM, Inc.)*, 52 F.3d 228, 232 (9th Cir. 1995).

Following this logic, the Bankruptcy Court for the District of Delaware recently stated that the "clear import of the statute would be defeated if it is held that the new value must remain unpaid" and, in so doing, "distinguished" (in reality questioned the logic behind) the opinion of the Court of Appeals for the Third Circuit in *New York City Shoes* and adopted the reasoning of *Check Reporting Services*. *See Hechinger Invest. Co. of Delaware v. Univ. Forest Prod., Inc. (In re Hechinger Invest. Co.)*, No. 99-02261, 2004 WL 3113718, at *5 (Bankr. D. Del. 2004).

Postpetition Payment of Prepetition New Value

Extending the logic, recent cases go an additional step in analyzing the plain meaning of section 547(c)(4). By concentrating on the words used in section 547(c), particularly "trustee" and "debtor," these courts will also allow the subsequent new value defense to be asserted by creditors who receive payment postpetition for any unpaid new value supplied prepetition.

In *In re Phoenix Rest. Group*, the plan administrator commenced a preference action against a creditor who provided temporary staffing services to the debtor. *Phoenix Rest. Group*, *supra*. Several payments were received by the creditor from the debtor during the preference period and a large payment was received postpetition. The creditor argued that its continual supply of staffing services to the debtor, for which as of the petition date it was unpaid, constituted new value. The plan administrator argued that the postpetition payments to the creditor should reduce the amount of "subsequent new value" defense the creditor was entitled to claim. The court found that the plain language of section 547 closes the preference window analysis at the petition date. *See Phoenix Rest. Group,* 317 B.R. at 496. "Throughout section 547 the 'debtor' refers to the prepetition entity. Had Congress intended § 547(c)(4)(B) to account for payments made post petition, the section would have included something like 'an otherwise unavoidable transfer of an interest of the estate in property to or for the benefit of such creditor.'"

In reaching its conclusion, the court was persuaded by cases that had not allowed postpetition advances of new value by a creditor to reduce prepetition preference exposure. *See Berquist v. Anderson-Greenwood Aviation Corp. (In re Bellanca Aircraft Corp.)*, 850 F.2d 1275, 1284 (8th Cir. 1988) (postpetition goods or services provided to a debtor in possession do not qualify as new value because any postposition advances are given to the debtor's <u>estate</u> not to the debtor)(*emphasis in original*); *Clark v. Frank B. Hall & Co. of Colo. (In re Sharoff Food Serv., Inc.)*, 179 B.R. 669, 678 (Bankr. D.Colo. 1995).

Therefore, if a creditor has received a postpetition payment by the trustee or debtor-in-possession pursuant to a critical vendor order or as a result of a debtor-in-possession not wanting the creditor to exercise reclamation rights, these payments or transfers are not made by the debtor, so the creditor is still entitled to the defense under the plain meaning section 547(c)(4).

Bad Habits Die Hard: The 'Replenishment Theory' Remains Alive and Well

Finding comfort in policy-based arguments and shorthanded tests, some courts are once again attempting to write in an "unpaid" requirement into the section 547(c)(4). *See GGSI Liquidation, Inc. v. Quad-tech, Inc. (In re GGSI Liquidation, Inc.)*, 313 B.R. 770, 777 (Bankr. N.D. Ill. 2004)*, Accessair, Inc. v. Airline Software, Inc. (In re Accessair, Inc.)*, 314 B.R. 386, 395 (B.A.P. 8th Cir 2004)*, Teligent, Inc. v. Level(3) Communications (In re Teligent, Inc.)*, 315 B.R. 308, 315. Paying little, if any, deference to the volumes of analysis in case law, commentary and legislative history on section 547(c)(4), these courts conclude in a summary fashion that if the new value is subsequently paid, the estate remains depleted, not replenished, by the new value and, therefore, the creditor should not be entitled to a defense to the preference action. *Compare Kroh Bros. Dev. Co. v. Continental Constr. Engineers, Inc. (In re Kroh Bros. Dev. Co.)*, 930 F.2d 648, 652-53 (8th Cir. 1991) (new value

