



# The Impact of New Legislation on Small Business Bankruptcies and the Risk of Preference Liability: A New Balancing Act Post-Pandemic

Presented by

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# Topics of Discussion

Elements of  
Preference  
Claim

Preference  
Defenses

Small Business  
Reorganization  
Act

Subchapter V  
Bankruptcies

Recent  
legislation and  
case law

# Elements of Preference Claim

- What is a preferential payment?
  - 11 U.S.C. 547(b)
  - Transfer of the debtor's property
  - To or for the benefit of the creditor
  - For or on account of an *antecedent debt* owed by the debtor
  - Made while the debtor was insolvent
  - Made within 90 days before the petition date (1 year for payments to insiders)
  - Enables the creditor to get more than in a chapter 7

# Preference Defenses

New Value

Ordinary Course

Contemporaneous Exchange

# New Value Defense

- A preferential transfer may not be avoided if, after the transfer, the creditor gave “new value” to or for the benefit of the debtor that is:
  - not secured by an otherwise unavoidable security interest; and
  - on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor
- What constitutes “new value”?
  - Shipments of inventory
  - Services provided
  - New credit

# New Value Defense (Cont.)

- Application of New Value
  - Majority Rule: New value may be applied to offset any prior preferential transfers, not just the immediately prior transfer
- Unpaid vs. Paid New Value
  - Majority Rule: New value must remain unpaid
  - Emerging Minority Rule: New value need not remain unpaid
- Does allowed/paid 503(b)(9) claim count as new value?

# Ordinary Course Defense

- Two Pronged Test: a preferential transfer may not be avoided if “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 the transfer was:
  - (1) made in the ordinary course of business between debtor and transferee;
  - OR**
  - (2) made according to ordinary business terms

# Ordinary Course Defense (Cont.)

- First Prong: made in the ordinary course of business between debtor and transferee
  - What constitutes “ordinary course”?
  - Subjective and fact driven
  - Look at actual conduct before and during the “Preference Period”
  - Timing, amount, and manner of the transaction and the circumstances under which the transfer was made
  - Past payment history of the debtor to the creditor and the timeliness of payments
  - The existence of any unusual debt collection practices
  - Changes in the means of payment



# Ordinary Course Defense (Cont.)

- Second Prong: made according to ordinary business terms
  - Creditor must prove that the debtor made its pre-petition preferential transfers consistent with relevant industry's norms
  - Look to firms similar to creditor in question
  - Creditor has some latitude in defining the relevant industry
  - Only dealings so unusual as to fall outside of that broad range should be deemed extraordinary

# Contemporaneous Exchange Defense

- A preferential transfer may not be avoided if it was:
  - (1) intended to be a substantially contemporaneous exchange for new value given by the debtor;
  - AND**
  - (2) In fact was substantially contemporaneous exchange

# Small Business Reorganization Act

- Small Business Reorganization Act (SBRA) effective February 19, 2020
- Purpose is to streamline bankruptcy reorganizations for small business debtors with limited aggregate liabilities
- Created new Subchapter V to Chapter 11 for “small business” debtors
- “Small business” defined by a \$7.5 million debt limit until March 27, 2022
- Single Asset Real Estate (SARE) debtors are not eligible

# Differences Between Traditional Chapter 11s and Subchapter V Cases

Traditional Chapter 11	Subchapter V Case
<ul style="list-style-type: none"><li>▪ Traditional Debtor in Possession/trustee typically not appointed</li><li>▪ Disclosure Statement</li><li>▪ Confirmation hearings often contested</li><li>▪ Absolute Priority Rule</li><li>▪ Quarterly fees are required to be paid by the debtor in possession</li><li>▪ Creditors committee</li><li>▪ Administrative claims must be paid on effective date</li></ul>	<ul style="list-style-type: none"><li>▪ Trustee appointed</li><li>▪ No Disclosure Statement</li><li>▪ Parties are encouraged to reach a consensual plan</li><li>▪ Absolute priority rule does not apply</li><li>▪ No quarterly fees</li><li>▪ Ability to cram-down debt on homes mortgaged to fund the business</li><li>▪ No creditors committee by presumption (§ 1102(a)(3))</li><li>▪ Administrative claims may be paid over duration of plan</li></ul>

# Subchapter V Timeline

- Court status conference within 60 days of the case filing
- 14 days prior to status conference, a report must be filed detailing business's efforts that have been or will be undertaken to have a consensual plan
- Plan must be filed within 90 days of case filing (absent extension)
- Plan payments — 3-5 Years

# Effect of SBRA on Preference Actions

- Amendments to Section 547 and Venue Requirement
- New requirements for a preference action: “...[B]ased 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)”
- Amended venue language: Preference actions in the amount of \$25,000 or less must be filed in the district where a non-insider defendant is located
- debtors in possession and trustees must now perform reasonable due diligence and consider the preference recipient’s known or reasonably knowable affirmative defenses before filing suit

# Consolidated Appropriations Act of 2021 (CAA)

- Enacted on December 27, 2020
- Added 11 U.S.C. 547(f)
- Preference protection to commercial landlords and suppliers who receive overdue payments from tenants and customers made on or after March 13, 2020
- Facilitates workouts & encourages payment deferment for tenants and customers
- Commercial tenant debtors may receive extra 60 days to pay post-petition rent
- Expires December 27, 2022

# Tactical and Practical Steps

- Filing a proof of claim and the right to a jury
- Preference and fraudulent transfer
- Executory contract puzzle



# Presenters



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