

**IN THE UNITED STATES BANKRUPTCY COURT  
FOR THE DISTRICT OF DELAWARE**

<p>In re:</p> <p>PACK LIQUIDATING LLC, <i>et al.</i>,</p> <p style="text-align: center;">Debtors.</p> <hr/> <p>OFFICIAL COMMITTEE OF UNSECURED CREDITORS OF PACK LIQUIDATING LLC, <i>et al.</i>, derivatively, on behalf of the Debtors' estates,</p> <p style="text-align: center;">Plaintiff,</p> <p>v.</p> <p>THE NATURE'S BOUNTY CO., d/b/a Active Nutrition,</p> <p style="text-align: center;">Defendant.</p>	<p>Chapter 11</p> <p>Case No. 22-10797 (CTG)</p> <p>(Jointly Administered)</p> <p>Adv. Proc. No. 23-50572 (CTG)</p> <p><b>Related Docket Nos. 23, 29</b></p>
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**MEMORANDUM OPINION**

The Bankruptcy Code gives the trustee the power to avoid and recover “any transfer of an interest of property of the debtor” that is made in the 90 days before bankruptcy in satisfaction of a prepetition debt, subject to various defenses.<sup>1</sup> This requirement will, at times, give rise to disputes over when a “transfer” occurred. The Supreme Court explained in *Barnhill*, for example, that when a check is delivered from the debtor to the creditor on Day 1 and the bank honors the check on Day 2, that those funds are transferred on Day 2.<sup>2</sup>

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<sup>1</sup> 11 U.S.C. § 547(b), (c).

<sup>2</sup> *Barnhill v. Johnson*, 503 U.S. 393 (1992).

The motion for leave to amend the complaint, now before this Court, presents a variant on that theme. The Committee, which is the plaintiff, seeks leave to amend its complaint.<sup>3</sup> According to the allegations of the proposed amended complaint, the debtors made a payment to Nature's Bounty, before the beginning of the 90-day preference period, that *overpaid* Nature's Bounty – by \$500,000 – for amounts that were then due.<sup>4</sup> Then, at a time *within* the preference period, it is alleged that Nature's Bounty applied the \$500,000 it was holding to satisfy other invoices it had issued to the debtors.

If the “transfer” occurred when the debtors made the overpayment, then there is no preference because the transfer occurred outside the preference period. In that case, the motion for leave to amend the complaint should be denied on the ground that it is futile. If, however, the transfer occurred when Nature's Bounty applied the funds, then the amended complaint would state a claim for the avoidance and recovery of that \$500,000, and the motion for leave to amend should be granted. For the reasons described below, the Court concludes the transfer of the funds did not occur until Nature's Bounty applied the funds. The Court will thus grant the motion for leave to amend.

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<sup>3</sup> The Official Committee of Unsecured Creditors, the plaintiff in this action, is referred to as the “Committee.”

<sup>4</sup> Packable Holdings LLC and its affiliated debtors are referred to as the “debtors.” Defendant The Nature's Bounty Co. is referred to as “Nature's Bounty.”

### Factual and Procedural Background

The debtors operated an e-commerce business.<sup>5</sup> They filed these bankruptcy cases on August 28, 2022.<sup>6</sup> In May 2023, the Court approved a stipulation that authorized the Committee to investigate, assert, and settle chapter 5 causes of action on behalf of the debtors' bankruptcy estates.<sup>7</sup>

The original complaint, filed in September 2023, sought to avoid and recover approximately \$1.675 million in transfers that the debtors had allegedly made to Nature's Bounty in the 90-day period before the bankruptcy filing.<sup>8</sup> In April 2024, the Committee moved for leave to amend its complaint.<sup>9</sup> The amended complaint added a claim to avoid and recover an additional \$500,000, which had allegedly been paid before the preference period but applied to particular invoices within the preference period.<sup>10</sup>

Nature's Bounty opposes the motion for leave to amend the complaint, arguing that amendment would be futile because the \$500,000 was transferred outside the

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<sup>5</sup> D.I. 23-1 ¶ 8. Because the question before the Court, whether to grant leave to amend the complaint, turns on whether amendment would be "futile," which itself depends on whether the proposed amended complaint would survive a Rule 12(b) motion to dismiss, this Court applies the motion to dismiss standard and for this purpose accepts the factual allegations in the proposed amended complaint as true. That proposed amended complaint, which was attached to the motion for leave to amend and docketed at D.I. 23-1, is hereafter cited as the "amended complaint."

