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Nation Chemical Credit Association

Bankruptcy Basics

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Automatic Stay

- Bankruptcy Filing Stays Creditor Action
 - Collect claims
 - Terminate agreements
 - Foreclose on collateral
- Why?
 - Provides “breathing spell” to allow Debtor to fix problems with business or liquidate

Automatic Stay

- Creditor Cannot Stop Doing Business If Otherwise Bound By Contract
 - Otherwise creditor is free to cease business with Debtor
 - Creditor Barred by Automatic Stay from Threatening to Stop Doing Business Unless Pre-petition Claim is Paid

Automatic Stay

- Can Goods Suppliers Switch From Credit to COD/CIA Terms?
 - If agreement(s) with Debtor allow Uniform Commercial Code may allow
- Consequences of Stay Violation
 - Contempt of Court sanction

Assumption Or Rejection

- If the debtor customer assumes your contract:
 - The customer wants to continue doing business with you under the terms of the existing agreement even after emerging from bankruptcy
 - By statute the customer must pay/cure all past due amounts – pre and post bankruptcy – owed to you
 - You must file an objection if the amounts are wrong
 - You should expect to negotiate if the customer has some leverage

Assumption And Assignment

- The debtor generally may assume and assign your contract to a third party
 - Usually as part of an asset sale
 - May be done even if the contract contains an anti-assignment clause
 - The debtor or new customer must cure – pay all amounts owed
 - The new customer must provide assurance of future performance

Rejection

- The customer/debtor terminates the contract
 - The customer no longer seeks to do business with you, at least under the current terms
 - The customer must pay post petition amounts due as an administrative expense
 - Prepetition/rejection damages are unsecured claims

Setoff

- Setoff is an equitable state law remedy, allowing entities that owe money to each other to cancel out or apply their mutual debts against each other
 - Avoids the absurd and unfair result of making A pay B when B owes A
 - As a general rule, setoff rights arise under state law when two parties acting in the same capacity owe mutual debts to each other under either the same or different contracts

Limitations On Setoff

- **Mutuality**
 - The obligations must be between the same parties acting in the same capacity
 - Prepetition against prepetition, post-petition against post-petition
- **Stay Relief**
 - Required if no safe harbor provision applies

What If?

- You are doing business with two different debtor affiliates - one owes you money and you owe the other - do you take the setoff, do you file a motion for stay relief to take the setoff?
 - Triangular setoff recently has come under attack

What If?

- You have a setoff and you need to assert those rights quickly.
 - If the debtor sells assets under section 363 of the Bankruptcy Code it is not unusual for the purchaser to buy certain receivables but leave certain claims (including your right to setoff) as a now unsecured claim against the debtor-seller. So the creditor now owes the purchaser the full amount of the receivable and holds an unsecured claim against the debtor-seller for the setoff amount, unless you have a court order or stipulation permitting the setoff and netting the claim.

PERIOD BETWEEN FILING DATE AND

- Bankruptcy Code is silent on rights and obligations of parties during period between Chapter 11 filing and assumption/rejection
- Prior to assumption/rejection, contract is enforceable by, but not against, Debtor
 - Non-debtor party must continue to perform prior to assumption/ rejection
 - Debtor could reject and stop performing
 - Ipso Facto Clause terminating or modifying contract upon bankruptcy filing is unenforceable

PERIOD BETWEEN FILING DATE

- Is non-debtor obligated to continue extending credit post-petition if required by contract?
- Helpful contractual provisions
 - Terms at creditor's discretion
 - Automatic switch to cash in advance terms upon default
- Common law right to demand adequate assurance of due performance upon reasonable grounds to believe Debtor will commit a breach of contract

PERIOD BETWEEN FILING DATE

- Risk of Switching from Credit to Cash in Advance
- Exposure To:
 - Breach of contract claim?
 - Claim of Violation of automatic stay?
 - Court's Issuance of OSC To Hold Creditor in Contempt

THE RIGHT WAY TO SWITCH TERMS

- Having the Right Contractual Provision
- Consensual Renegotiation of Terms
- Creditor Can File a Motion Seeking:
 - Expedited decision by Debtor to assume or reject contract
 - 11 U.S.C. §356(d) provides:
 - On request of any party to contract
 - Court may order the trustee/debtor to determine within specified period of time to assume or reject such contract

THE RIGHT WAY TO SWITCH TERMS

- As part of relief for expedited assumption/rejection, a creditor can also seek adequate assurance/adequate protection to obtain any of the following
 - Critical vendor status (subject to court approval)
 - Switch to cash in advance terms
 - Cash deposit
 - Letter of credit
- Examples of The Right Way: Reader's Digest, Visteon, Linens n' Things

DEBTOR'S LEASE OBLIGATIONS

- Section 365(d)(3) and “Stub Rent”
 - Section 365(d)(3) requires a debtor to timely perform all of its obligations from and after the petition date until the lease is assumed or rejected
 - “Stub rent” refers to the rent due for the period between the petition date and the last day of the month in which the petition is filed
 - Split of authority regarding the treatment of stub rent and related lease obligations in bankruptcy

DEBTOR'S LEASE OBLIGATIONS

- Proration approach: A debtor is required to make post-petition rental payments on a pro rata basis, regardless of when the monthly payment was due.
- Payment Date: A debtor's obligations under a lease must only be performed in full as they become due and the date a rental payment is due determines whether it constitutes a pre-petition or post-petition obligation. Nonetheless, the landlord can seek payment of post-petition stub rent as an administrative claim.

LEASE WHERE DEBTOR IS THE LESSOR

- Can be rejected under section 365
- Lessee may elect to remain in the premises for the remaining term of the lease, plus any renewal or extension of the term that may be provided in the lease, so long as the right is enforceable under applicable state law
- Lessee must continue to pay rent and other obligations under the terms of the lease

SUB-LESSEE'S RIGHTS UNDER

- Section 365(h) does not create a right for the sub-lessee to stay in possession of the property after the rejection or termination of the lease under which the debtor acquired its interest in the real property
- Whether the sub-lessee has any right to continue to stay in the leased premises after the rejection or termination of the underlying lease is a question of applicable non-bankruptcy law
- Because the dispute turns on state law between two non-debtors, bankruptcy courts frequently abstain from determining what rights, if any, the sub-lessee has against the lessor after the rejection of the lease

INTELLECTUAL PROPERTY LICENSES

- Intellectual property licenses are generally considered executory for purposes of section 365
- Where debtor is licensor:
 - Governed by section 365(n), which affords certain protections to licensees
 - If a debtor or trustee rejects such a license, the licensee may elect to treat the license as terminated or may elect to retain its rights thereunder
 - Note definition of “intellectual property” in section 101(35A) of the Bankruptcy Code excludes trademarks

INTELLECTUAL PROPERTY LICENSES

- Where debtor is licensee:
 - Section 365(n) does not apply
 - Assignability depends on whether license is exclusive or non-exclusive

