

**BUSINESS BANKRUPTCY AND  
BANKRUPTCY LITIGATION UNDER  
THE BAPCPA**

by

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**TABLE OF CONTENTS**

Introduction. . . . .	Page 3 of 40
1. General Business Bankruptcy Provisions. . . . .	Page 3 of 40
1.1. Non-Residential Real Property Leases.. . . .	Page 4 of 40
1.1.1. The time to assume, assign or reject. . . . .	Page 4 of 40
1.1.2. Default after Assumption.. . . .	Page 5 of 40
1.2. Executory Contracts and Unexpired Leases. . . . .	Page 5 of 40
1.3. Utilities.. . . .	Page 7 of 40
1.4. The Reclamation Rights of Sellers of Goods.. . . .	Page 7 of 40
1.5. Labor Issues. . . . .	Page 8 of 40
1.6. Creditors Committees. . . . .	Page 10 of 40
1.7. Single Asset Real Estate Bankruptcies. . . . .	Page 11 of 40
1.8. Exclusivity Periods. . . . .	Page 13 of 40
1.9. “Adequate Information” . . . . .	Page 14 of 40
1.10. Discharge of Chapter 11 Debtors.. . . .	Page 15 of 40
1.11. Tax Provisions. . . . .	Page 17 of 40
1.12. The Appointment of Trustees. . . . .	Page 19 of 40
1.13. Prepackaged Bankruptcies. . . . .	Page 20 of 40
2. Small Business Bankruptcies.. . . .	Page 20 of 40
2.1. The Exclusivity Period and the Deadline for Filing a Plan for the Debtor . . . . .	Page 21 of 40
2.3. The Disclosure Statement and Plan . . . . .	Page 23 of 40
2.4. The Duties of the Debtor-in-possession or Trustee.. . . .	Page 24 of 40
2.5. The United States Trustee’s Review of the Case.. . . .	Page 25 of 40
3. Bankruptcy Litigation. . . . .	Page 26 of 40
3.1. Changes in Preference Actions. . . . .	Page 26 of 40
3.1.1. Changes to the Plaintiff’s Case in Preferences. . . . .	Page 26 of 40
3.1.1.1. Transfer of an Interest of the Debtor in Property . . . . .	Page 27 of 40
3.1.1.2. To or For the Benefit of a Creditor. . . . .	Page 29 of 40
3.1.1.3. For or on Account of an Antecedent Debt. . . . .	Page 30 of 40

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3.1.1.4.	Ninety Day Reachback Period; “Insider” Extension of the Preference Period.....	Page 31 of 40
3.1.1.6.	That Enables the Creditor to Receive More Than Such Creditor Would Have Received in a Hypothetical Chapter 7 Case.....	Page 34 of 40
3.1.2.	Impact of BAPCPA on Procedures Associated with Preference Action .....	Page 34 of 40
3.1.3.	Defense -- The Ordinary Course of Business Exception. . . .	Page 35 of 40
3.2.	Fraudulent Conveyance Actions .....	Page 37 of 40
3.3.	Statutory Lien Actions (11 U.S.C. §545).....	Page 39 of 40
3.4.	Post Petition Transfers (11 U.S.C. §549).....	Page 39 of 40
CONCLUSION. ....		Page 40 of 40

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## **Introduction**

Considering the large changes made to other areas of bankruptcy practice under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “BAPCPA”), the revisions to business bankruptcies and bankruptcy litigation are small in comparison. While the BAPCPA made some changes to business bankruptcies, many of the revisions discussed in this presentation are not limited to business reorganizations. For example, the changes in bankruptcy litigation apply in all bankruptcy chapters, not just business reorganizations. However, as business reorganizations have developed, we have found that some of these general provisions apply with particular rigor in business reorganization. Thus, this presentation will focus on (1) revisions to some of the general business bankruptcy provisions, (2) the revisions to the small business bankruptcy provisions, and (3) changes to bankruptcy litigation.

### **1. General Business Bankruptcy Provisions.**

Ordinarily, the focus of any discussion of business bankruptcies would be a focus on Chapter 11 of Title 11 of the United States Code of Laws (the “Bankruptcy Code”). However, the BAPCPA has revised several of the sections of the Bankruptcy Code that deal with related issues. Specifically, the BAPCPA has amended (1.1) the treatment of Non-Residential Real Property Leases, (1.2) the treatment of executory contracts and unexpired leases, (1.3) the treatment of utilities, and (1.4) the reclamation rights of sellers of goods. Each of these provisions, while not exclusive to business bankruptcies can play a key role in any reorganization. After discussing these non-Chapter 11 provisions, this presentation will discuss the changes to Chapter 11 that relate to general business

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bankruptcies including (1.5) the treatment of labor issues, (1.6) the treatment of unsecured creditors committees, (1.7) the change in single asset real estate bankruptcies, (1.8) changes in the exclusivity periods, (1.9) changes in the definition of “adequate information,” (1.10) changes in provisions relating to discharge of Chapter 11 debtors, (1.11) tax provisions, (1.12) the appointment of Trustees and (1.13) the use of prepackaged bankruptcies.

### **1.1. Non-Residential Real Property Leases**

The BAPCPA impacts the time to assume, assign or reject leases of non-residential real property and affects what happens in the event that a lease is assumed only to result in a default by a debtor.

#### **1.1.1. The time to assume, assign or reject**

Current Section 365(d)(4) gives the debtor-in-possession or trustee sixty days to assume, assign or reject an unexpired lease of non-residential real property. While a short deadline, courts routinely granted extensions to this deadline, if the debtor-in-possession or trustee were to ask prior to the expiration of the deadline.

The BAPCPA provides the deadlines as the earlier of:

- (i) the date that is 120 days after the date of the order for relief; or
- (ii) the date of the entry of an order confirming the plan.

BAPCPA §404. So the initial deadline is extended from 60 to 120 days. But the BAPCPA goes further to provide that the court may grant a single 90 day extension and then, any further extension may only be given “upon prior written consent of the lessor.” *Id.* Thus, while the current practice

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is to freely give extensions to make what could be an extremely complex, time consuming and difficult decision, under the BAPCPA, without consent, the debtor-in-possession and trustee can only get 210 days without the consent of the lessor.

### **1.1.2. Default after Assumption**

In the case of *Nostas Assoc. v. Costich (In re Klein Sleep Products, Inc.)*, 78 F.3d 18 (2<sup>nd</sup> Cir. 1996), the debtor-in-possession assumed a lease of non-residential real property. Later, still during the Chapter 11, the debtor defaulted. The Second Circuit held that the lessor's claim for all future rent was an administrative expense and not subject to any cap or limitation provided for under Section 502(b)(6). The BAPCPA changes this result, and while continuing the giving of the administrative claim, creates a cap under 502(b)(7) in the amount of "2 years following the later of the rejection date or the date of actual turnover of the premises." BAPCPA §445.

