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Eighth Circuit Holds That Section 547(c) "New Value" Need Not Come from Preferential Transferee

By LISA M. SCHWEITZER and DANIEL J. SOLTMAN*

The authors review a recent circuit court decision that closes a possible loophole under the Bankruptcy Code's rules governing preferential transfers.

INTRODUCTION

The U.S. Court of Appeals for the Eighth Circuit, in *Stoebner v. San Diego Gas & Elec. Co.* (the "Opinion"),[1] recently held that when a debtor makes a preferential transfer under Section 547(b) of the Bankruptcy Code[2] to a third party for the benefit of a primary creditor, a contemporaneous or subsequent transfer by the primary creditor to the debtor is "new value" under § 547(c) of the Bankruptcy Code[3] that can shield the third party from preference liability in the amount of the "new value," even if the third party also is a creditor. The Opinion represents an issue of first impression in the Eighth Circuit, and the court's holding is significant because it closes the door to a potential end-run around the § 547(c) "new value" exceptions to preferential transfers in tri-party arrangements.

BACKGROUND AND PROCEDURAL HISTORY

Prior to its February 6, 2009 involuntary bankruptcy filing, LGI Energy Solutions, Inc. and LGI Data Solutions Company, LLC (collectively "LGI") performed bill payment services for their clients, which consisted of large utility customers,

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[1] *In re LGI Energy Solutions, Inc.*, 746 F.3d 350 (8th Cir. 2014).

[2] Section 547(b) of the Bankruptcy Code provides in relevant part that, "Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent; (4) made (A) on or within 90 days before the date of the filing of the petition . . . ; and (5) that enables such creditor to receive more than such creditor would receive if (A) the case were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title."

[3] Section 547(c) of the Bankruptcy Code provides in relevant part that, "The trustee may not avoid under this section a transfer (1) to the extent that such transfer was (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and (B) in fact a substantially contemporaneous exchange . . . (4) 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."

including Buffets, Inc. and Wendy's International, Inc. ("Buffets" and "Wendy's" respectively). In LGI's business model, utility companies that provided services to LGI's clients sent invoices directly to LGI, rather than to their customers. LGI periodically provided invoice summaries to its clients, which in turn paid the aggregate invoice amounts to LGI. LGI placed these payments into a comingled account and used the pool of money to pay the utility companies for the outstanding invoice amounts. The utility companies had no contractual relationship to LGI.

During the ninety days prior to LGI's bankruptcy filing, LGI made payments on behalf of its clients Buffets and Wendy's for a total of $75,053.85 to San Diego Gas & Electric Company ("SDGE") and $183,512.74 to Southern California Edison Company ("SCE," and together with SDGE, the "Utility Companies") to pay outstanding invoices for utility services provided to Buffets and Wendy's (the "LGI Payments"). Subsequent to the LGI Payments but before LGI's bankruptcy filing, business continued as it had before; the Utility Companies provided services to Buffets and Wendy's and sent invoices directly to LGI, while Buffets and Wendy's paid roughly $297,000 to LGI pursuant to their existing contractual arrangement (the "Primary Creditor Payments").

Following the bankruptcy filing, the LGI trustee brought a preferential transfer action under § 547(b) to recover the value of the LGI Payments on behalf of the estates. In separate decisions, the bankruptcy court held that (1) the LGI Payments were preferential transfers within the meaning of § 547(b) "to or for the benefit of" the Utility Companies as creditors, and (2) the reference in § 547(c)(4) to "such creditor" requires that subsequent "new value" be provided by the creditor that received the preferential transfer, and as a result, the Utility Companies were entitled to a § 547(c)(4) "new value" setoff in preference liability only to the extent that they provided utility services to Buffets and Wendy's after the LGI payments.[4]

The Utility Companies appealed the decision to the United States Bankruptcy Appellate Panel for the Eighth Circuit ("BAP") on the grounds that (1) the Utility Companies were not "creditors" of LGI within the meaning of § 547(b), (2) the transfers were not on account of antecedent debts owed to the Utility Companies within the meaning of § 547(b), and (3) the § 547(c)(4) "new value" setoff to the preferential transfer liability should have been allowed in the amount of the Primary Creditor Payments (i.e. all payments received after the dates of the challenged LGI Payments), rather than the value of the utility services provided to Buffets and Wendy's after the LGI Payments.[5] Consolidating the cases, the BAP denied the appeal on the first two grounds, but overruled the bankruptcy court's findings and held that the Utility Companies were entitled to a "new value" defense in the amount of the Primary Creditor Payments. The trustee appealed the BAP's decision to the Eighth Circuit, arguing that the language of the preference statute mandates that any

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[4] *In re LGI Energy Solutions, Inc.*, Nos. ADV 11-4065 and 11-4066 (Bankr. D. Minn. June 11, 2012).