INTELLECTUAL PROPERTY LICENSES

- Rejection of Trademark License Agreements
 - Bankruptcy courts have permitted chapter 11 debtors to assume or reject trademark license agreements like any other executory contract
 - Third Circuit decision: Exide Techs. v. EnerSys Del., Inc. (In re Exide Techs.), 607 F.3d 957, 960 (3d Cir. 2010)
 - Trademark licensing agreement that granted the licensee a perpetual and exclusive royalty-free license to use the debtor's trademark held not executory
 - Court applied “substantial performance” doctrine

INTELLECTUAL PROPERTY LICENSES

- Recent Eighth Circuit decision, *Lewis Brothers Bakeries Inc. v. Interstate Brands Corp.* (Interstate Bakeries Corp.), 690 F.3d 1069 (8th Cir. 2012), reached the opposite conclusion:
 - Perpetual, royalty-free trademark license subject to Illinois law was executory and could be rejected.
 - Eighth Circuit's ability to distinguish *Exide* hinged largely on the express language of the agreement stating that a breach of the quality standards provision would constitute a material breach.

Forward Contract Merchant Issues

- Protections for forward contract merchants in the bankruptcy code include:
 - Section 556, which protects the exercise of certain contractual rights to liquidate, terminate or accelerate forward contracts;
 - Sections 362(b)(6) and 362(o), which exempt the exercise of setoff, netting and secured party rights under forward contracts from the automatic stay and all other Bankruptcy Code stays; and
 - Sections 546(e) and 548(d), which provide exemptions from preference and fraudulent transfer avoidance for settlement payments, margin payments and other transfers in connection with commodity and forward contracts.

Forward Contract Merchant Issues

- Non-defaulting party has the right to terminate, liquidate and accelerate the contract
 - Damages will be calculated based on market conditions at the time of liquidation and acceleration of required payment date of the remaining obligations and damages under the terms of the contract.
- Forward contract merchant may receive variation or maintenance margin payments with respect to open forward contracts of a customer.
 - However, the debtor does not have any statutory duty to make variation or maintenance margin payments. If the debtor fails to make such payments, a forward contract merchant may exercise its contractual right to terminate and liquidate, if it has not already done so.

CONSIGNMENTS

- What is a consignment?
 - A transaction where a vendor, consignor, delivers goods to a buyer, consignee, for sale or use
 - Vendor/consignor retains title to goods until the buyer/consignee either sells or uses goods
 - Generally, consignor issues an invoice containing payment terms to the consignee after consignee's reported sale or use

CONSIGNMENT –

- Governing Law Article 9 - Uniform Commercial Code
- State not federal law
- May vary by state

CONSIGNMENT

- UCC Article 9 Definition of Consignment
 - Delivery of goods having a value of at least \$1,000 to merchant for sale, provided:
 - No security interest created in consigned goods
 - Goods not consumer goods prior to delivery; and
 - Merchant deals in goods of that kind under name other than that of consigner, is not auctioneer and is not generally not known by creditors to be substantially engaged in selling goods of others

CONSIGNMENT - CREATION

- Consignment Agreement
 - Must be signed or authenticated by Consignee
- Name of Consignee
 - Correct legal name
 - How to verify?
- Authority of Signer

CONSIGNMENT - PERFECTION

- Follow UCC Article 9 Rules for Perfection
- UCC Financing Statement
 - Does not require Consignee's signature
 - File by Consignee's correct legal name
 - Impact of filing against wrong name?
 - Impact of filing against trade name?

CONSIGNMENT - PERFECTION

- Where to file UCC
 - State of Consignee's location
 - State of registration for corporation or limited liability company
 - State of principal place of business for unregistered entity - general partnership
 - State of residence for individual
 - Foreign Customer check with counsel
 - Usually with Secretary of State, but check!
 - Some states provide for local UCC filing

CONSIGNMENT - PERFECTION

- Longevity of UCC Financing Statement
 - Not perpetual
 - General rule: 5 years
 - May vary by state
- UCC Continued by Filing Continuation
 - As a general rule, must be filed within 6 months prior to expiration (but check state UCC for any variance)

CONSIGNMENT - PERFECTION

- Amending UCC
 - Consignee name change
 - Old name seriously misleading
 - Changing description of consigned goods
 - Address changes
- UCC Amendment Form
 - For name changes, must file within 4 months to relate back

CONSIGNMENT - PRIORITY

- How to Find Competing Security Interests/Liens
 - Do UCC/Lien Search
 - Where?
 - State of Consignee's location
 - State where Consignee's physical assets are located
 - State of Consignee's principal place of business

CONSIGNMENT –

- General UCC Priority Rules
 - First to perfect
- Exceptions with Priority Over First to Perfect
 - Qualifying consignments
 - Qualifying purchase money security interests
 - IRS and certain other statutory liens

CONSIGNMENT –

- UCC Article 9 Rules for Superpriority Status
- Consignment Agreement Signed or Authenticated by Consignee
- UCC filing before Consignee's receipt of goods
- Authenticated written notification to prior secured inventory creditors
- Good for 5 years

BAILMENTS

- Bailment:
 - Delivery of goods by owner, bailor, to another party, bailee, for an express purpose
 - Once purpose is completed, bailee is obligated to return the goods or dispose of them as bailor instructs
 - Common example
 - Warehouse relationship
 - Tolling arrangement

BAILMENT

- Per UCC Article 2, Bailment is an Entrustment
- Entrustment
 - Any delivery and acceptance of possession of goods, regardless of any conditions between the parties as to delivery and acceptance

BAILMENTS –

- Common Characteristics
 - Bailor delivers raw materials to Bailee for processing
 - Bailor retains the option to either obtain return of the goods prior to processing or decide upon the disposition of the finished product
 - Bailor retains title to supplied raw materials and finished product
 - Bailee/processor retains risk of loss for raw materials and finished goods in its possession

BAILMENTS –

- Common Characteristics, cont'd
 - Bailor's raw materials and finished goods segregated from bailee/processor's other property
 - Bailee/processor does not include bailor's raw materials and finished goods in its inventory
 - Bailor does not show account receivable owing by bailee/processor

BAILMENTS vs. CONSIGNMENTS

- Bailments
 - Title remains with bailor — not a sale or consignment
 - Not subject to UCC Article 9 filing requirements
 - Bailor has priority rights to goods over bailee and bailee's secured creditors and lienholders
- Consignments
 - Title passes to consignee upon its use or sale of goods
 - Governed by UCC Article 9
 - Must perfect via UCC financing statement to obtain priority over rights of consignee's creditors

BAILMENTS vs. CONSIGNMENTS

- Consignments
 - Generally, consignee bears risk of loss for goods and finished goods in its possession but can be modified by contract
 - Invoices are usually issued after consignee reports sale or use
- Bailments
 - Bailee maintains risk of loss for goods and finished goods in its possession
 - No invoices for bailments