## **1.2. Executory Contracts and Unexpired Leases**

The BAPCPA attempts to deal with the issue of non-monetary defaults. Previously, in cases such as *Worthington v. General Motors Corp. (In re Claremont Acquisition Corp., Inc.)*, 113 F.3d 1029 (9<sup>th</sup> Cir. 1997), the court would prohibit the assumption and assigning of an executory contract based upon the inability of a debtor to cure a non-monetary default. For example in *Claremont*, the franchise agreement included a prohibition from ceasing operations or "going dark." Because the debtor had "gone dark" the court held that the franchise agreement was terminated and that this default prevented the Chapter 11 debtor from assuming and assigning the franchise agreement. *Id.* at 1035. In reading Section 365(b)(2), one is presented with a list of items that do not need to be

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cured before assuming and assignment. Subsection (D) discusses nonmonetary defaults and provides that “the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.” 11 U.S.C. §365(b)(2)(D). You and I might take this provision to relate to two separate items penalty rates or any other provision relating to a default. The Ninth Circuit felt that the adjective penalty applied to both rate and provision. Thus, the Ninth Circuit reasoned that neither penalty rates nor penalty provisions need be cured. But, going further the Ninth Circuit reasoned that the termination of the contract caused by the “going dark” was not a “penalty provision” but was instead simply a “historic fact” that could not be cured. *Id.* at 1033-34.

The BAPCPA does two things. First, the BAPCPA changes subsection (D) to actually read “penalty rate or penalty provision.” But for those of you who like the reasoning of *Claremont*, the BAPCPA adds the following to Subsection (A):

cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph.

BAPCPA §328(a). Thus, it appears that the BAPCPA overturns *Claremont* and trustees are no longer required to cure nonmonetary defaults when (a) it is impossible to do so, (b) in nonresidential real property leases and (c) if they can begin opening the nonmonetary requirement after the assumption.

To carry these changes into the formulation of a plan, the BAPCPA also amends Section 1124(2) dealing with the impairment of claims. Thus, if a lessor has a claim arising from the failure to perform a nonmonetary obligation, other than a default arising from a failure to operate a non-residential real property lease subject to 365(b)(1)(A), that claim may be impaired and entitled to vote under proposed plans of reorganization.

### **1.3. Utilities**

Under the BAPCPA, utility companies are given added protection. Specifically, Section 417 of the BAPCPA amends Section 366. The utility company may alter, refuse or even discontinue service without relief from the automatic stay and without court approval if the trustee does not provide “adequate assurance” within the first 30 days of the bankruptcy filing. Unless the utility consents, the trustee is required to bring the matter before the court as to whether it is offering “adequate assurance.” Further, the BAPCPA specifically states that providing the utility with an administrative expense priority is not “adequate assurance.” BAPCPA §417.

### **1.4. The Reclamation Rights of Sellers of Goods**

Section 1227 of the BAPCPA strengthens a seller's rights to reclaim goods. Under prior law, the seller had 20 days from the receipt of goods to seek to reclaim the goods if the debtor filed

bankruptcy within 10 days of the receipt. Under BAPCPA, if the debtor receives the goods within 45 days of the bankruptcy, the seller could reclaim the goods. The seller must reclaim the goods within 45 days of receipt or within 20 days of the commencement of the bankruptcy if the 45 days expires after the commencement of the case. Further, if the seller satisfies the written demand and notice provisions of Sections 546(c)(1) or (2), the seller has an absolute right to reclaim his goods.

While the seller is given these rights, he may have a hurdle in the automatic stay. Specifically, the BAPCPA does not appear to have amended Section 362 to provide for the added protection of sellers of goods.

Lastly, Section 503(b)(9) gives the seller an administrative expense claim for the value of goods delivered within 20 days before the date of the bankruptcy petition.

## **1.5. Labor Issues**

The BAPCPA seeks to impact the following areas associated with current and former employees:

- 1.5.1. The BAPCPA deals with employee benefits by (a) providing that money collected as part of a benefit plan is not property of the estate (BAPCPA §323); (b) requiring the debtor in possession or trustee to perform the obligations of a plan administrator and wind up the plans (BAPCPA §446); (c) increases the length of time for unsecured priority status given to wage and benefit obligations from 90 days to 180 days and increases the cap for such claims from \$4,925 to \$10,000 (BAPCPA §1401); (d) provides for the appointment of a committee of retired employees (BAPCPA § 447); and (e) permits the court to reinstate retiree medical, disability and death benefits that were modified by the debtor within 180 days of the bankruptcy petition unless the balance of equities favors the modification (BAPCPA §1403).
- 1.5.2. The BAPCPA makes it more difficult to provide for a Key Employee Retention Program (“KERP”). Previously, KERPs were not dealt with under

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the Bankruptcy Code. The BAPCPA adds a new subsection to Section 503 as follows:

- (c) Notwithstanding subsection (b), there shall neither be allowed, nor paid –
  - (1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that –
    - (A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
    - (B) the services provided by the person are essential to the survival of the business; and
    - (C) either –
      - (i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
      - (ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;
  - (2) a severance payment to an insider of the debtor, unless –
    - (A) the payment is part of a program that is generally applicable to all full-time employees; and
    - (B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

- (3) other transfers or obligations that are outside of the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

BAPCPA §331. Thus, the BAPCPA limits KERPs. Further, to justify a KERP, the debtor will need to show that each key employee has another job offer.

1.5.3. The BAPCPA deals with back pay awards. For example, in a workers compensation case, sometimes there is an award of back pay for improper termination. Previously, some courts would give the worker an administrative claim for the entire period of back pay. The BAPCPA provides that back pay awards will be pro rated with pay and benefits attributable to the period during the commencement of the case being treated as a administrative claim. BAPCPA §329.

Thus, as to labor issues, the BAPCPA has attempted to strengthen an employee's claims to benefits, limit the ability to provide for KERPs and limit back pay awards.

## **1.6. Creditors Committees**

Previously, there has been a split of authority as to whether the attorney fees incurred by an individual member of a creditors committee was entitled to reimbursement for those attorney fees. See *First Merchants Acceptance Corp. v. J.C. Bradford & Co. (In re First Merchants Acceptance Corp.)*, 198 F.3d 394 (3d Cir. 1999) (holding that Section 503(b)(3)(F) provided for an award of attorney fees incurred by individual members of the committee); *In re Firstplus Financial*, 254 B.R. 888(Bankr. N.D. Tex. 2000) (holding that the attorney fees for individual members of a committee were not considered expenses that could be reimbursed); *In re County of Orange*, 179 B.R. 195 (Bankr. C.D. Cal. 1995) (holding attorney fees for individual members were not to be reimbursed).

The BAPCPA amends Section 503(b)(4) to make it clear that individual members of the committee are not entitled to have their individual attorney fees reimbursed. Section 504(b)(4) will exclude attorney fees from Section 504(b)(3)(F) reimbursements.