<sup>6</sup> *Id.* ¶ 9.

<sup>7</sup> *Id.* ¶ 13.

<sup>8</sup> D.I. 1.

<sup>9</sup> D.I. 23.

<sup>10</sup> D.I. 23-1 ¶ 25.

preference period.<sup>11</sup> Nature's Bounty's opposition also argues that the motion for leave to amend should be denied because the Committee failed to conduct adequate diligence before filing the complaint, as § 547(b) requires.<sup>12</sup>

The contention about due diligence led the parties down something of a rabbit hole. The Committee responded to the contention, in the reply brief, by attaching documents it obtained in discovery, arguing that they support its contention that it had conducted appropriate diligence before filing the original complaint.<sup>13</sup> Nature's Bounty responded to that reply by moving to strike one of the documents on which the Committee relied and any discussion of that document, on the ground that it should have been included as part of the opening brief.<sup>14</sup> The Committee responds that those documents simply rebut contentions made in the responsive brief and were thus appropriately included in the reply.<sup>15</sup>

### **Jurisdiction**

The complaint seeks to avoid and recover alleged transfers under §§ 547, 548 and 550 of the Bankruptcy Code. These claims “arise under” the Bankruptcy Code and are thus within the district court's subject-matter jurisdiction under 28 U.S.C. § 1334(b). They have been referred to this Court in accordance with

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<sup>11</sup> D.I. 25 ¶¶ 18-21.

<sup>12</sup> *Id.* ¶¶ 50-56; *see also* 11 U.S.C. § 547(b) (“the trustee may, based on reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c), avoid any transfer of an interest of the debtor in property...”).

<sup>13</sup> D.I. 26 at 12-13 & Exs. 1 & 2.

<sup>14</sup> D.I. 29.

<sup>15</sup> D.I. 30.

28 U.S.C. § 157(a) and the district court's standing order of reference, dated February 29, 2012.

### Analysis

**I. The motion to strike is denied as moot because the attached documents are not relevant to the motion before this Court and thus will not be considered.**

As far as the Court can discern, the set of issues around the motion to strike is based on an erroneous premise and therefore need not be addressed on the merits. The question before the Court is whether to grant leave to amend the complaint. The opposition to the motion is based on the argument that the Committee's effort to avoid the alleged transfer of the additional \$500,000 is futile. In addressing that question, the Court accepts the allegations of the complaint as true and addresses essentially the same question as it would if the issue were before it on a motion under Rule 12(b)(6).<sup>16</sup>

Nature's Bounty opposes the motion for leave to amend by arguing that the Committee failed to conduct adequate diligence into potential defenses as required by § 547(b). There are two fairly straightforward reasons why that argument is essentially irrelevant to the motion for leave to amend. *First*, for the purposes of the motion for leave to amend, the question is only whether the complaint adequately *alleges* that the Committee conducted appropriate diligence. The Court does not conduct a mini trial on the question of the adequacy of the Committee's diligence in

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<sup>16</sup> See *In re Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1434 (3d Cir. 1997) ("Futility' [as a basis to deny leave to amend] means that the complaint, as amended, would fail to state a claim upon which relief could be granted. In assessing 'futility,' the district court applies the same standard of legal sufficiency as applies under Rule 12(b)(6).") (citations omitted).

order to determine whether the Committee is entitled to leave to amend the complaint. In response to a motion for summary judgment or at trial, the Committee either will or will not present sufficient evidence of its diligence to satisfy that element of its claim.<sup>17</sup> But for purposes of the motion for leave to amend, the Court accepts as true the allegations in the second amended complaint, which include an allegation that the Committee conducted appropriate diligence.

