

Finally A Clear Ruling On A Much Needed Bankruptcy Preference Defense

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SUMMARY

The United States Bankruptcy Court for the District of Delaware has finally clarified that the administrative expense claim for goods delivered post-bankruptcy filing may be set off – dollar for dollar – to reduce any open preference exposure. The decision provides the first written decision from Delaware providing authority for preference defendants with post-bankruptcy filing administrative expense claims to apply these expense claims, dollar for dollar, against any preference liability they may incur.

In the chapter 11 bankruptcy cases of Quantum Foods, LLC and certain related debtors, Tyson Fresh Meats, Inc. and Tyson Foods, Inc. (collectively, "Tyson"), were sued for preference claims (payments made during the 90 days prior to the filing of the bankruptcy case) totaling approximately \$13.7 million. Prior to the preference action, Tyson Fresh Meats, Inc. obtained an order from the bankruptcy court granting it an administrative claim in the amount of \$2,603,841 on account of deliveries made subsequent to the filing of the bankruptcy case. In defense of the preference action, Tyson asserted, among other things, that the claims are subject to, and need to be reduced by, Tyson's right of setoff in the amount of the administrative expense claim.

Judge Kevin J. Carey, United States Bankruptcy Judge for the District of Delaware, issued an opinion addressing the right of setoff, and granted the setoff. The court first addressed the argument that Tyson's post-petition right of setoff argument is really a "disguised" post-petition new value defense. New value is a statutory defense to a preference action provided in the Bankruptcy Code but is often limited by certain technical requirements. In rejecting this argument, the court noted that the new value defense involves pre-petition activity between a debtor and a preference defendant, and does not take into account post-petition conduct. Additionally, Judge Carey stated that the right of setoff would not impact the value of the preference claim, but would only impact the amount paid to the estate. Thus, Tyson's claim is a setoff claim, independent from the preference cause of action under 11 U.S.C. § 547(b).

The next issue addressed by the court was whether the cause of action arose post-petition. As Tyson was allowed an administrative claim on account of post-bankruptcy filing activity, it could only exercise its right of setoff if the preference cause of action also arose post-petition. The court determined that the right to payment of any preference award arose post-bankruptcy filing, therefore, the preference claim is a post-bankruptcy cause of action. Based on the fact that both the preference claim and the administrative expense setoff arose post-bankruptcy, Tyson had a valid right of setoff.

The opinion provides the first written decision from Delaware providing authority for preference defendants with post-bankruptcy filing administrative expense claims to apply their post-bankruptcy filing administrative expense claims, dollar-for-dollar, against any preference liability they may incur.

For more information on this development, please contact the authors or the attorney at the firm with whom you are regularly in contact.

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