### **1.7. Single Asset Real Estate Bankruptcies**

Prior to BAPCPA, there was a limit on the size of a single asset real estate (“SARE”) bankruptcy and there had developed some ambiguities relating to the timing of required monthly payments, the source of the monthly payments, the interest to be charged to calculate the monthly payments and the creation of tax liens on the property. The BAPCPA seeks to eliminate the cap and the ambiguities.

Prior to BAPCPA, the cap on SARE bankruptcies was Four Million Dollars (\$4,000,000). The BAPCPA eliminated this cap. The definition of a SARE bankruptcy “means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor who is not a family farmer on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental ...” BAPCPA §1201. Thus, larger real estate projects will be included in this definition.

Prior to BAPCPA, there was an issue as to when the debtor was required to begin the monthly payments to prevent relief from the automatic stay under Section 362(d)(3) in situations where the debtor was challenging whether they fit the definition of a SARE. Section 444 of the

BAPCPA clarifies this by including in Section 362(d)(3) that the debtor may begin payments to avoid relief from the automatic stay “30 days after the court determines that the debtor is” a SARE.

Prior to the BAPCPA, there was a split of authority as to whether the debtor in a SARE could use rents from the property to make adequate protection payments in those situations where the creditor also had a security interest in those rents. The BAPCPA clarifies this issue by allowing debtors to make the adequate protection payments from the rents. BAPCPA §444.

Prior to the BAPCPA, the interest rate charged in calculating the monthly payments was the “current fair market value rate.” 11 U.S.C. §363d(3)(B)(ii). This provision lead to possible disputes concerning the definition and appropriate rate to calculate the payments. Under BAPCPA, the applicable rate is now the “nondefault contract rate.” BAPCPA §444. Hopefully, this change will avoid the necessity of having the court determine the appropriate interest rate.

Lastly, in *Lincoln Sav. Bank v. Suffolk County Treasurer (In re Parr Meadows Racing Ass’n, Inc.)*, 880 F2d 1540, 1542 (2<sup>nd</sup> Cir. 1989), the Court held that the automatic stay prohibited the creation of a tax lien on real property unless the local governmental authority had a prepetition interest in the property. The 1994 Amendments sought to alter this result by allowing a political subdivision an exemption from the automatic stay for the attachment of an “ad valorem property tax.” 11 U.S.C. §362(b)(18). The BAPCPA amends section 362(b)(18) even further by allowing not just “ad valorem property taxes” but also “a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit.” BAPCPA §1225.

Further as it relates to property taxes, the BAPCPA gives higher priority to some property taxes, limits the ability of a debtor to contest property taxes in the bankruptcy court and prevents the subordination of tax liens to secured creditors and administrative expenses in a Chapter 11 bankruptcy. Section 507(a)(8) has been amended so that property taxes incurred (even if not assessed) before the commencement of the case will receive priority treatment under any distribution. BAPCPA §706. Section 505(a)(2) has been added to prevent the bankruptcy court from contesting or redetermining the amount of a ad valorem tax or real or personal property tax after the time has expired under nonbankruptcy law. BAPCPA §701(b). Section 724(b)(1) was amended to prevent the subordination of ad valorem taxes to the payment of a secured claim. Section 724(b)(2) was amended to continue to allow the subordination of tax liens to administrative claims in Chapter 7 proceedings but disallow the subordination to administrative claims in a Chapter 11 proceeding.

### **1.8. Exclusivity Periods**

Section 411 of the BAPCPA changed exclusivity periods and the ability of a debtor to get extensions of the exclusivity periods. Before BAPCPA, §1121(d) permitted a party to reduce or increase the exclusivity periods (120 days) and the solicitation of acceptance periods (180 days). For an extension, the debtor needed to only show “cause.” 11 U.S.C. §1121(d). Under BAPCPA, the exclusivity period may not be extended beyond 18 months from the order for relief (in voluntary cases, the date of the bankruptcy petition). Similarly, under BAPCPA, the 180 day period within which the debtor must obtain acceptances to its proposed plan cannot be extended beyond 20 months

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after the order for relief. To assist the practitioner in understanding this change, the following is a redline version of the change to Section 1121(d):

- (d) (1) Subject to paragraph (2), on ~~On~~ request of a party in interest made within the respective periods specified in subsections (b) and (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.
- (2) (A) The 120-day period specified in paragraph (1) may not be extended beyond a date that is 18 months after the date of the order for relief under this chapter.  
(B) The 180-day period specified in paragraph (1) may not be extended beyond a date that is 20 months after the date of the order for relief under this chapter.

### 1.9. “Adequate Information”

Section 431 of the BAPCPA expands the definition of adequate information. The following is a red lined version of Section 1125(a)(1) as is amended:

“adequate information” means information of a kind, and in sufficient detail, as far as is reasonably practicable in light of the nature and history of the debtor and the condition of the debtor’s books and records, including a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case, that would enable such a hypothetical ~~reasonable~~ investor ~~typical of holders of claims or interests~~ of the relevant class to make an informed judgment about the plan, but adequate information need not include such information about any other possible or proposed plan and in determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information;

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Thus, the disclosure statement will need to include a discussion of Federal tax consequences to the debtor and to the hypothetical investor. It appears that tax advice has become a prerequisite for obtaining approval of a disclosure statement.

### **1.10. Discharge of Chapter 11 Debtors**

The BAPCPA appears to bring individual Chapter 11 Debtors closer to Chapter 13 Debtors in their treatment under the Bankruptcy Code and appears to have added certain exceptions to the ability of a corporate debtor to obtain a discharge in Chapter 11.

As it relates to the individual Chapter 11 debtor, the BAPCPA has done two things. First, some of the requirements found in Chapter 13 plans have been imported into Chapter 11. Second, prior to the BAPCPA, several courts held that a discharge provided for in a plan of reorganization was effective upon confirmation of the plan.

As it relates to making Chapter 11 and Chapter 13 individual debtors closer, the BAPCPA changes these rulings by adding paragraphs (14) and (15) to Section 1129(a). Specifically, the additions are as follows:

- (14) If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amount payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.
- (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan -
  - (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account

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- of such claim is not less than the amount of such claim; or
- (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.

So, in Chapter 11 cases the individual debtor cannot get around the requirement of paying the projected disposal income over the next 5-year period.

