Ice Cream Makes Everything Better

By John V. Burch & David A. Harris August 31, 2018

A recent Eleventh Circuit decision about ice cream may reduce the surety's payment bond exposure when its principal files for bankruptcy.

Kaye v. Bluebell Creameries, Inc., No. 17-13588, 2018 WL 3850101 (11th Cir. Aug. 14, 2018), extends the "new value" defense creditors have to bankruptcy preference claims.

At risk of oversimplifying the topic, a "preference" in bankruptcy is a payment made by a debtor within 90 days of the bankruptcy filing for an old debt. 11 U.S.C. § 547. The bankruptcy trustee can seek to "avoid" preference payments and force creditors to repay those amounts to the debtor's estate. The creditor may defend against a preference claim when it shows "new value" was provided to the debtor.

In *Kaye*, the bankruptcy trustee for a grocery-store chain sought to recover over $500,000 paid by the chain to an ice cream supplier during the 90-day preference period. The grocery-store chain made numerous payments on old invoices and continued to receive ice cream during the preference period. Some of the payments made during the preference period were for ice cream supplied earlier in the preference period. The court held that the ice cream supplier could keep those payments so long as additional new value was later provided.

What impact will this case about payments for ice cream have on payment bond sureties?

When a contractor enters bankruptcy, its surety is exposed to potential payment bond claims from subcontractors or suppliers who have already been paid but who may be forced to pay back funds received during the 90-day preference period.

Under a prior Eleventh Circuit decision, the "new value" defense to preferences was limited. To constitute "new value," the material supplied during the preference period was required to "remain unpaid" at the time of the bankruptcy filing.

In rejecting this prior application, the Eleventh Circuit joined the 4th, 5th, 8th, and 9th circuits and expanded the "new value" defense by not requiring the material provided during the preference period to remain unpaid in order to constitute new value.

Indirectly, this decision will benefit sureties by reducing the number of claims brought by subcontractors and suppliers, who will be able to hold on to more payments received during the preference period.

But the decision will benefit sureties directly as well. The preference rule applies where a creditor receives a "benefit" from the preferential payment. Rather than attempting to recoup preferential payments from subcontractors and suppliers, bankruptcy trustees will occasionally file preference claims directly against the payment bond sureties who benefitted from the preferential payment (i.e., no bond claims). Sureties can rely on *Kaye* when defending against preference claims brought in bankruptcy courts in the Eleventh Circuit.