[5] *Stoebner v. San Diego Gas & Elec. Co. (In re LGI Energy Solutions, Inc.)*, 482 B.R. 809 (8th Cir. BAP 2012).

subsequent "new value" setoff to a defendant's § 547(b) preference liability must be provided by the same creditor who received the preferential transfer.

THE DECISION

The Eighth Circuit affirmed the BAP's holding, finding it consistent with existing Eighth Circuit precedent and the statutory purpose of §§ 547(b) and (c) that a party other than the preferential transferee in what was effectively a tri-party arrangement could provide "new value" for purposes of the statute.

Before addressing the merits, the court pointed out the inequities inherent in the trustee's position that § 547(c)(4) requires that any subsequent "new value" must be provided by the creditor that received the preferential transfer. Recognizing that LGI did not have a contract with the Utility Companies and the LGI Payments were not only made "to or for the benefit of" the Utility Companies, but also "to or for the benefit of" Buffets and Wendy's, the court noted that the trustee's position, if followed, would do fundamental violence to the prime bankruptcy policy of equality of distribution among creditors. The court further explained that if the Utility Companies were not entitled to a § 547(c)(4) preference liability setoff in the amount of the Primary Creditor Payments, "the estate [would be] 'doubly replenished' entirely at the expense of only two creditors, Buffets and Wendy's," who were not sued directly but would be left in the untenable position of having made further payments to LGI that they would not recover, while remaining liable to the Utility Companies for their unpaid invoices because the Utility Companies would be required to return the payments they received from LGI with respect to these customers' invoices. The court further noted that it was not asked to review the BAP's ruling that the Utility Companies were "creditors" within the meaning of § 547(b)—an essential element that "opened the door for the trustee's inequitable application of the preference statutes"—but that such a finding "seems open to serious question . . . [and] should *not* be considered Eighth Circuit precedent."

Turning to the merits and addressing the issue of whether subsequent "new value" for the purposes of § 547(c)(4) must be provided by the party who received the preferential transfer, the court relied primarily on its prior decision.[6] In *Jones Truck Lines*, the Eighth Circuit concluded that transfers made by the debtor to an employee benefit fund pursuant to a collective bargaining agreement were exempted from preference liability to the extent that the employees (on whose behalf the transfer was made) provided the debtor with contemporaneous (or in the alternative, subsequent) "new value" by continuing to work for the debtor. The court agreed with the BAP and found the facts of the present case to be "closely analogous" to *Jones Truck Lines*, explaining that "LGI's preferential transfers to the [Utility Companies] were based upon its contractual obligations to [Buffets and Wendy's], who benefitted from those transfers by having their utility bills paid. Applying the reasoning in *Jones Truck Lines*, each [Utility Company] may offset all new value Buffets and Wendy's transferred to

[6] *Jones Truck Lines, Inc. v. Central States, Se. and Sw. Areas Pension Fund (In re Jones Truck Lines, Inc.)*, 130 F.3d 323 (8th Cir. 1997).

LGI subsequent to an avoidable preference." The court also noted that its decision is consistent with the statutory purpose of encouraging creditors to deal with troubled businesses since it assures that creditors similarly positioned to Buffets and Wendy's will receive the benefit of the subsequent "new value" that they provide to the estate.

While the court explicitly limited its holding to the facts presented in the case, citing the complexity of § 547, it confirmed that "in three-party relationships where the debtor's preferential transfer to a third party benefits the debtor's primary creditor, new value (either contemporaneous or subsequent) can come from the primary creditor, even if the third party is a creditor in its own right and is the only defendant against whom the debtor has asserted a claim of preference liability."

SIGNIFICANCE OF *LGI ENERGY SOLUTIONS*

LGI Energy Solutions is significant because it avoids inequitable consequences by closing a possible loophole under the preference statute created by the trustee's discretion in deciding which party it brings a preference action against. As the court notes in the Opinion, the trustee attempted an end-run around the § 547(c) "new value" exception to preferential transfers, suing only the preferential payment transferees which did not themselves replenish the estate. While this strategy would have been beneficial to the estate, it would have come at the expense of only two creditors, violated the fundamental principal of equality of distribution among creditors, and discouraged creditors from working with financially distressed companies. The Eighth Circuit has successfully avoided such an inequitable result.