CONSIGNMENT v BAILMENT

- Assess your risk
 - Have your credit department determine what steps must be taken
 - Best practice is to ensure agreements protect supplier's rights in goods delivered and in any finished products produced from such goods

BAILMENT SUGGESTIONS

- When in doubt....
 - Follow consignment procedures
- File a UCC financing statement!
 - Make sure the statements describes the raw materials supplied AND the finished product in the processor's possession

BAILMENT SUGGESTIONS

- Follow all other steps necessary under UCC Article 9 to obtain priority over the processor's blanket secured inventory lender
 - Obtain waiver of lender's interest in goods subject to bailment
 - Send notice of bailment to creditors with prior UCC filings covering bailed goods

Review Loan Documentation

- Check for Errors, Weaknesses and Omissions
- Determine Whether Defects Are Correctable
- Make a Plan for Correction

Review Note

- Correct (legal) Name of Debtor?
- Authorized Signature?
- Check Payment Terms: Demand or Term?
- Any Defaults? What Cross-Default Provisions?
- Attorney Fee Provisions?
- Notice Requirements?
- Any Waiver of Enforcement of Terms?

Review Security Agreements

- Review Obligation Secured
- Signed by Authorized Party?
- Cover Correct Collateral?
- What Cross Collateralization?
- What Assets of Debtor Not Encumbered?
- Review Grant Language
- Review Default & Notice Language
- Article 9 Collateral Issues

Review Guaranties

- Are Contemplated Guaranties in File?
- Check Debt Which Is Guaranteed
- Any Limitation on Guaranty?
- Any Conditions Precedent to Obligation?
- Is Guaranty Stale?
- Is Signature Notarized?
- Attorney Fee Provision?
- Review Notice Requirements

Review Guarantors

- Current Financial Statements?
- Any Defenses (ECOA)?
- Any Other Guarantors Available?
- Can Guarantors Collateralize?
- Is Pledge of Stock Available?

Review Facts that Affect UCC

- Where is State of Incorporation? Article 9 issues.
- Where Is Chief Executive Office
- Where Are Financial Functions Based?
- Debtor's Correct Legal Name
- Where Are Inventory and Machinery Located?
- Any Landlord/Warehouse Waivers?

Review UCC Filings

- Name and Address of Debtor and Creditor
- Match Collateral to Security Agreement
- Collateral Description
- Filing Description
- Filing Location
- Are Filings Current? Any Lapse?

Specialty Collateral

- Trademarks
- Patents
- Copyrights
- Investment Property (UCC Article 8)
- Securities, Brokerage Accounts
- Motor Vehicles
- Airplanes
- Ships

Specialty Collateral - Stock Pledge

- Check Voting Powers
- Any Restrictions?
- Review Pledge Agreement
- Who Has Possession?
- In split, Who Receives New Shares?

Real Property Collateral

- Review Debt Instrument & Deed of Trust/Mortgage
- Confirm D/T or Mortgage Recorded in Proper Jurisdiction
- Review Environmental Issues
 - Any Environmental Review? More Needed?
 - Projected Clean-up Cost?
- Is There Title Insurance?
- Environmental Liability Insurance Available

UCC/Lien/Title Search

- Conduct State UCC/Tax/ Lien/Judgment Lien Search
 - Check for Sales Tax Liens & Ad Valorem Tax Liens
- Check Federal Tax Liens/Judgment Liens
- Do Title/Mortgage Search on Real Property
- Check for Pending Lawsuits
- Consider “Secret Liens/Trusts” That Could Prime the Lender’s Lien in Certain Assets

UCC/Tax/Judgment Lien

- Search
 - Old Article 9 Filings
 - State of Principal Office
 - All States Where Physical Collateral Located
 - Current Article 9 Filings
 - State of Registration - Organization
- Identify Senior and Junior Liens
- Check Files or Notice Requests
 - Lender's Files
 - Requests Filed With State Agency

Review Status of Collateral

- You (Lender) Aren't Best Collector
- Adequacy of Collateral Coverage
- Verify Existence and Condition
- Review A/R Aging
 - Disputed, Past Due, Offsets, Inter-Company, Concentration, Any A/R Ins.
- Any Fraud Concerns?
- Inventory
- Equipment

Receivables Collateral

- Trade Receivables
 - Offsets, Returns, Charge backs
 - Aging
- Credit Card Receivables
- Health Insurance Receivables

Inventory Collateral

- Verify Existence of Collateral
- Value of Inventory
 - Mix, Amount, Age, Seasonality, Location
 - P\$SI, Consignments, Warehouse Goods
 - Competing Liens (Tax, Statutory, Landlord, Trust Fund)
- Trademark or License Issues

UCC ADEQUATE

- UCC 2-609 Provides That Upon Reasonable Grounds for Insecurity, a Contract Party may Demand Adequate Assurance of Due Performance from Financially Distressed Party
- Demanding Party can Suspend Performance Until Adequate Assurance is Provided (e.g., Suspending Credit Terms and Switching to Cash in Advance)
- Financially Distressed Party's Failure to Provide Such Performance Within Reasonable Time (Not Exceeding 30 Days) is a Repudiation of the Contract

UCC ADEQUATE

- Reasonable Grounds for Insecurity
 - Determined by “commercial standards” as between merchants in good faith
 - Customer past due with creditor
 - Customer defaults on other obligations
 - Customer insolvent
 - Balance sheet (liabilities exceed assets)
 - Equitable (not paying debts as they mature)
- Customer’s bankruptcy filing alone not grounds for insecurity

UCC ADEQUATE ASSURANCE DEMAND

- What constitutes adequate assurance of performance?
 - Revoke credit terms and switch to cash in advance
 - Collateral security
 - Letter of credit

UCC STOPPAGE OF DELIVERY

- Creditor's Right to Stop Delivery of Goods to Debtor Due to Insolvency or Breach of Contract Governed by UCC 2-702, 20703 and 2-705
 - Withholding delivery of goods in creditor's possession
 - Stopping delivery of goods in possession of carrier/warehouse/other third party
 - Insolvency
 - Balance Sheet (liabilities exceed assets)
 - Equitable (Debtor not paying debts as they mature)

UCC STOPPAGE OF DELIVERY

- Notice Must be Given to Carrier/Warehouse and Debtor
- Following Notice, Carrier/Warehouse/Other Third Party Must Hold and Deliver Goods According to Creditor's/Seller's Direction
 - Seller liable for charges or damages
 - Bankruptcy automatic stay
 - Does not preclude stoppage
 - Does preclude recovery without court approval

UCC STOPPAGE OF DELIVERY

- Right of stoppage of delivery cut off by any of the following:
 - Debtor's receipt of goods
 - Warehouse acknowledgment that it is holding goods for Debtor
 - Carrier acknowledgment that it is 'holding goods for Debtor (e.g., by reshipping)
 - Negotiation to Debtor of negotiable bill of lading or warehouse receipt