Similarly, Section 1141(d)(5)(A) was amended to clarify that an individual must confirm a plan and complete all of the payments under the plan before the discharge is effective. Similar to hardship discharges in Chapter 13 cases, Section 1141(d)(5)(B) gives the court the ability to grant the discharge even if the payments have not been completed, but only under certain limited circumstances. Section 1141(d)(5) will read as follows:

- (5) In a case in which the debtor in an individual -
- (A) unless after notice and a hearing the court orders otherwise for cause, confirmation of the plan does not discharge any debt provided for in the plan until the court grants a discharge on completion of all payments under the plan;
- (B) at any time after the confirmation of the plan, and after notice and a hearing, the court may grant a discharge to the debtor who has not completed payments under the plan if -
- (i) the value, as of the effective date of the plan, of property actually distributed under the plan on account of each allowed unsecured claim is not less than the amount that would have been paid on such claim if the estate of the debtor had been liquidated under chapter 7 on such date; and
- (ii) modification of the plan under section 1127 is not practicable; and

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- (C)(\*) unless after notice and a hearing held not more than 10 days before the date of the entry of the order granting the discharge, the court finds that there is not reasonable cause to believe that -
- (i) section 522(q)(1) may be applicable to the debtor; and
  - (ii) there is pending any proceeding in which the debtor may be found guilty of a felony of the kind described in section 522(q)(1)(A) or liable for a debt of the kind described in section 522(q)(1)(B).

Thus it appears that in granting the Chapter 11 discharge, the Court must consider more than the Chapter 13 hardship provisions.

As for corporate debtors, the BAPCPA specifically provides that under a confirmed plan cannot discharge the corporate debtor from debts resulting from tax or customs duties that are the result of a fraudulent return or a willful attempt to evade or defeat the tax or duty. Specifically, Section 1141(d)(6) will be changed to read as follows:

- (6) Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor that is a corporation from any debt -
- (A) of a kind specified in paragraph (2)(A) or (2)(B) of section 523(a) that is owed to a domestic governmental unit, or owed to a person as the result of an action filed under subchapter III of chapter 37 of title 31 or any similar State statute; or
- (B) for a tax or customs duty with respect to which the debtor -
  - (i) made a fraudulent return; or
  - (ii) willfully attempted in any manner to evade or to defeat such tax or such customs duty.

Thus, for governmental units, fraud claims cannot be discharged in a Chapter 11 proceeding.

### **1.11. Tax Provisions**

In addition to the property tax provisions that have been included in the discussion of SARE bankruptcies in this material, the BAPCPA adds Section 511 to the Bankruptcy Code (BAPCPA

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§704), changes the timing of payments under a plan (BAPCPA §710), and changes the provisions of the automatic stay as they previously related to tax refunds and the determination of tax claims (BAPCPA §718 and §709).

Section 511(a) will provide as follows:

If any provision of this title requires the payment of interest on a tax claim or on an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law.

Thus, interest on tax claims will be determined by nonbankruptcy law.

Section 1129(a)(9)(C) and (D) will be amended as follows:

- (C) with respect to a claim of a kind specified in section 507(a)(8) of this title, the holder of such claim will receive on account of such claim ~~deferred cash~~ regular installment payments in cash - ~~over a period not exceeding six years after the date of assessment of such claim;~~
- (i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;
  - (ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, of 303; and
  - (iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under section 1122(b); and
- (D) with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under section 507(a)(8), but for the secured status of that claim, the holder of that claim will receive on account of that claim, cash payments, in the same manner and over the same period, as prescribed in subparagraph (C).

Thus, the code will require “regular installment payments” which pay the taxing entity within five years after the date of the entry of the order, in a manner not less favorable than other non-priority unsecured claims, and taxing authorities hold secured claims get the same treatment.

Lastly, Section 362 is amended to allow a governmental unit to set off against a tax refund unless there is a pending action contesting the tax. See 11 U.S.C. §362(b)(26). Section 362(a)(8) is also changed to apply the automatic stay only to the continuation of a proceeding in tax court when the bankruptcy court could determine the amount of the taxing authorities claim. Because the bankruptcy court does not have unlimited authority to determine tax claims (see property tax discussion under SARE), the automatic stay does not apply where the bankruptcy court could not make that determination.

### **1.12. The Appointment of Trustees**

Section 1405 of the BAPCPA amends the provision of Chapter 11 dealing with the appointment of a trustee. Specifically, the BAPCPA adds a new subsection (e) to Section 1104. The new subsection will read:

The United States trustee shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect the current members of the governing body of the debtor, the debtor’s chief executive or chief financial officer, or members of the governing body who selected the debtor’s chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor’s public financial reporting.

11 U.S.C. §1104(e). Thus, the U.S. Trustee’s office will have the responsibility of making this determination and making this motion and putting the issue of the appointment of a trustee before

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the Court. Even though the U.S. Trustee's office will have this responsibility, the ultimate determination of whether to appoint a trustee remains with the bankruptcy court.

### **1.13. Prepackaged Bankruptcies.**

The BAPCPA has made prepackaged bankruptcies a little easier by allowing the continued solicitation of acceptances and rejections after the filing of a petition and the ability to avoid having a first meeting of creditors in appropriate circumstances. Specifically, subsection (g) has been added to 1125 stating:

Notwithstanding subsection (b), an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable nonbankruptcy law.

So, if solicited before bankruptcy, the debtor can continue to solicit after bankruptcy.

As it relates to the first meeting of creditors, Section 341(e) has been added so that a party in interest can request that the U.S. Trustee refrain from convening a meeting of creditors where acceptances have been solicited to a prepackaged bankruptcy plan.

## **2. Small Business Bankruptcies**

The BAPCPA alters the present discretionary use of small business bankruptcies. Instead, the BAPCPA deletes the definition of small business and replaces it with definitions for a "small business case" and a "small business debtor." BAPCPA §432. The "small business case" will mean "a case filed under chapter 11 of this title in which the debtor is a small business debtor." 11 U.S.C. §101(51)(C). The "small business debtor"

- (A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning and operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition or the date of the order for relief in an amount not more than \$2,000,000 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and
- (B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than \$2,000,000 (excluding debt owed to 1 or more affiliates or insiders).

11 U.S.C. §101(51)(D). By defining the small business case as one that does not have an active unsecured creditors committee, it appears that the BAPCPA is either trying to get the debtor to encourage participation in its bankruptcy through creditor involvement or trying to get the debtor to make its creditors as angry as possible. In that way, the creditors committee would likely become active and the small business provisions would not apply.

If the debtor meets these definitions, then BAPCPA impacts (2.1) the exclusivity period and the deadline for confirming a plan, (2.2) the disclosure statement and plan, (2.3) the duties of the debtor-in-possession or trustee, and (2.4) the US Trustee's review of the case.