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our legal, adversarial system." 299 B.R. at 318. Whether the attempt to rewrite the Code takes place in a routine motion, or in the fine print of a reorganization plan, the effect is the same, to deprive parties in interest of their rights without adequate notice and disclosure. The courts and all parties in interest have a right to rely on the Code and Rules. Attempts to circumvent, defy or rewrite the Code or Rules in pleadings or plans, should be vigorously resisted by the courts. Ample means exist to curb such practices, including Section 1129(a)(1) in Chapter 11, Section 1325(a)(1) in Chapter 13, and in simply applying the Code according to its plain meaning. The alternative is to invite the parties in every case to re-write the Code to suit their desires rather than to treat all parties in interest with the consistency that results when parties can rely upon the Code and Rules that are readily accessible to everyone.

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must remain unpaid); *New York City Shoes v. Bentley Int'l Inc. (In re New York City Shoes, Inc.)*, 880 F.2d 679, 680 (3d Cir. 1989); *Charisma Inv. Co. v. Airport Sys., Inc. (In re Jet Florida Sys., Inc.)*, 841 F.2d 1082, 1083 (11th Cir. 1988); *In re Prescott*, 805 F.2d 719, 728 (7th Cir. 1986); *Pettigrew v. Trust Co. (In re Bishop)*, 17 B.R. 180 (Bankr. N.D. Ga. 1982) *with IRFM*, 52 F.3d 228, *Toyota of Jefferson, Inc.*, 14 F.3d at 1093 n.2 (pursuant to plain language of statute, new value need not remain unpaid); *Crichton v. Wheeling Nat'l Bank (In re Meredith Manor, Inc.)*, 902 F. 2d 257 (4th Cir. 1990); *Isis Foods,* 39 B.R. at 653; Boyd *v. Water Doctor (In re Check Reporting Servs., Inc.)*, 140 B.R. 425 (Bankr. W.D. Mich. 1992).

Recently, in *GGSI*, the Bankruptcy Court for the Northern District of Illinois stated that, for the subsequent new value defense to apply, the following sequence of events must occur: 1) the creditor must have received a preference otherwise voidable under section 547(b); 2) after receiving the preferential transfer, the creditor must advance additional unsecured credit to the debtor; and 3) the additional credit must be unpaid. *See GGSI*, 313 B.R. at 777 *citing Prescott*, 805 F.2d at 728 and *Kroh Bros.*, 930 F.2d at 652. The creditor in *GGSI* attempted to assert the subsequent new value defense to a preference action brought by the Chapter 7 trustee. During the preference period, the creditor/subcontractor had received partial payments from the debtor/general contractor for some of the new value it supplied. In addition, a third-party customer of the debtor was authorized to pay the subcontractor/creditor postpetition and offset the amounts paid to the creditor/subcontractor against amounts owed to the debtor. The creditor/subcontractor in arguing entitlement to the subsequent new value defense correctly asserted that recent cases have approached the "unpaid" question differently in analyzing a section 547(c)(4) defense and argued that this approach is more in tune with the statutory language and legislative history. *See GGSI,* 313 B.R. at 778 *citing IRFM, Inc.*, 52 F.3d at 231. In addition, the creditor argued that, because a third party, not the debtor, had repaid some of the new value, the debtor had not been depleted. Therefore, the policy reasons promoted by the courts requiring new value to remain unpaid were not served.