UCC STOPPAGE OF DELIVERY

- Stoppage of Delivery Rights Not Cut Off by Passage of Title/Risk of Loss From Creditor to Debtor
- Stoppage of Delivery Rights Not Cut Off Where Debtor Had Engaged Carrier

UCC STOPPAGE OF DELIVERY RIGHTS

- Stoppage of Delivery Rights Superior to Secured Inventory Lender's Rights
- In Contrast, Reclamation Rights are Subordinate to Secured Inventory Lender's Rights

STATE LAW RECLAMATION

- Additional Reclamation Requirements:
- Reclamation demand describing goods
- Demand sent within 10 days of debtor's receipt of goods

STATE LAW RECLAMATION

- Defenses:
- Sale of goods to good faith/bona fide purchaser prior to demand
 - Includes creditor with a security interest in inventory
- Goods processed – no longer identifiable at time of demand
- Goods commingled – cannot be traced at time of demand

STATE LAW RECLAMATION

- Remedy:
- Recovery of goods
- State court action necessary if Debtor refuses to return goods

BANKRUPTCY RECLAMATION –

- Goods Sold to Debtor in Ordinary Course of Seller's Business that Debtor Received While Insolvent, Within 45 Days Before Commencement Of Bankruptcy Case
- Insolvency – Balance Sheet definition
- Liabilities exceed assets

BANKRUPTCY RECLAMATION –

- Written Reclamation Demand –
 - No Later Than 45 Days From Debtor's Receipt Of The Goods
 - No Later Than 20 Days After The Commencement Of The Bankruptcy Case, If 45-day Period Expires After The Commencement Of The Bankruptcy Case
 - Contrast to State Law – 10 Day Reclamation Period

BANKRUPTCY RECLAMATION –

- **WARNING! Seller's Reclamation Rights Still Subject To Prior Rights Of A Creditor With A Security Interest In Such Goods**
 - Stoppage of Delivery Preferable – Beats Secured Inventory Lender

BANKRUPTCY RECLAMATION –

- Must the Debtor be in Possession of the Goods at the Time of Receipt of the Reclamation Demand
Must Creditor Identify the Goods
 - Most likely – yes
 - Reclamation rights defeated by sale/conversion of goods prior to demand

BANKRUPTCY RECLAMATION –

- Return of Goods
- No Other Statutory Remedies
- Courts May Create Remedies in the Future

“20 Day” Administrative Claim

- Administrative Claim for the value of goods
 - Sold in ordinary course of Debtor’s business and received by Debtor within 20 days of bankruptcy filing
- New Safety Net For Trade Creditors Disregards More Onerous Reclamation Requirements:
 - No written reclamation demand required
 - No secured inventory lender defense
 - No goods on hand requirement
 - No solvency defense

“20 Day” Administrative Claim

- Administrative Expense Priority Claim
 - How to Assert?
 - Notice And A Hearing:
 - Need to retain counsel
 - No Automatic Administrative Claim Without Court Approval
 - Check court docket for orders that may permit creditors filing proof of Section 503(b)(9) Administrative Claim

“20 Day” Administrative Claim

- Creditor should act quickly
 - No deadline to act in statute
 - Court orders may create deadline
 - Early administrative claims bar date set
 - Bankruptcy Court Local Rules may create deadline for asserting claim

Section 503(b)(9): Frequently Litigated

- Before you get your section 503(b)(9) administrative expense claim you may have to address:
 - What are goods?
 - What does “received” mean?
 - Preference exposure as a basis to disallow
 - Debtor’s setoff rights as a basis to disallow
 - Is a section 503(b)(9) invoice both part of a “new value” preferences defense and the basis for an administrative expense claim

Timing Of Payment Of “20 Day”

- When does claim get paid?
 - Immediately?
 - Court order may permit Debtor to immediately pay, conditioned on extension of credit
- At end of case?
 - Risk of liquidation and insufficient sums to fully pay claim
 - However, under a plan all administrative expense claims, including section 503(b)(9) claims, must be paid in full unless the claimant agrees otherwise
 - Note: A section 363 sale does not require payment if full of section 503(b)(9) administrative expense claims

Claims Priority

- Equitable Distribution of Debtor's Assets According to size of Claim and Priority
- Hierarchical Distribution System
 - Higher priority claims must be paid in full before distributions to lower priority creditors can be made
 - Parties could agree to different treatment

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Claims Priority

- Secured Creditors on Top
 - Prior right to collateral
 - Next in Line: Administrative claims
 - Actual and necessary costs and expenses of preserving the debtor's bankruptcy estate

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Claims Priority

- Examples of Chapter 11 Administrative Claims
 - Post-petition trade credit
 - Post-petition rent
 - Post-petition employee compensation
 - Post-petition professional fees
 - Section 503(b)(9) claims for “20 Day” goods
 - Risk of Administrative Insolvency – Administrative Claims not Paid in Full

Claims Priority

- Next in Line: Lower Level Priority Claims
 - Certain taxes
 - Certain employee claims
 - Other special claims

Claims Priority

- Next in Line: Pre-Petition General Unsecured Claims
 - Pre-petition unsecured trade claims
 - Same treatment
 - Disposition at conclusion of case
 - Exception – court-approved critical vendor

Creditor Participation

- File Proof of Claim
- Purpose:
 - Share in distributions to creditors
 - Vote on Chapter 11 Plan
 - Preserve Rights

Creditor Participation

- Proof of Claim Deadlines
- Chapter 7:
 - 90 days after 341 meeting/examination of debtor
- Chapter 11:
 - Deadline set by Court order
 - Clerk will issue notice of the deadline

Creditor Participation

- Impact of Missing Proof of Claim Deadline:
 - Loss of distribution
 - Loss of voting rights
- Exceptions to Proof of Claim Deadline:
 - Chapter 11
 - Claim scheduled
 - Not disputed/contingent/unliquidated
 - Chapter 7
 - No asset case

Creditors' Committees

- Representative of entire unsecured creditor body:
 - Comprises debtor's largest unsecured creditors
- May include:
 - Bondholders
 - Trade creditors
 - Labor
 - PBGC
 - Landlord

Creditors' Committees

- Investigates the acts and financial affairs of the Debtor:
 - Committee members should have access to Debtor's financials
- Consults with the trustee or debtor concerning administration of the case

Creditors' Committees

- Restructure operations to retain a credit worthy customer
- Provide for a distribution to unsecured creditors
- Investigate and prosecute claims against third parties (senior lenders, officers and directors, and others)
- Eliminate preference exposure to trade creditors