## **2.1. The Exclusivity Period and the Deadline for Filing a Plan for the Debtor**

Before the BAPCPA the small business debtor had an exclusive right to file a plan for the first 100 days and in any event a plan was required to be filed within 160 days. 11 U.S.C. 1121(e)(1). Extensions were allowed only if the debtor could demonstrate "the need for an increase

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is caused by circumstances for which the debtor should not be held accountable.” 11 U.S.C. §1121(e)(3)(B). Now if no committee is appointed or the court determines that the committee is inactive, the designation of being a small business debtor applies. Section 1121(e) has been changed as follows:

- (e) ~~In as case in which the debtor is a small business and elects to be considered a small business~~ case -
  - (1) only the debtor may file a plan until after ~~100~~ 180 days after the date of the order for relief, ~~unless this chapter~~ unless that period is -
    - (A) extended as provided by this subsection, after notice and a hearing; or
    - (B) the court, for cause, orders otherwise;
  - (2) ~~all plans shall be filed within 160 days after the date of the order for relief; and~~
  - (3) ~~on request of a party in interest made within the respective periods specified in paragraphs (1) and (2) and after notice and a hearing, the court may -~~
    - (A) ~~reduce the 100-day period or the 160-day period specified in paragraph (1) or (2) for cause; and~~
    - (B) ~~increase the 100-day period specified in paragraph (1) if the debtor shows that the need for an increase is caused by circumstances for which the debtor should not be held accountable.~~
- (2) the plan and a disclosure statement (if any) shall be filed not later than 300 days after the date of the order for relief; and
- (3) the time periods specified in paragraphs (1) and (2), and the time fixed in section 1129(e) within which the plan shall be confirmed, may be extended only if -
  - (A) the debtor, after providing notice to parties in interest (including the United States trustee), demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time;
  - (B) a new deadline is imposed at the time the extension is granted; and
  - (C) the order extending time is signed before the existing deadline has expired.

BAPCPA §437. Thus, the small business exclusivity period is 180 days and deadline for filing a plan is 300 days. The court still has the ability to extend these deadlines but to do so the debtor is required to show that it will most likely confirm a plan within a reasonable period of time, a new

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deadline is imposed and the extension order is signed before the existing deadline has expired. See BAPCPA §438.

### **2.3. The Disclosure Statement and Plan**

Under the BAPCPA, the Judicial Conference of the United States in accordance with Rule 9009 is to provide standard form disclosure statements and plans of reorganizations for small business debtors. See BAPCPA §433. As of the preparation of these materials, the author has not yet seen the new form disclosure statements and plans but the forms are supposed to achieve a practical balance between the reasonable needs of the courts, US trustee, creditors and other parties in interest for reasonably complete information vs. economy and simplicity for the debtors.

In addition to these standard forms, the BAPCPA amends Section 1125(f) to authorize a court to determine that a plan itself provides adequate information, making it unnecessary for the small business debtor to prepare a separate disclosure statement. Specifically, Section 1125(f) was amended as follows:

- (f) Notwithstanding subsection (b), in a **small business** case ~~in which the debtor has elected under section 1121(c) to be considered a small business --~~
  - (1) the court may determine that the plan itself provides adequate information and that a separate disclosure statement is not necessary;
  - (2) the court may approve a disclosure statement submitted on standard forms approved by the court or adopted under section 2075 of title 28; and
  - (+3) (A) the court may conditionally approve a disclosure statement subject to final approval after notice and a hearing;
  - (2B) acceptances and rejections of a plan may be solicited based on a conditionally approved disclosure statement ~~as long as~~ **if** the debtor provides adequate information to each holder of a claim or interest that is solicited, but a conditionally approved disclosure statement shall be mailed ~~at least 10~~ **not later than 25** days ~~prior to~~ **before** the date of the hearing on confirmation of the plan; and

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(3C) — a the hearing on the disclosure statement may be combined with a the hearing on confirmation of a plan.

See BAPCPA §431. So, under the BAPCPA, the rules relating to disclosure statements and plans seem to make it more flexible and easier for a small business debtor.

#### **2.4. The Duties of the Debtor-in-possession or Trustee**

The BAPCPA adds a new Section 1116 to the bankruptcy code. This section provides as follows:

In a small business case, a trustee or the debtor in possession, in addition to the duties provided in this title and as otherwise required by law, shall -

- (1) append to the voluntary petition or, in an involuntary case, file not later than 7 days after the date of the order for relief -
  - (A) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or
  - (B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;
- (2) attend, through its senior management personnel and counsel, meetings scheduled by the court or the United States trustee, including initial debtor interview, scheduling conferences, and meetings of creditors convened under section 341 unless the court, after notice and a hearing, waives that requirement upon a finding of extraordinary and compelling circumstances;
- (3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances.
- (4) file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court.
- (5) subject to section 363(c)(2), maintain insurance customary and appropriate to the industry;
  - (A) timely file tax returns and other required government filings; and
  - (B) subject to section 363(c)(2), timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and

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- (7) allow the United States trustee, or a designated representative of the United States trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.

BAPCPA §436. Thus, it appears that the debtor's tax return must be filed with the court in a small business case.

Such a requirement seems consistent with the increased requirement for reporting in a small business case. See BAPCPA §434. The act also adds Section 308 that requires a small business debtor to file periodically financial and other reports containing information with respect to the profitability and projected cash receipts and disbursements. Again, the Judicial Conference is to provide information on forms to use and the implementation of this section. See BAPCPA §435.

## **2.5. The United States Trustee's Review of the Case**

Section 439 of the BAPCPA expands the role of the US Trustee's office in monitoring small business cases. As previously seen, they must determine if the unsecured creditors committee is to be appointed and if it is active. As previously seen, they are involved in determining whether to hold a first meeting of creditors. In addition, Section 586(a)(7) will require the U.S. Trustee to interview the debtor as soon as practical and (1) begin to investigate the debtor's viability, (2) inquire about the debtor's business plan, (3) explain the debtor's obligations on reporting, (4) attempt to develop a schedule for proceeding through the bankruptcy process and (5) inform the debtor of the other obligations imposed upon it by the code. The code even goes so far as to provide that the US Trustee may visit the debtor's business to examine books and records as well as the debtor's tax returns. In South Carolina, the US Trustee's office has already been performing many of these services for

debtors and has assisted many small business debtors (even though in the past they elected not to be defined as small business debtors) through the bankruptcy process. The mixed result associated with their efforts has not been from a lack of trying on the part of South Carolina's U.S. Trustee's office.

### **3. Bankruptcy Litigation**

The BAPCPA made changes to (3.1) Preference Actions (11 U.S.C. §547), (3.2) Fraudulent Conveyance Actions (11 U.S.C. §548), (3.3) Statutory Lien Actions (11 U.S.C. §545), and (3.4) Post Petition Transfers (11 U.S.C. §549).

#### **3.1. Changes in Preference Actions**

To understand the changes made in Preference Actions, one must first have a fundamental understanding of preference actions. This section of the presentation will first discuss the elements of a preference action and when applicable will discuss the changes to these elements. This section will then discuss the procedural changes associated with preference actions adopted in the BAPCPA. Lastly, this section will discuss the most important change in this area of litigation, the change in the definition of the ordinary course of business.