Despite the creditor/subcontractor's argument, the *GGSI* court reiterated the "requirement" that the new value must remain unpaid in order to be a defense to a preference action, and the policy justification that, by remaining unpaid, the new value supplied, in effect returns the preference to the estate. *See Id.* The Bankruptcy Court for the Northern District of Illinois stated that it was bound by the Seventh Circuit decision in *Prescott* and dismissed the creditor's argument without discussing its merit. *See Prescott*, 805 F.2d at 728 (new value must remain unpaid). As to the third party payments, the court noted that, because the third party creditor was permitted to offset amounts owed to the debtor by amounts it paid to the creditor, the estate had been depleted and not replenished by the repayment of the new value to the extent of the offset.

In addition to the *GGSI* case, the Bankruptcy Appellate Panel of the Eighth Circuit in *In re Accessair, Inc.*, and the Bankruptcy Court for the Southern District of New York in *In re Teligent, Inc.*, recently stated, in dicta, that the relevant inquiry in analyzing a subsequent new value defense is whether the new value replenished the bankruptcy estate and the new value remained unpaid. *See Accessair* 314 B.R. at 394 *citing Kroh Bros.*; *Teligent, Inc.*, 315 B.R. at 315 *citing Jet Florida Sys.* and *Kroh Bros.* After restating the policy reasons behind requiring that new value remain unpaid, the *Teligent* court concluded the new value exception encourages creditors to deal with troubled businesses and recognizes that the new value effectively repays the earlier preference. *See Teligent, Inc.*, 315 B.R. at 315.

The rationale underlying these courts' holdings appears to be the "replenishment theory" — *ie*, that the preference should only be unavoidable to the extent the creditor replenished the estate with new value. *See GGSI*, 313 B.R. at 777; *Chrysler Credit Corp.*, 312 B.R. at 803. Since the facts of these cases did not require an in-depth analysis of subsection 547(c)(4)(B), their restatement of the "requirement" that subsequent new value must remain unpaid highlights the extent to which these courts have applied a judicial gloss to section 547(c)(4) rather than focusing on the plain language in the statute. *See Toyota of Jefferson, Inc.*, 14 F.3d at 1093 n.2; *Check Reporting Servs.*, 140 B.R. at 433 (noting the superficial nature with which the courts have dealt with the requirement of section 547(c)(4)(B)); *Successor Comm. of Creditors Holding Unsec. Claims v. Bergen Brunswig Drug Co. (In re Ladera Heights Community Hosp., Inc.)*, 152 B.R. 964, 968 (Bankr. C.D. Cal. 1993) (none of the cases provide a detailed analysis of the issue, instead they simply treat the proposition as well established).

CONCLUSION

Again, the plain meaning of the language in section 547(c)(4) does not require that the new value remain unpaid. The requirement that does exist, as stated in a double negative in section 547(c)(4)(B), is that to qualify for the defense, the "new value" cannot be repaid with an otherwise unavoidable transfer. New value can be repaid provided that the payment is an unavoidable prepetition payment or court authorized postpetition payment because those payments are not "unavoidable transfers" made by the debtor. The proper inquiry is not whether the new value has been repaid but whether the new value has been repaid by the debtor, prepetition, or debtor-in-possession, postpetition, with an unavoidable transfer.

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Shortly after its U.S. petition was filed, Core-Mark filed an application under section 18.6 of the Canadian Companies' Creditors Arrangement Act (the CCAA) in the Supreme Court of British Columbia. The CCAA is federal legislation passed by the Government of Canada dealing with restructurings, and operates in a manner roughly akin to Chapter 11. Specifically, section 18.6(2) of the CCAA provides that "[t]he [Canadian] court may, in respect of a debtor company, make such orders and grant such relief as it considers appropriate to facilitate, approve or implement arrangements that will result in co-ordination of proceedings under this Act with any foreign proceeding." The purpose of section 18.6(2) of the CCAA is to give the court broad and flexible jurisdiction to facilitate cross-border insolvency proceedings that involve concurrent filings in Canada under the CCAA and in a foreign jurisdiction under the insolvency laws of that jurisdiction. In appropriate circumstances, this may include a Canadian court making an order that recognizes and gives effect to insolvency proceedings in foreign courts.

