

HELPFUL BANKRUPTCY LAW CHANGES FOR COMMERCIAL CREDITORS

The Bankruptcy Reform Act of 2005 drew much public attention for controversial changes to personal bankruptcies. Less well-noticed were helpful changes for commercial creditors whose customers file for bankruptcy protection. These changes particularly affect three areas: preferences, fraudulent conveyances and reclamation claims.

Preferences

A "preference" is a transfer made by a debtor within a specified time (usually 90 days) prior to a bankruptcy filing. The creditor who receives such payment is at risk of having to return the money unless the creditor can establish one of a list of statutory defenses. Under the old law, the creditor could be dragged into court across the country to defend a preference claim for even a nominal amount.

Under the new law, the days of compelling a commercial creditor to defend a small nuisance claim in an inconvenient forum are over. Payments made by a commercial debtor to a commercial creditor may not be challenged as "preferences" if the aggregate amount is less than \$5,000. Further, unless the creditor is an "insider" of the debtor, claims for less than \$10,000 may only be brought in the state where the creditor resides.

Preference Defenses

Ordinary Course of Business. A primary defense against a preference claim is that the payment was made in the "ordinary course of business." Until 2005, this defense required the creditor to establish that the payment was made both "in the ordinary course of business between the debtor and the creditor" and "according to ordinary business terms." Now it is enough to establish that the payment was made *either* in the ordinary course of business between the parties *or* according to ordinary business terms.

Contemporaneous Exchange. Another defense is that any value received by the creditor was "contemporaneous" with the creditor's transfer of some *other* value back to the debtor. For example, if a creditor makes a loan or extends credit to a debtor and takes back a mortgage or security interest, the mortgage or security interest could be deemed a preference unless the mortgage is recorded or the financing statement is filed within a certain limited time. That time used to be 20 days. Now it is 30 days.

Insiders. A pre-bankruptcy payment made on a debt guaranteed by an "insider" of the debtor is deemed to benefit the insider as well as the creditor. Such payments have been subject to

recovery as preferences if made any time up to a full year before the bankruptcy, and recovery historically could be sought against either the creditor or the insider. Now the rule is different: recovery against the *creditor* is possible only if the payment was made within 90 days prior to the bankruptcy; recovery against the insider is still possible for payments made up to a full year before the bankruptcy.

Fraudulent Conveyances

A fraudulent conveyance is a transfer by a debtor either with intent to hinder, delay or defraud creditors, or for less than "reasonably equivalent value" at a time when the debtor cannot pay its debts. Under federal law, prior to the 2005 amendments, such a transfer could only be undone if it occurred within one year prior to the bankruptcy filing. Effective April 20, 2006, the look-back period under federal law is extended to 2 years. Under most state laws (including Connecticut) the look-back period is 4 years, though in some states (like New York) the period is 6 years.

Reclamation

Reclamation is the process by which a seller seeks to take back goods it has delivered on credit to a debtor who files bankruptcy after receiving the goods. Under the old law, the seller could attempt reclamation only if the goods were delivered to the debtor within 10 days prior to the bankruptcy. That period is now 45 days, provided that the creditor makes written demand either within 45 days after the debtor's receipt of the goods or, if the 45 day period expires after the commencement of the bankruptcy case, not later than 20 days after the date the case is filed. Further, a reclaiming creditor whose goods are not returned, is now automatically entitled to an administrative claim equal to the value of goods received by the debtor in the ordinary course of business within 20 days prior to the filing of the bankruptcy case. Note, however, that a creditor with a security interest in the debtor's goods has rights superior to those of the reclaiming creditor, and return of the goods or payment of the administrative expense will be subject to the debtor's ability to satisfy the secured creditor's claims.

There are other changes to the Bankruptcy Code which may affect creditors, such as changes in the treatment of leases. However, the changes in the preference, fraudulent conveyance and reclamation laws are likely to affect the majority of creditors who were involved with a debtor prior to its bankruptcy.

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