*Second*, the diligence obligation imposed by § 547(b) is limited to the *defenses* that may be available to the defendant.<sup>18</sup> Because the alleged failure of diligence here relates to an affirmative element of the transfer claim (whether the transfer occurred within the preference period) and not one of the defenses set out in § 547(b), the diligence requirement does not even apply to this circumstance.

The Committee, however, apparently took the bait and responded by trying to submit documentary evidence that would rebut the allegation that its diligence was inadequate. It is those documents that are the subject of the motion to strike. But for the reasons described above, none of that is relevant to the question now before the Court. The Court is not conducting an evidentiary proceeding on the Committee's diligence. It takes the allegations in the complaint as true. And the diligence requirement is not even applicable to the Committee's satisfaction of the elements of

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<sup>17</sup> Technically, the question whether the diligence requirement is a formal "element" is a disputed one on which courts are divided. In *In re Pinktoe Tarantula Ltd.*, No. 20-50597-LSS, 2023 WL 2960894, at \*5 (Bankr. D. Del. Apr. 14, 2023), Judge Silverstein held that this was an element to a preference claim. This Court finds that analysis to be thorough and persuasive.

<sup>18</sup> See *In re Art Institute of Philadelphia, LLC*, No. 20-50627, 2022 WL 18401591, at \*20 (Bankr. D. Del. Jan. 12, 2022).

a preference, only potential defenses. The Court therefore has no occasion to consider the attached documents in connection with the motion for leave to amend. And it will not do so. The motion to strike is thus denied as moot.<sup>19</sup>

In the alternative, however, Nature's Bounty seeks leave to file a sur-reply brief, which was attached as Exhibit C to its motion to strike. That motion will be granted, and the proposed sur-reply brief shall be deemed filed.

**II. The proposed amended complaint adequately alleges that the \$500,000 transfer occurred in the preference period; the motion for leave to amend the complaint will therefore be granted.**

The principal issue raised by the motion for leave to amend is whether amendment is futile. The claim for futility is based on Nature's Bounty's argument that, even accepting the allegations as true, there is no avoidable transfer with respect to the \$500,000. The reason, Nature's Bounty argues, is that those funds were transferred to it from the debtors before the beginning of the preference period, and thus are not avoidable.

The facts, as alleged, are that the overpayment of \$500,000 was made on February 25, 2022. And paragraph 33 of the amended complaint states that Nature's

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<sup>19</sup> Nature's Bounty contends that the Committee's opening brief did not suggest that the \$500,000 transfer would also be challenged as a fraudulent conveyance under § 548, and that the defense of that claim in the Committee's reply brief should also be stricken. But the amended complaint makes clear that it is alleging that all of the alleged transfers, to the extent they were not made on account of antecedent debt, are challenged as fraudulent conveyances. This contention accordingly provides no reason to strike any of the Committee's reply brief.

Bounty applied those funds against other unpaid invoices during the preference period, which was from May 30, 2022 until August 28, 2022.<sup>20</sup>

As the Supreme Court explained in *Barnhill*, the Bankruptcy Code defines the term “transfer” to mean “each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with ... property[] or ... an interest in property.”<sup>21</sup> And while the construction of that statute is a question of federal law, because it refers to “property” and “interests in property,” under the principle of *Butner*, one must look to state law to determine how and when interests in property are conveyed.<sup>22</sup> The *Barnhill* Court accordingly turned to the Uniform Commercial Code to determine when the funds in that case were legally transferred from the debtor to the creditor. Relying on those state law provisions, the Court concluded that “no transfer of any part of the debtor’s claim against the bank occurred until the bank honored the check.”<sup>23</sup>

Nature’s Bounty’s argument on this question essentially assumes its conclusion. It’s argument treats the overpayment of the \$500,000 as the “transfer” that the complaint seeks to avoid. And based on that premise, Nature’s Bounty

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<sup>20</sup> The opposition brief also contends that the amended complaint lacks sufficient detail about the nature of the transfers, that the complaint fails to allege facts that show that Nature’s Bounty received more than it would have in a liquidation, and that the complaint fails to allege insolvency. None of those arguments has merit. The complaint contains sufficient detail to permit Nature’s Bounty to defend on the merits. The complaint specifically alleges that Nature’s Bounty recovered more than it would have under a chapter 7, and the debtors are presumed to be insolvent during the 90-day preference period. 11 U.S.C. § 547(f).