Tools to Implement Committee Goals

- Object to terms of financing, sale, management incentive programs
- Motion to convert or dismiss case
- Alternate more favorable plan proposal
- Litigation against prepetition secured lenders
 - Avoid liens, preference claims, fraudulent transfers, equitable subordination, re-characterization of interest
- Litigation against officers and directors
 - Breach of fiduciary duty, fraud, corporate waste
 - Recovery for D&O insurance proceeds

Chapter 11 Plan Process

- Participants:
 - Debtor
 - Secured Creditors
 - Unsecured Creditors
 - Equity Holders

Creditor Participation

- Proof of Claim Deadlines
 - Chapter 7:
 - 90 days after 341 meeting/ examination of debtor
 - Chapter 11:
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Chapter 11 Plan Process

- Participants:
 - Debtor
 - Secured Creditors
 - Unsecured Creditors
 - Equity Holders

Claims Priority

- Confirmation Of Plan:
 - Requirements
 - Section 363 sales
- Consequences Of Confirmation:
 - Plan governs amount payable on claims and timing of payment
 - Discharges Debtor from any claim that arose pre-confirmation, other than as provided in the confirmed plan
 - Releases

The Faster Chapter 11 Process

- Faster Chapter 11 Processes:
 - Pre-Packaged and Pre-Negotiated Plans
 - Section 363 sales
 - Going Concern sale of the business
 - Liquidation vehicle

The Faster Chapter 11 Process

- Faster Chapter 11 Processes - The Pre-Packaged Plan:
 - Debtor is able to complete a significant portion of the restructuring pre-petition
 - Balance sheet restructuring – converting debtor to equity does not require a traditional restructuring of the business operations
 - Reduces cost and disruption to the debtor's business operations
 - Chapter 11 more expensive with section 503(b)(9) administrative expense claims for 20 day goods and certain expended utility rights for deposits and setoffs
 - Compressed deadlines
 - 210 day limit to assume or reject commercial real estate leases
 - 18 month limit on the debtor's exclusive right to file a plan

Pre-Packaged Chapter 11

- Limited Risk to A Fast Chapter 11 Plan Process
 - Risk the dissenting creditors challenge fairness of the treatment, fairness of the prepetition process, and valuation
 - Debtor may still file plan
- Trade Claims
 - Often paid in cash or according to trade creditor agreements on the effective date of the plan
 - Often receive critical vendor status
 - Often 100 percent recovery to remove the trade from a capital restructuring
 - WARNING – alternative approach is limited payment to trade as senior debt is taking a reduced treatment

Pre-Negotiated Chapter 11 Cases

- Bankruptcy filed before plan negotiations conclude
 - Debtor may not have reached agreement with all creditors
 - Debtor may still file plan
 - Debtor needs to solicit votes

Pre-Negotiated Chapter 11 Case Risks

- Non-Settling Creditors may:
 - Oppose the plan
 - Oppose the financing
 - Proposed an alternative plan
 - Seek a trustee or examiner
- Trade Creditors
 - Payment in full not quite as often
 - Change in treatment during the case

The Faster Chapter 11 Process

- Section 363 sale process timeline:
 - Possible stalking horse bid identified
 - Often the senior secured lenders “credit bid”
 - Buyer diligence and negotiation of asset purchase agreement
 - File bid procedures motion
 - Court hearing on bid procedures
 - Marketing of assets, diligence by other competing bidders
 - Winning bidder selected
 - Auction
 - Sale hearing, court approval of sale
 - Closing (before or after appeal period)

The Faster Chapter 11 Process

- Section 363 sale process uses:
 - Increasingly used by debtors to sell:
 - Groups of assets
 - Lines of business
 - Entire business
 - Liquidation vehicle of debtor's assets
 - Going out of business (“GOB”) sales in retail sector
 - Loan to own
 - Secured claims “credit bid”

The Faster Chapter 11 Process

- Section 363 sale process legal standard:
 - Transaction must be a reasonable exercise of the debtor's business judgment
 - No requirement for a plan or solicitation of votes
 - Creditors can object to terms of proposed bidding procedures and sale

The Faster Chapter 11 Process

- Section 363 sale - risk to unsecured creditors:
 - Expedited sale process may not maximize recoveries
- Administrative insolvency – insufficient cash to pay:
 - Section 503(b)(9) administrative expense claims
 - Unsecured claims
 - Preference exposure to trade creditors

PREFERENCE – ITS PURPOSE

- Avoidance of a Preferential Payment is Intended to:
- Promote fairness of treatment among all creditors
- Prevent race to the court house by creditors
- Prevent a creditor from gaining an advantage over other creditors

PREFERENCE ELEMENTS

- To or for the Benefit of a Creditor transaction
- For or on Account of an Antecedent or Existing Debt Owed by the Debtor Before Such Transfer Was Made
 - Cash-in-advance payment not a preference
- Made While the Debtor was Insolvent
 - Balance sheet definition – liabilities exceed assets
 - Presumed within 90 days of bankruptcy filing so easier to prove insolvency

PREFERENCE ELEMENTS

- Made:
- On or within 90 days before bankruptcy filing or
- Between 90 days and one year before bankruptcy filing for transfers to insider creditors

PREFERENCE ELEMENTS

- That Enables Such Creditor to Receive More Than Such Creditor Would Receive if:
 - The case were a Chapter 7 case
 - The transfer had not been made
 - Such creditor received payment to the extent provided by other provisions of Title 11
 - Creditor Fully Secured by Debtor's Assets Not Subject to Preference Risk
 - Creditor Paid From Collateral Proceeds Not Subject to Preference Risk

PREFERENCE ELEMENTS

- Any Transfer of an Interest of the Debtor in Property
- Letter of credit payment not from property of Debtor
- Per U.S. Courts of Appeal for 6th, 10th and 11th Circuits, Debtor's payment by credit card from property of Debtor

PREFERENCE ELEMENTS: APPLIED

- Raised in the Linens ‘n’ Things Chapter 11 Case Pending in Delaware
- Arizona Bankruptcy Court, in In re MicroAge Corporation, a 2003 Decision, Ruled That Applied Credits to Reduce Debtor’s Obligation on Invoices Was Not a Preference
 - Question whether there was transfer of interest of Debtor in property?
 - No preferential transfer (reducing amounts payable to other creditors)
 - No transfer for creditor’s benefit
 - Creditor did not realize more than in Chapter 7 liquidation

PREFERENCE DEFENSES:

- Transfer was Intended by Debtor and Creditor to be Contemporaneous Exchange for New Value and
- Transfer was Substantially Contemporaneous Exchange

PREFERENCE DEFENSES:

- Examples:
- COD transaction: check tendered for delivery of goods
- Risk of bounced COD check: replacement payment not subject to this or any other defense

PREFERENCE DEFENSES: NEW VALUE

- The “New Value” Defense (also known as the “Subsequent Extension of New Value” Defense) is used in situations where a creditor provides goods to a debtor (well before the debtor was a debtor) on credit on a periodic basis and the debtor made a series of payments to the creditor during the preference period (i.e., the period of 90 days prior to the debtor’s bankruptcy filing).