Mr. Justice Tysoe of The Supreme Court of British Columbia (the Canadian Court) issued an order under section 18.6 that, among other things, recognized Core-Mark's bankruptcy proceedings in the United States as a "foreign proceeding" for purposes of the CCAA and appointed an information officer that was required to provide a report to the Canadian Court once every three months on the status of the U.S. proceedings.

PROTECTING THE ASSETS

Core-Mark's initial concerns were protecting its Canadian assets. The company had relationships with major suppliers who threatened to take COD payments for new products and apply those payments to old debt. There was also the concern that U.S. creditors would take action against Core-Mark's assets in Canada, which would frustrate the ability of the company to reorganize in the United States. Under the CCAA, there is no statutory equivalent to the automatic stay provisions of section 362 of the Bankruptcy Code. An application must be made to obtain similar relief. Section 18.6(3) of the CCAA allows the courts to issue orders "on such terms and conditions as the court considers appropriate in the circumstances," leaving the Canadian courts flexibility to craft a stay order to meet the needs of the company. The Canadian Court in *Core-Mark* granted a stay against all actions, enforcements and proceedings against the company for a specified period of time (which was extended further by subsequent orders). The imposition of the stay provided Core-Mark and its affiliates the breathing room they needed to proceed with the primary restructuring in the U.S.

All orders in the U.S. bankruptcy that had a significant impact on Canadian creditors were disclosed to the Canadian creditors, and the more significant orders were specially recognized by the Canadian Court. For example, the Canadian Court was asked to, and did, adopt the U.S. claims process and bar date. This was significant because Canadian courts have not always agreed that there should be one claims process. For example, in the Philip Services Corp. restructuring, the company sought approval in Ontario of a Canadian plan of arrangement that would require all Canadian claims against Philip to be dealt with in the company's U.S. proceedings. *Menegon v. Philip Services Corp.* (1999), 11 C.B.R. (4th) 262 (Ont. S.C.J. [Commercial List]). In not approving the plan, Mr. Justice Blair expressed his concern that forcing Canadian creditors of Philip to file claims in the U.S. would take away their right to vote on the Canadian plan as proposed. The court held that comity and international co-operation do not mean that one court must cede its authority and jurisdiction over its own process or over the application of the substantive laws of its own jurisdiction, whenever any kind of differences between the two jurisdictions arise.

A HAPPY BALANCE

In Core-Mark, a happy balance was reached to satisfy similar concerns by creditors. Canadian creditors, particularly the provincial governments, which were major creditors, did not want to jeopardize any statutory or other special rights they may have enjoyed in Canada, and wanted to preserve their ability to call upon Canadian statutes that afforded them favorable treatment. After extensive discussions and negotiations with key Canadian creditors, all stakeholders committed to a single claims process recognizing the U.S. claims process and bar date as applicable in Canada and binding on Canadian creditors, without prejudice to the Provincial Governments' rights and remedies under Canadian statutes. Additionally, both the U.S. Court and the Canadian Court entered orders that held that the mere fact of filing a proof of claim in the U.S. proceeding by a Canadian creditor was not deemed a submission to the jurisdiction of the U.S. Court by the Canadian creditor.

The single claims process was critical to the quick and efficient emergence of Core-Mark from Chapter 11. Not only are dual claims processes costly, as the debtor is funding two claims processes, but they are also inefficient. With two claims processes, creditors who do business both in Canada and the United States would inevitably have filed claims in both jurisdictions leading to problems with large amounts of duplicate claims.