##### **3.1.1. Changes to the Plaintiff's Case in Preferences**

Pursuant to section 547(b) of the United States Bankruptcy Code, a Trustee may avoid any transfer of an interest of the debtor in property:

- (1) to or for the benefit of a creditor;
- (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
- (3) made while the debtor was insolvent;

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- (4) made --
    - (a) on or within 90 days before the date of the filing of the petition; or
    - (b) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
  - (5) that enables such creditor to receive more than such creditor would receive if --
    - (a) the case were a case under chapter 7 of this title;
    - (b) the transfer had not been made; and
    - (c) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b). It is the plaintiff's burden to prove each and every one of these elements by a preponderance of the evidence. 11 U.S.C. § 547(g); *Danning v. Bozek (In re Bullion Reserve of N. Am.)*, 836 F.2d 1214 (9th Cir. 1988). Failure to satisfy this burden on any one element precludes a finding that a transfer is a preference. *Hood v. Brownyard-Sharon Park Center Inc. (In re Hood)*, 118 B.R. 417, 421 (Bankr. D.S.C. 1990); *Norman v. Jirdon Agri Chemicals, Inc. (In re Cockreham)*, 84 B.R. 757, 761 (D.Wyo. 1988). Further, because the elements above are objective, the intent of the debtor is irrelevant. *Marathon Oil Co. v. Flatau (In re Carig Oil Co.)*, 785 F.2d 1563 (11th Cir. 1986). Accordingly, it is the *effect* of the transfer which is controlling. *Barash v. Public Fin. Corp.*, 658 F.2d 504, 510 (7th Cir. 1981).

**3.1.1.1. Transfer of an Interest of the Debtor in Property**

Section 101 of the Bankruptcy Code defines a "transfer" as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with

an interest in property, including retention of title as a security interest and foreclosure of the debtor's equity of redemption." 11 U.S.C. § 101(54). This definition is exceptionally broad, and therefore this author previously thought that it included virtually every conceivable transfer, including the creation or fixing of judicial liens.<sup>1</sup>

Apparently, this definition was not broad enough for some courts<sup>2</sup> and in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "BAPCPA"), Congress decided to make the definition even more broad. Under the BAPCPA, a transfer is now:

- (A) the creation of a lien;
- (B) the retention of title as a security interest;
- (C) the foreclosure of a debtor's equity of redemption; or
- (D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with –
  - (i) property; or
  - (ii) an interest in property

Section 1214, BAPCPA. Precisely because the past definition was so broad and the new definition is more broad, the true test is not whether a transfer occurred, but whether the debtor had an actual or constructive ownership interest in the transferred property. *In re Hood*, 118 B.R. 417 at 419; *In*

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<sup>1</sup> See 4 COLLIER ON BANKRUPTCY § 547.03 (15th Ed. 1991) ("Any judicial proceeding that creates or fixes a lien upon the debtor's property will constitute a preference."). In South Carolina, a lien on real property is created when the judgment is enrolled in the county where the property is located. S.C. Code Ann. § 15-35-810 (1976).

<sup>2</sup> See *Thompson v. Margen (In re McConville)*, 110 F.3d 47, 49 (9<sup>th</sup> Cir. 1997) (Under section 549, the attachment of a lien on real property is not a transfer of property that could be set aside.).

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*re Flooring Concepts, Inc.*, 37 B.R. 957, 961 (9th Cir. 1984).<sup>3</sup> In this regard, ownership is determined by the debtor’s ability to control the disposition of the property.

**3.1.1.2. To or For the Benefit of a Creditor**

Section 101 of the Bankruptcy Code defines a “creditor,” in relevant part, as an “entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor.” 11 U.S.C. § 101(10)(A). Further, a “claim” means:

- (A) right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured; or
- (B) right to an equitable remedy for breach of performance if such breach gives rise to a right to payment, whether or not such right to an equitable remedy is reduced to judgment, fixed, contingent, matured, unmatured, disputed, undisputed, secured, or unsecured.

11 U.S.C. § 101(5)(A)-(B). In construing these terms, the United States Supreme Court stated in *Ohio v. Kovacs*, 469 U.S. 274, 105 S.Ct. 705, 83 L.Ed.2d 649 (1985) that Congress intended for them to be used in their broadest possible sense.

The courts have obliged by finding “creditors” in even the most contingent and remote cases. *See, e.g., Sigmon v. Royal Coke Co. (In re Cybermech)*, 13 F.3d 818 (4th Cir. 1994) (buyer was a creditor of the seller because the buyer had paid for the goods, and therefore had a claim against the seller for a right to payment or a right to an equitable remedy for breach of performance); *Nolden v. VanDyke Seed Co. (In re Gold Coast Seed Co.)*, 751 F.2d 1118 (9th Cir. 1985) (holding that a seller acquired a claim against the buyer at the time the buyer received and accepted the goods).

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<sup>3</sup> In determining whether a debtor has an interest in property, state law governs.

The transfer, however, must also benefit the creditor. Accordingly, this benefit can either be direct, *see, e.g., Bucki v. Singleton (In re Cardon Realty Co.)*, 146 B.R. 72 (Bankr. W.D.N.Y. 1992) (holding that debtor's payment to creditor/assignee of loan obligation benefitted the creditor/assignee, regardless of what she did with the money after she received it, because it paid off an antecedent debt), or indirect, *see, e.g., Sommers v. Burton (In re Conrad Corp.)*, 806 F.2d 610 (5th Cir. 1987) (holding that the debtors' transfer of restaurants in exchange for a simultaneous assumption of their debt by a third party benefitted the creditor, and therefore, constituted a voidable indirect transfer to the creditor).

Thus, if the creditor received something of value, in a preference action, the plaintiff can seek the return of that something of value. The BAPCPA did not change these provisions.

**3.1.1.3. For or on Account of an Antecedent Debt**

An antecedent debt is simply a debt that the debtor incurs before he makes the alleged preferential transfer. 4 COLLIER ON BANKRUPTCY § 547.05 (15th Ed. 1991). This element is present to promote the central concept governing the existence of a preference action -- the preservation of the debtor's assets. Accordingly, any transfer to a creditor that occurs during the preference period on account of an antecedent debt serves only to deplete the debtor's bankruptcy estate, and therefore is in derogation of this policy of preservation. Again, BAPCPA did not change these provisions.

**3.1.1.4. Ninety Day Reachback Period; "Insider" Extension of the Preference Period**

Subsection (b)(4)(A) of section 547 provides that a transfer can only be avoided where it was made on or within ninety days before the filing of the petition. 11 U.S.C. § 547(b)(4)(A). While this is generally an absolute rule, subsection (b)(4)(B) immediately follows and provides that where the transfer was made to an “insider,” the time limit for avoidance is extended to one year pre-petition. An “insider,” in the conventional sense, is simply someone who stands in a close relationship with the debtor and who possesses the ability to control the debtor’s actions. *Pineview Care Center, Inc. v. Mappa (In re Pineview Care Center, Inc.)*, 152 B.R. 703 (D.N.J. 1993).<sup>4</sup> The most common examples include a relative or general partner of the debtor in cases where the debtor is an individual or a partnership, and the director(s) or officers of the debtor in cases where the debtor is a corporation. 11 U.S.C. § 101(31).

