

March 9, 2026

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## Courts Hold that Affirmative Defenses under U.S. Bankruptcy Code § 547 May be Applied in the Order Deemed Most Advantageous to Defendants

Under Section 547 of the United States Bankruptcy Code, a “preferential payment” is a transfer of money or other property made by a debtor to a creditor before the filing of a bankruptcy case that ultimately gives that creditor more than it would receive in a Chapter 7 liquidation. See, 11 U.S.C.A. § 547. To qualify as a preference, the payment must be made on account of a preexisting debt, while the debtor is insolvent, and within 90 days before the bankruptcy filing (or within one year if the creditor is an insider). If these elements are met, the bankruptcy trustee may recover the payment for the benefit of the estate. The purpose of Section 547 is to ensure equal treatment among similarly situated creditors and to prevent a debtor from favoring certain creditors over others shortly before seeking bankruptcy protection.

There are two common affirmative defenses under Section 547 for preferential payments: (1) the “ordinary course” defense and (2) the “new value” defense. The ordinary course defense protects a preferential payment transfer if the payment was for a debt that was incurred in the ordinary course of business of the debtor and transferee (the subjective test) or according to ordinary business terms (the objective test). See, 11 U.S.C.A. § 547(c)(2). The new value defense, by contrast, allows a creditor to reduce or eliminate preference exposure to the extent the creditor subsequently provided new value—such as additional goods or services—after receiving the alleged preferential payment, so long as the new value was not secured by an otherwise unavoidable security interest and was not repaid by an otherwise unavoidable transfer.

When applying affirmative defenses, trustees have typically analyzed the new value defense first and then apply the ordinary course defense. New Jersey Bankruptcy Courts, however, are now finding that these affirmative defenses should be applied in the order deemed most advantageous to the defendants and that, in many cases, it made most sense to apply the ordinary course defense first before the new value defense. See, In re Dots, LLC, 562 B.R. 286 (Bankr. D.N.J. 2017). In In re Dots, LLC, the New Jersey Bankruptcy Court held “. . . to hold that the new value affirmative defense, Bankruptcy Code section 547(c)(4) [new value], must be applied prior to the ordinary business terms defense is inconsistent with the language of the statute and irreconcilable with its practical application. Pursuant to Bankruptcy Code section 547(c)(4), the new value defense is only available to a creditor where the transfer in question is ‘otherwise unavoidable.’ Therefore, to determine the validity of the new value defense under Bankruptcy Code section 547(c)(4), a court must necessarily undertake an examination of whether the transfer is unavoidable as protected by another Bankruptcy Code 547(c) affirmative defense, such as an ordinary business terms defense. See, e.g., In re Phoenix Rest. Grp., Inc., 317 B.R. 491, 499–500 (Bankr. M.D. Tenn. 2004) (collecting cases) (holding that application of Bankruptcy Code section 547(c)(4) requires prior determination of whether the transfer is protected under other portions of Bankruptcy Code 547).” In re Dots, LLC, 562 B.R. at 295; see also, In re Parkline Corp., 185 B.R. 164, 171 (Bankr. D.N.J. 1994) (the court found that, after analyzing the ordinary course defense, it was not necessary to analyze the new value defense asserted).

This approach has been explored previously in other jurisdictions as well. See, e.g., *In re Phoenix Rest. Grp., Inc.*, 317 B.R. at 500; *In re George Transfer, Inc.*, 259 B.R. 89, 95 (Bankr. D. Md. 2001).

Because of this alternative approach, such as applying the defenses in the order most advantageous to the defendants, Ruskin Moscou Faltischek was successful in obtaining a dismissal for our client in a case worth nearly \$550,000.00. Based on our analysis of the ordinary course defense before the new value defense, we obviated any exposure that our client had and obtained a full dismissal of the complaint.

It will be interesting to see if other circuits will adopt this alternative approach coming out of the Third Circuit. At this point in time, there are no published decisions from the Second Circuit affirming this approach.

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