As the next significant follow-up to the single claims process, it was crucial to ensure that all creditors were treated fairly pursuant to one plan of reorganization. The Canadian Court, upon application, allowed Core-Mark to adopt the U.S. plan and balloting process as the single plan process and relieved Core-Mark of the obligation of filing a separate plan of reorganization under the CCAA. Obtaining this order was a substantial benefit to Core-Mark as it allowed the restructuring to proceed on one time track on a global basis that encompassed all creditors. Core-Mark also

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THE BANKRUPTCY HOTLINE

SECURED CREDITOR MAY COLLECT INSURANCE ON DAMAGED COLLATERAL

In an issue of first impression in the Third Circuit, the appeals court has ruled that a secured creditor in a Chapter 7 bankruptcy may recover the insurance proceeds intended to pay for damage to its collateral, while retaining the fully repaired collateral. *Stanziale v. Finova Capital Corp. (In re Tower Air Inc.),* No. 03-3101 (Feb. 10).

The court held that under the relevant Uniform Commercial Code (§ 9-306 of the Arizona UCC), the finance company, as an undersecured and cross-collateralized creditor, was entitled to recover both the collateral (an aircraft engine) and the insurance proceeds. The court relied on the language of both the contractual agreements and insurance documents. In the contractual agreements between the debtor and the secured creditor, the creditor retained the right of approval over any use of insurance proceeds. As for the insurance proceeds, the court noted that the insurance documents conferred upon the secured creditor the significant status of a mortgagee payee, and not a mere loss payee.

The court further rejected the Trustee's equitable exception argument under § 552(b). The court reasoned that because this was a Chapter 7 liquidation with no hope of rehabilitation, the assets of the estate were not used to increase the value of the secured creditor's collateral during the bankruptcy proceedings. The repairs to the damaged collateral were made pre-petition and while they did increase the value of the collateral, the debtor's apparent negligence also seems to have caused the destruction of other collateral, leaving the creditor greatly undersecured. Therefore, the finance company would only recover what it is due as a secured creditor with a valid security interest in the insurance proceeds.

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sought and received approval of an order recognizing and implementing the confirmed U.S. plan of reorganization in the Canadian proceedings, which order had the effect of making the plan enforceable in Canada and ensuring that all claims against Core-Mark in Canada would be treated pursuant to the terms of a single plan.

The key facts that the Canadian Court considered in entering these orders, were that: 1) the Canadian proceeding was ancillary to the primary restructuring activity by the parent and its other subsidiaries without Canadian operations because, among other things, the majority of Core-Mark's business was conducted in the United States; 2) the U.S. claims process was intended to treat claimants equally, regardless of the jurisdiction in which they resided; 3) the U.S. plan of reorganization was comprehensive in nature and contemplated a global restructuring of the companies, including the Canadian operations; 4) ample notice had been given to the Canadian Court of the developments in the U.S. proceedings; and 5) ample notice had been given to the Canadian creditors of Core-Mark's intentions.

IMMEASURABLE BENEFIT

The benefit of filing ancillary proceedings directly in Canada and moving for relief under section 18.6 for Core-Mark were immeasurable. The filing served the key purpose of allowing all of the debtors' assets to be reorganized in a central fashion, without the worry of piece-meal attack from creditors outside of the U.S. As Judge Blair summarized when he approved the cross-border protocol in *Olympia & York*:

"Insolvency disputes with international overtones and involving property and assets in a multiplicity of jurisdiction are becoming increasingly frequent. Often there are differences in legal concepts — sometimes substantive, sometimes procedures — between the jurisdictions. The [c]ourts of the various jurisdictions should seek to cooperate amongst themselves, in my view, in facilitating the transborder resolution of such disputes as a whole, where that can be done in a fashion consistent with their own fundamental principles or jurisprudence. The interests of international cooperation and comity, and the interests of developing at least some degree of certitude in international business and commerce, call for nothing less."

Olympia & York Developments Ltd., 20 C.B.R. (3d) 165, 169 (1993). Core-Mark was a textbook case of cooperation and efficiency in a cross-border restructuring. Implementation of the strategy allowing the U.S. proceeding to be the primary proceeding while simultaneously recognizing the rights of Canadian creditors allowed Core-Mark to emerge from bankruptcy protection more quickly and cost-effectively.

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