As it relates to the time that the transfer is made, the courts generally look at when the debtor parted with the thing of value. Thus, for checks, the important date for when the transfer took place is the date that the debtor’s bank honored the check. If the honoring of the check was within the preference period, the Court will generally find that the transfer took place during the preference period. *See Barnhill v. Johnson*, 503 U.S. 393 (1992).

One of the more interesting situations occurred when the plaintiff attempted to recover a transfer to a non-insider creditor that benefitted an insider creditor. Such an action was referred to as a “Deprizio Action.” The most common example of this scenario exists where the insider creditor guarantees a loan and then directs the debtor’s payment to the creditor advancing the loan. In *Levit*

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<sup>4</sup> A more exact definition of the term appears in 11 U.S.C. § 101(31).

*v. IngersollRand Fin. Corp.*, 874 F.2d 1186 (7th Cir. 1989), the court examined such a situation and set forth the “Deprizio” doctrine. This doctrine essentially allowed the plaintiff to recover from non-insider transferees payments made during the extended preference period which benefitted insider creditors. While many courts adopted the “Deprizio” doctrine, *see, e.g., Ray v. City Bank & Trust Co.*, 899 F.2d 1490 (6th Cir. 1990), other courts vehemently refused to apply its reasoning. Prior to the Amendments in 1994, South Carolina bankruptcy courts followed the Deprizio doctrine. *See In re Hoffman Assoc.*, 179 B.R. 797 (Bankr. D.S.C. 1995).

The drafters of the 1994 Bankruptcy Reform Act thought that they had done away with the Deprizio doctrine, except in pre-1994 actions. They did so by adding subsection (c) to section 550. This section states:

- (c) If a transfer made between 90 days and one year before the filing of the petition –
  - (1) is avoided under section 547(b) of this title; and
  - (2) was made for the benefit of a creditor that at the time of such transfer was an insider; the trustee may not recover under subsection (a) from the transferee that is not an insider.

11 U.S.C. § 550(c). This author thought the resolution was pretty simple. You cannot recover from a non-insider transferee during the extended preference period.

However, some courts continued to apply the doctrine under certain circumstances. In the case of *Roost v. Associates Home Equity Servs. Inc. (In re Williams)*, 234 B.R. 801 (Bankr. D. Or. 1999), the debtor and his non-debtor wife financed the purchase of their mobile home and pledged as collateral the mobile home and its real property. The secured creditor did not file the lien

contemporaneously but did file the lien more than 90 days before the bankruptcy. The trustee sought to set aside the transfer because it benefitted the debtor's wife, an insider. The trustee argued that he was not seeking to recover anything, the property was already property of the estate under Section 541 of the Bankruptcy Code. He was only seeking to avoid the security interest. The court agreed saying that recovery of a payment would be precluded by section 550(c) but the avoidance of the security interest is not a recovery and therefore is not precluded.

The BAPCPA has added yet another anti-Deprezio section. Specifically, sub-section (i) to Section 547 states:

If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer shall be considered to be avoided under this section only with respect to the creditor that is an insider.

See § 1213, BAPCPA. As it relates to this particular section, it applies to any case that is pending or commenced on or after the date of the enactment of the BAPCPA. So, this probably means that *Deprezio* is no more.

**3.1.1.5. Made While the Debtor was Insolvent . . .**

A debtor is essentially insolvent when his liabilities exceed his assets. 4 COLLIER ON BANKRUPTCY § 547.06 (15th Ed. 1991).<sup>5</sup> In this regard, there is a presumption of insolvency during the ninety day reachback period. *Id.* See Also 11 U.S.C. § 547(f). In *Transit Homes, Inc. v. South Carolina Nat'l Bank (In re Transit Homes, Inc.)*, 57 B.R. 40 (Bankr. D.S.C. 1985), however,

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<sup>5</sup> For a more extensive definition, see 11 U.S.C. § 101(32).

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the court held that the presumption of insolvency can be rebutted by the introduction of the debtor's filed schedules. The BAPCPA did not change this provision.

**3.1.1.6. That Enables the Creditor to Receive More Than Such Creditor Would Have Received in a Hypothetical Chapter 7 Case.**

Subsection (b)(5) is merely a codification of the United States Supreme Court holding in *Palmer Clay Products Co. v. Brown*, 297 U.S. 227, 56 S.Ct. 450, 80 L.Ed. 655 (1936). In that case, the court held that whether a transfer is preferential should be determined “not by what the situation would have been if the debtor's assets had been liquidated and distributed among his creditors at the time the alleged preferential payment was made, *but by the actual effect of the payment as determined when bankruptcy results.*” [Emphasis added]. The BAPCPA did not change this provision.

**3.1.2. Impact of BAPCPA on Procedures Associated with Preference Action**

The BAPCPA added some procedural hurdles to the elements of a preference action. Specifically, the BAPCPA provides:

- A. Corporate debtors cannot avoid transfers of less than \$5,000. *See* BAPCPA, § 409 (Oddly, Congress actually adds a paragraph 9 to subsection 547(c) thereby making this limitation an affirmative defense. So technically, a plaintiff can bring an action to avoid a transfer of less than \$5,000 thereby requiring the defendant to raise the affirmative defense.).
- B. Plaintiffs must bring an action in the district court for the district in which the defendant resides where the recovery is for less than
  - (i) \$1,000 against an insider;
  - (ii) a consumer debt of less than \$15,000; or
  - (iii) a debt against a non-insider of less than \$10,000.*See* BAPCPA § 410.

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- C. The 10 day grace period provided for in Section 547(e)(2) for the perfection of security interests is expanded to a 30 day grace period. *See* BAPCPA § 403.
  - D. The 20 day grace period provided for in Section 547(c)(3)(B) for perfection of a security interest in a purchase money security interest is expanded to a 30 day grace period. *See* BAPCPA § 1222.

It is clear from these amendments that Congress wants fewer small preference actions and wants fewer actions in situations where the timing of the perfection of a security interest is close to being contemporaneous.

### **3.1.3. Defense -- The Ordinary Course of Business Exception**

While section 547(c) sets forth a number of instances where a trustee cannot avoid a preference transfer, the BAPCPA's perhaps greatest impact is on the ordinary course of business defense. This exception is embodied in the text of subsection 547(c)(2) which provides that a trustee cannot avoid a transfer:

- (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
- (B) made in the ordinary course of business or financial affairs of the debtor or the transferee; and
- (C) made according to ordinary business terms.