PREFERENCE DEFENSES: NEW VALUE

- In other words, the creditor delivers goods to a customer (now a debtor) on several different days over the course of a month, and the customer gradually makes several different payments over the same period, but each delivery fails to match neatly up with each payment.
- The “New Value” Defense, in simple terms, helps the creditor make the argument that if it received a payment of \$10,000 on the 90th day before the bankruptcy filing, and the creditor subsequently delivered \$4,000 worth of goods on day 85 before the filing, then the “preference payment” in dispute would be reduced to \$6,000 rather than \$10,000.
- Most trade relationships, of course, are not as simple as the one described above. There may be multiple transactions and deliveries of goods. And calculating the amount of the “new value” can be complicated, both mathematically and legally, as courts have differed in their interpretations. More on that in a future post.

PREFERENCE DEFENSES: NEW VALUE

- The new value defense, like other preference defenses, is designed to encourage creditors to continue doing business with, and extending credit to, companies in financial distress. The new value defense protects creditors from preference exposure where the creditor replenishes the debtor and its bankruptcy estate by extending new credit subsequent to a preference payment.
- The net effect of the defense is that the debtor's other unsecured creditors are no worse off by the preferential payment to the extent of any new credit the creditor subsequently provides to the debtor.
- The new value defense may be used with other preference defenses but may be limited if the goods and/or services claimed as new value did not conform to what the debtor had ordered, or the goods were damaged, defective, rejected or returned because the creditor did not provide value to the debtor.

PREFERENCE DEFENSES:

| Date Check Recv'd or New Value Shipped | Alleged Preference Payment by Debtor | New Value Given | Preference Exposure (Running Balance) |
|--|--------------------------------------|-----------------|---------------------------------------|
| 1/6 | \$2,000 | | \$2,000 |
| 1/7 | | \$1,500 | \$500 |
| 1/8 | | \$1,000 | \$0 (NOT Negative \$500) |
| 1/15 | \$1,000 | | \$1,000 (NOT \$500) |
| 1/21 | | \$750 | \$250 |

PREFERENCE DEFENSES: NEW VALUE

- Paid for New Value May Also Count to Reduce Preference Exposure
- U.S. Circuit Courts of Appeal are Divided on Whether Paid New Value Counts:
 - 4th, 5th and 9th say Yes
 - 3rd, 7th and 11th say No
 - 8th goes both ways
 - Other Circuits Open – Yes and No

PREFERENCE DEFENSES: NEW VALUE

- In re Pillowtex Corporation – U.S. Bankruptcy Court, Delaware – in 3rd Circuit
 - Upheld paid new value
 - Ruled 3rd Circuit never decided this issue

PREFERENCE DEFENSES: NEW VALUE

- In re Frey Mechanical Group – U.S. Bankruptcy Court, Eastern District, Pennsylvania – also in 3rd Circuit
 - March 2011 decision
 - Followed Pillowtex that new value does not have to remain unpaid

PREFERENCE DEFENSES:

| Date Check Recv'd or New Value Shipped | Alleged Preference Payment by Debtor | New Value Given | Preference Exposure Paid New Value (Running Balance) | Preference Exposure Unpaid New Value (Running Balance) |
|--|--------------------------------------|-----------------|---|---|
| 1/10 | \$1,000 | | \$1,000 | \$1,000 |
| 1/20 | | \$1,000* | \$0 | \$1,000 |
| 1/30 | \$1,000 | | \$1,000 | \$2,000 |
| 2/10 | | \$1,000* | \$0 | \$2,000 |
| 2/20 | \$1,000 | | \$1,000 | \$3,000 |
| 3/1 | | \$1,000 | \$0 | \$2,000 |

CRITICAL VENDOR PREFERENCE RISK

- Does Critical Vendor's Receipt of Post-Petition Payment of Pre-Petition Claim Result in Loss of Section 547(c)(4) New Value Defense to Preference Claim?
 - Yes and No!
 - Recent Delaware Decision – In re Friedman's counts new value paid post-petition pursuant to court order because new value is determined as of bankruptcy filing date
 - Other courts have held that new value is disqualified if paid post-petition
 - Suggestion: critical vendor order should either release preference claims against vendor or preserve new value defense

IS A FULLY FUNDED 503(B)(9) CLAIM

- Yes: In re Commissary Operations, Inc. U.S. Bankruptcy Court, Middle District of Tennessee
 - New value window closes on bankruptcy filing date (same ground cited by Delaware court in In re Friedman's)
 - Section 503(b)(9) claims impaired if excluded from new value defense

FULLY FUNDED 503(B)(9) CLAIM

- No: In re Circuit City Stores (U.S. Bankruptcy Court, Eastern District of Virginia) and In re TI Acquisition LLC (U.S. Bankruptcy Court, Northern District of Georgia)
- Paid Section 503(b)(9) Priority Claim Does Not Satisfy Section 547(c)(4)'s Requirement That "The Debtor Did Not Make An Otherwise Unavoidable Transfer To or For the Benefit of Such Creditor"
- Creditor Gets a Double Dip If It Can Use Fully Paid/Funded Section 503(b)(9) Claim As Part Of Its New Value Defense

ORDINARY COURSE OF BUSINESS

- 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 Creditor and
- Subjective Test – Made in the Ordinary Course of Business or Financial Affairs of the Debtor and the Creditor OR
- Objective Test – Made According to Ordinary Business Terms
- Creditor Can Choose Most Beneficial (Subjective or Objective Test) Prong of Ordinary Course of Business Defense

ORDINARY COURSE OF BUSINESS

- Subjective Component – Ordinary Between Parties
- Range of Views
 - How long of a payment history?
 - Range of payments
 - All payments? [Recent American Home Mortgage bankruptcy court decision in Delaware]
 - Modified range? [Recent Philadelphia Newspapers bankruptcy court decision in Eastern District, Pennsylvania]
 - Payments only when Debtor is healthy? [Circuit City bankruptcy court decision in Eastern District, Virginia]
 - Deviation from average/mean?
 - Comparison of average days to pay/days late prior to and during preference period [Archway Cookies bankruptcy court decision in Delaware]

ORDINARY COURSE OF BUSINESS

- Impact of Following on ‘Subjective Test’
- Ordinary Between Parties Component:
 - Change in the form of payment during preference period (regular check to wire)
 - Change in method of invoicing (electronic to paper)
 - Change in credit terms
 - Imposition of credit limit/enforcement of existing credit limit
 - Threats to stop shipment
 - Change in mode of delivery (regular mail to Federal Express)