<sup>21</sup> 11 U.S.C. § 101(54)(D).

<sup>22</sup> See *Butner v. United States*, 440 U.S. 48, 54 (1979).

<sup>23</sup> *Barnhill*, 503 U.S. at 399.



argues that because “the alleged \$500,000.00 Transfer occurred outside the preference period, any amendment to the Complaint seeking to pursue the alleged \$500,000.00 Transfer as a preferential payment would be inherently futile.”<sup>24</sup> That argument does not engage the question of when Nature’s Bounty acquired an interest in the \$500,000 overpayment – either at the time the payment was made or when it later applied those funds to other invoices.

In its reply brief, the Committee points to cases that arise in the context of tax overpayments. In *Nichols*, the debtors made tax payments that exceeded their tax obligations and were thus entitled to a refund.<sup>25</sup> They elected, however, to have those payments applied to their following year’s tax obligation. When the debtors filed for bankruptcy, however, the trustee sought the return of the overpayment, on the ground that it became property of the estate as of the filing of the bankruptcy case. The Ninth Circuit, relying on the expansive definition of property under § 541, agreed that the refund was property of the estate.<sup>26</sup>

While the cases about ownership of a tax refund are instructive, *Barnhill* explains that the question of when a transfer occurs is, at bottom, dependent on state law. On that issue, general principles of commercial law support the Committee’s assertion that a party who overpays an invoice retains a legal interest in the

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<sup>24</sup> D.I. 25 at 5.

<sup>25</sup> *Nichols v. Birdsell*, 491 F.3d 987 (9th Cir. 2007).

<sup>26</sup> *Id.* at 990. As the Committee acknowledges, other courts have emphasized the irrevocable nature of the election to apply an overpayment to the following year’s taxes in reaching the opposite conclusion. See *In re Graves*, 609 F.3d 1153 (10th Cir. 2010).

overpayment. Accordingly, the debtors' interest in the funds would not be transferred to Nature's Bounty until it applied those funds in satisfaction of other invoices.

The Second Circuit explained this point in a recent decision involving an erroneous payment. It is a "well-recognized principle of law" that "a party who pays money under a mistake of fact, to one who is not entitled thereto, must in equity and good conscience be permitted to get it back."<sup>27</sup> That same principle is set forth in the Restatement: "Where the owner of property by mistake transfers it to one person under such circumstances that a third person is entitled to restitution from the transferee, the transferee holds the property upon a constructive trust for the third person."<sup>28</sup>

It is sufficiently implicit in the concept of an "overpayment" that the amount paid in excess of what is due is made by mistake. For that reason, accepting as true the allegation in the complaint (and the reasonable inferences that can be drawn therefrom) that the \$500,000 that the debtors paid to Nature's Bounty was transferred by mistake, it follows that those funds would have been held in constructive trust for the benefit of the debtors. If that is the case, the "transfer," meaning (as § 101(54)(D) defines it) the time at which the debtors parted with their interest in the \$500,000, would have occurred when those funds were applied to satisfy a separate obligation that the debtors owed to Nature's Bounty. The

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<sup>27</sup> *Citibank, N.A. v. Brigade Capital Management, LP*, 49 F.4th 42, 58 (2d Cir. 2022) (internal quotation and citation omitted).

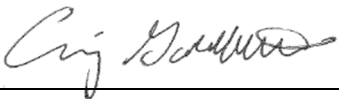
<sup>28</sup> *Restatement (First) of Restitution* § 165.

complaint sufficiently alleges that this occurred within the preference period. Accordingly, the motion for leave to amend the complaint will be granted.

**Conclusion**

For the foregoing reasons, the Court will grant the Committee's motion for leave to amend the complaint. The motion to strike the Committee's reply brief will be denied but Nature's Bounty's motion for leave to file a sur-reply will be granted. The parties are directed to settle an appropriate order.

Dated: July 16, 2024

  
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CRAIG T. GOLDBLATT  
UNITED STATES BANKRUPTCY JUDGE