The essential purpose of this exception is "to leave undisturbed normal financial relations because it does not detract from the general policy of the section to discourage unusual action by either the debtor or its creditors during the debtor's slide into bankruptcy." *Morrison v. Champion Credit Corp. (In re Barefoot)*, 952 F.2d 795, 801 (4th Cir. 1991). In this regard, the creditor who claims the exception also possesses the burden of proof. *Advo-System, Inc. v. Maxway Corp.*, 37 F.3d 1044,

1047 (4th Cir. 1995). Further, the creditor must satisfy its burden by a preponderance of the evidence. *Id.*

Remember that little “and” between subsection (B) and subsection (C)? The BAPCPA changed that little “and” to an “or.” Prior to BAPCPA, the defendant had to prove (A) and (B) and (C). Now, the defendant has to prove former subsections (A) and either (B) or (C). Specifically, §547(c)(2) will read:

to the extent that such transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee, and such transfer was –

- (A) made in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) made according to ordinary business terms.

BAPCPA, § 409. Under the new law, the debt must still be incurred in the ordinary course of business. Once this element is established, the defendant can show either that the practice was ordinary between the parties or is ordinary in the industry.

In so amending the current law, it appears that Congress has abandoned the sliding scale approach found in *Advo-System, Inc. v. Maxway Corp.*, 37 F.3d 1044 (4th Cir. 1995). Instead, Congress appears to have adopted the analysis of *In re Tolona Pizza Products Corp.*, 3 F.3d 1029 (7<sup>th</sup> Cir. 1993) (allowing the defendant to establish either ordinary course between the debtor and transferee or according to ordinary business terms). It is likely that initially, in examining the meaning of the amended statute, courts will use the analysis provided by the Seventh Circuit.

### **3.2. Fraudulent Conveyance Actions**

The BAPCPA has weighed in as it relates to three areas of Section 548. First, the BAPCPA specifically makes transfers to insiders under employment contracts, not in the ordinary course of business, subject to the constructive fraud provisions of § 548(a)(1)(B). See BAPCPA §1402. Because of its inclusion in the constructive fraud provision, the defendant can defend on the basis of a reasonably equivalent value being given for the transfer. Further, the application of § 548 to employment contracts is not delayed. Instead, this section is effective on the date of the enactment for cases filed on or after the date of the enactment. So, if a case was filed after the enactment of the BAPCPA, a plaintiff could challenge a transfer under an employment contract that occurred within two (2) years of the filing of the bankruptcy.

Second, Section 548 of the Bankruptcy Code provides the limitations period available to trustees and debtors-in-possession. The section provides that a trustee may avoid any transfer of an interest of the debtor that was made or incurred on or within one year before the date of the filing of the petition, if procured through fraudulent means of the debtor. 11 U.S.C. § 548(a)(1)(A). The BAPCPA amends this section of 548. Specifically, instead of a 1 year reach back period, the BAPCPA provides for a two year reach back period. See BAPCPA §1402. However, Section 1406 of the BAPCPA provides that this amendment to 548 from 1 year to 2 years, applies only to cases commenced under title 11 more than one year after the date of the enactment. So, Congress decided to delay this amendment an additional six months from when other parts of the BAPCPA will become effective.

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Third, the BAPCPA gives the trustee the ability to set aside certain transfers within 10 years of the filing of the bankruptcy. Specifically, subsection (e) was added to Section 548 and provides as follows:

- (e) (1) In addition to any transfer that the trustee may otherwise avoid, the trustee may avoid any transfer of an interest of the debtor in property that was made on or within 10 years before the date of the filing of the petition if -
  - (A) such transfer was made to a self-settled trust or similar device;
  - (B) such transfer was by the debtor;
  - (C) the debtor is a beneficiary of such trust or similar device; and
  - (D) the debtor made such transfer with actual intent to hinder, delay, or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.
- (2) For the purposes of this subsection, a transfer includes a transfer made in anticipation of any money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by, or which the debtor believed would be incurred by -
  - (A) any violation of the securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934 (15 U.S.C. 78c(a)(47))), any State securities laws, or any regulation or order issued under Federal securities laws of State securities laws; or
  - (B) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 of 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 781 and 78o(d)) or under section 6 of the Securities Act of 1933 (15 U.S.C. 77f).

Like actions based upon employment contracts, this section takes effect upon the enactment of BAPCPA and does not have any delay in its effectiveness.

### **3.3. Statutory Lien Actions (11 U.S.C. §545)**

Section 545(2) of the Bankruptcy Code allows a trustee to set aside certain statutory liens. Currently, the trustee can set aside unrecorded tax liens. This provision does not change. However, some trustees have sought to set aside recorded tax liens under Section 6323 of the Internal Revenue

Code (the “IRC”). This section of the IRC protects bona fide purchasers for value without notice of the tax lien. Under Section 545(a)(3), the trustee becomes a bona fide purchaser of real property and there is plenty of precedent for the idea that the trustee takes the property without notice.

The BAPCPA seeks to prevent the trustee from exercising his bona fide purchaser status pursuant to Section 6323 of the IRC. Specifically, the BAPCPA adds the following to Section 545(2) “except in any case in which a purchaser described in section 6323 of the Internal Revenue Code of 1986, or in any other similar provision of State or local law.” BAPCPA §711.

Further, currently, the Trustee has the ability to set aside certain warehouseman’s liens. The BAPCPA changes this provision by specifically stating that “the trustee may not avoid a warehouseman’s lien for storage, transportation or other costs incidental to the storage and handling of goods.” BAPCPA §406.

### **3.4. Post Petition Transfers (11 U.S.C. §549)**

Section 549 of the bankruptcy code allows a trustee to set aside post-petition conveyances outside of the ordinary course of business. Section 549(c) limits this ability when the transferee is a good faith purchaser for present fair equivalent value and without knowledge of the bankruptcy filing. In the case of *Thompson v. Margen (In re McConville)*, 110 F3d 47 (9<sup>th</sup> Cir. 1997), the court held that a lender without knowledge of the bankruptcy filing that made a post petition loan secured by a mortgage from the debtor was not a good faith purchaser and was not protected by Section 549(c). The BAPCPA overrules this result and includes lenders as being protected by 549(c). The BAPCPA does this by altering the definition of transfer found in Section 101(54). See BAPCPA

§1201. The BAPCPA also modifies the automatic stay to prevent the use of Section 362 to void the post petition transfer. *See* BAPCPA §311(a) (the stay does not prevent the fixing “of any transfer that is not avoidable under section 544 and that is not avoidable under section 549”).

### **CONCLUSION**

Thus, while the amendments resulting from the BAPCPA to business bankruptcies and bankruptcy litigation are not as severe or dramatic as the amendments to other sections of the bankruptcy code, the practitioner should be aware of these changes and how they might impact his particular bankruptcy proceeding.