PREFERENCE DEFENSES: ORDINARY

Extract of Pre-Preference Period Ordinary Course Defense Analysis

| Check / Wire Number | Check Date | Received Date | Check Amount | Invoice Number | Invoice Date | Invoice Amount | Total Days from Invoice Date | | | |
|------------------------|------------|------------------|-----------------|-------------------|-----------------|-------------------|------------------------------------|------------|------------|----|
| 083013 | 11/12/2004 | 11/15/2004 | \$32,895.61 | 9020088873 | 08/11/2004 | \$6,160.00 | 96 | | | |
| | | 11/15/2004 | | 9020088874 | 08/11/2004 | \$5,126.00 | 96 | | | |
| | | 11/15/2004 | | 9020088875 | 08/11/2004 | \$1,408.00 | 96 | | | |
| | | 11/15/2004 | | 9020088876 | 08/11/2004 | \$1,061.50 | 96 | | | |
| | | 11/15/2004 | | 9020088877 | 08/11/2004 | \$1,061.50 | 96 | | | |
| | | 11/15/2004 | | 9020089235 | 08/12/2004 | \$5,959.80 | 95 | | | |
| | | 11/15/2004 | | 9020089236 | 08/12/2004 | \$3,184.50 | 95 | | | |
| | | 11/15/2004 | | 9020089710 | 08/13/2004 | \$1,140.48 | 94 | | | |
| | | 11/15/2004 | | 9020091563 | 08/19/2004 | \$3,139.95 | 88 | | | |
| | | 11/15/2004 | | 9020091992 | 08/20/2004 | \$3,956.48 | 87 | | | |
| | | 11/15/2004 | | 9020092307 | 08/24/2004 | \$697.40 | 83 | | | |
| | | 083159 | | 11/12/2004 | 11/15/2004 | \$22,705.65 | 9020096731 | 09/08/2004 | \$1,140.48 | 68 |
| | | | | | 11/15/2004 | | 9020097343 | 09/10/2004 | \$1,193.50 | 66 |
| | | | | | 11/15/2004 | | 9020097736 | 09/10/2004 | \$3,250.50 | 66 |
| 11/15/2004 | 9020097737 | | 09/10/2004 | | \$13,746.15 | | 66 | | | |
| 11/15/2004 | 9020097738 | | 09/10/2004 | | \$668.80 | | 66 | | | |
| 11/15/2004 | 9020097739 | | 09/10/2004 | | \$704.00 | | 66 | | | |
| 11/15/2004 | 9020097740 | | 09/10/2004 | | \$3,642.10 | | 66 | | | |
| 11/15/2004 | 9020097741 | | 09/13/2004 | | \$2,601.50 | | 63 | | | |
| 11/15/2004 | 9020098094 | | 09/14/2004 | | \$12,191.30 | | 62 | | | |
| 11/15/2004 | 9020098095 | | 09/14/2004 | | \$492.25 | | 62 | | | |
| 11/15/2004 | 9020098527 | | 09/15/2004 | | \$764.50 | | 61 | | | |
| 11/15/2004 | 9020098528 | | 09/15/2004 | | \$1,394.80 | | 61 | | | |
| 11/15/2004 | 9020098862 | | 09/15/2004 | | \$1,146.75 | | 61 | | | |
| 11/15/2004 | 9020099617 | | 09/20/2004 | | \$1,276.00 | | 56 | | | |
| 11/15/2004 | 9020099618 | | 09/20/2004 | | \$492.80 | | 56 | | | |
| 11/15/2004 | 9020104789 | | 10/06/2004 | | \$3,971.55 | | 40 | | | |

Average Days to Pay = ____
Range of ____ to ____ Days to Pay Considered Ordinary

PREFERENCE DEFENSES: ORDINARY

Extract of Preference Period Ordinary Course Defense Analysis

| CHECK # | AMOUNT | CHECK DATE | RECEIVED DATE | INVOICE NUMBER | INVOICE DATE | TERMS | DAYS TO PAY | ORDINARY (Y)es (N)o | INVOICE AMOUNT | BALANCE |
|---------|-------------|------------|---------------|----------------|--------------|-------|-------------|---------------------|----------------|-------------|
| 958604 | \$58,681.87 | 5/16/2001 | 5/30/2001 | 425812 | 3/8/2001 | N45 | 83 | N | \$392.40 | \$392.40 |
| | | | | 425813 | 3/8/2001 | N45 | 83 | N | \$637.20 | \$1,029.60 |
| | | | | 430495 | 3/12/2001 | N45 | 79 | Y | \$16,042.50 | \$1,029.60 |
| | | | | 430497 | 3/12/2001 | N45 | 79 | Y | \$136.80 | \$1,029.60 |
| | | | | 430498 | 3/12/2001 | N45 | 79 | Y | \$98.10 | \$1,029.60 |
| | | | | 431908 | 3/13/2001 | N45 | 78 | Y | \$18,800.10 | \$1,029.60 |
| | | | | 431909 | 3/13/2001 | N45 | 78 | Y | \$4,486.80 | \$1,029.60 |
| | | | | 431910 | 3/13/2001 | N45 | 78 | Y | \$18,087.97 | \$1,029.60 |
| 959409 | \$91,119.50 | 5/21/2001 | 6/4/2001 | 434359 | 3/14/2001 | N45 | 82 | N | \$21,704.40 | \$22,734.00 |
| | | | | 434360 | 3/14/2001 | N45 | 82 | N | \$2,616.00 | \$25,350.00 |
| | | | | 434361 | 3/14/2001 | N45 | 82 | N | \$17,068.80 | \$42,418.80 |
| | | | | 438377 | 3/15/2001 | N45 | 81 | Y | \$3,476.90 | \$42,418.80 |
| | | | | 438378 | 3/15/2001 | N45 | 81 | Y | \$20,639.40 | \$42,418.80 |
| | | | | 438379 | 3/15/2001 | N45 | 81 | Y | \$11,718.00 | \$42,418.80 |
| | | | | 438380 | 3/15/2001 | N45 | 81 | Y | \$11,394.00 | \$42,418.80 |
| | | | | 438381 | 3/15/2001 | N45 | 81 | Y | \$10,314.00 | \$42,418.80 |

Range of 55-81 Days to Pay Considered Ordinary
(based upon complete data)

PREFERENCE DEFENSES: ORDINARY

- Extract of Combined Ordinary Course Defense/New Value Analysis

| Check / Wire Number | Received Date | Check Amount | Invoice Number | Invoice Date | Invoice Amount | Total Days from Invoice Date | Ordinary (Y)es/(N)o | Balance |
|---------------------|---------------|--------------|----------------|--------------|----------------|------------------------------|---------------------|-------------|
| 086439 | 11/16/2005 | 19,846.91 | 9020199191 | 09/15/2005 | 9,575.28 | 62 | N | \$9,575.28 |
| | 11/16/2005 | | 9020199192 | 09/15/2005 | 2,112.00 | 62 | N | \$11,687.28 |
| | 11/16/2005 | | 9020199896 | 09/01/2005 | 8,159.63 | 76 | Y | \$11,687.28 |
| | | | 9020215396 | 11/21/05 | \$2,742.23 | | | \$8,945.05 |
| | | | 9020215648 | 11/22/05 | \$5,899.70 | | | \$3,045.35 |
| | | | 9020215650 | 11/22/05 | \$10,696.17 | | | \$0.00 |
| | | | 9020217147 | 11/30/05 | \$935.62 | | | \$0.00 |
| | | | 9020217148 | 11/30/05 | \$2,339.05 | | | \$0.00 |
| | | | 9020217149 | 11/30/05 | \$1,530.26 | | | \$0.00 |
| | 086572 | | 12/01/2005 | 49,591.71 | 9020199897 | 09/19/2005 | 13,047.65 | 73 |
| 12/01/2005 | | 9020201072 | 09/22/2005 | | 14,659.72 | 70 | Y | \$0.00 |
| 12/01/2005 | | 9020202279 | 09/27/2005 | | 10,961.79 | 65 | N | \$10,961.79 |
| 12/01/2005 | | 9020202280 | 09/27/2005 | | 6,508.99 | 65 | N | \$17,470.78 |
| 12/01/2005 | | 9020203137 | 09/29/2005 | | 4,413.56 | 63 | N | \$21,884.34 |
| | | 9020218054 | 12/2/05 | | \$1,662.63 | | | \$20,221.71 |
| | | 9020218055 | 12/2/05 | | \$5,542.09 | | | \$14,679.62 |
| | | 9020218056 | 12/2/05 | | \$1,662.63 | | | \$13,016.99 |
| | | 9020218514 | 12/2/05 | | \$8,378.56 | | | \$4,638.43 |
| | | 9020218057 | 12/5/05 | | \$2,761.88 | | | \$1,876.55 |
| | 9020218058 | 12/5/05 | \$1,097.15 | | | \$779.40 | | |
| | 9020218059 | 12/5/05 | \$305.86 | | | \$473.54 | | |
| | 9020218852 | 12/7/05 | \$3,173.57 | | | \$0.00 | | |

New Value is Shaded in Gray

Ordinary Course Range 68-88 Days to Pay (+/- 10 Days Off of 78 Day Pre-Preference Avg Days to Pay)
(based upon complete data)

ORDINARY COURSE OF BUSINESS

- Proof Requirement For Objective Test Is Currently Evolving
- General Standard? Transfer Was Not So Unusual As To Render It An Aberration In The Relevant Industry
- Which Industry to Consider?
 - Creditor's industry?
 - Debtor's industry?
 - General business standards/sound business practice?
- Use of Credit Industry Data to Satisfy Objective Requirement (e.g., Credit Research Foundation; Dun & Bradstreet; Risk Management Association; Trade Credit Group)

PREFERENCE DEFENSES: STATUTE OF

- Statute of Limitations – Later of:
 - 2 years from date of bankruptcy filing or
 - 1 year from appointment of trustee
 - Interim trustee?
 - Permanent trustee?
 - Linens ‘n’ Things – trustee argues statute of limitations expired in excess of 2 years, 11 months after bankruptcy filing

PREFERENCE DEFENSES: SMALL

- Aggregate Preference Claim Amount of Less Than \$5,850
 - Less than \$5,475 for preference actions brought in bankruptcy cases filed before 4/1/10
 - CAVEAT: Objections to claims being used to “collect” preferences
- Be on the Lookout for Trustee’s Efforts to Collect on Small Preference Claims

VENUE LIMITS FOR SMALL DOLLAR

- Claims Against Non-Insiders For Recovery Of Less Than \$11,725 Can Be Commenced Only in Federal District Court Where Defendant “Resides”
 - Does venue limit apply to small preference claims?

DOES VENUE LIMIT FOR SMALL

- Yes! – Recent Cases:
 - In re Dynamica Manf., LLC (Bankruptcy Court, District of Delaware)
 - In re Nukote International, Inc. (Bankruptcy Court, Middle District, Tennessee)
- No! – Recent Cases:
 - In re Bamboo Abbott Inc. (Bankruptcy, District of New Jersey)
 - In re Rosenberger (Bankruptcy Court, Western District, Michigan)
 - In re Sunbridge Capital, Inc. (Bankruptcy Court, Kansas)
 - In re Excel Storage Products (Bankruptcy Court, Middle District of Pennsylvania)

PREFERENCES AND ADMINISTRATIVE

- Is Bankruptcy Code Section 502(d) Grounds For Disallowance of Administrative Claim Based on Avoidable Preference?
- Yes and No

PREFERENCES AND ADMINISTRATIVE

- Section 502(d) provides as follows:
 - “Notwithstanding subsections (a) and (b) of this section, the court shall disallow any claim of any entity from which property is recoverable under section 542, 543, 550, or 553 of this title or that is a transferee of a transfer avoidable under section 522(f), 522(h), 544, 545, 547, 548, 549, or 724(a) of this title, unless such entity or transferee has paid the amount, or turned over any such property, for which such entity or transferee is liable under section 522(f) 542, 543, 550, or 553 of this title.”

PREFERENCES AND ADMINISTRATIVE

- Majority View: Administrative Claims Are Unaffected By Preference Risk
- Section 502(d) Does Not Bar Administrative Claims Asserted by Claimants Subject to Preference Exposure
- Ames Department Stores – U.S. 2d Circuit Court of Appeals
 - Administrative claims are not included in the types of claims governed by Section 502(d)
 - Ames did not address Section 503(b)(9) priority claims

PREFERENCES AND ADMINISTRATIVE

- Contrary Minority View: Administrative Claims Are Subject to Disallowance Based on Preference Exposure
- Section 502(d) Does Bar Administrative Claims Asserted by Claimants Subject to Preference Exposure
- In re MicroAge – 9th Circuit Bankruptcy Appellate Panel
 - Did not address Section 503(b)(9) priority claims

PREFERENCES AND SECTION 503(B)(9)

- Preference claim not grounds for disallowance of administrative priority claim, such as Section 503(b)(9) claim, based on Section 502(d)
 - In re Plastech Engineered Products, Inc. – Bankruptcy Eastern District of Michigan, decision
 - In re TI Acquisition LLC – U.S. Bankruptcy Court, agrees with Plastech holding

PREFERENCES AND SECTION 503(B)(9)

- Debtor could assert preference claim as basis for temporarily disallowing Section 503(b)(9) priority claims
 - In re Circuit City Bankruptcy Court disagrees with Plastech and TI Acquisition decisions

PREFERENCE DEFENSE: HEIGHTENED

- A Complaint must contain “a short and plain statement of the claim”
 - The old standard was that a claim was stated unless it appeared beyond doubt that there are no set of facts in that could be proven in support of the claim
 - Now, under the Twombly decision, the “factual allegations must be enough to raise a right to relief above the speculative level”

MEDIATION

- Increased Frequency to Facilitate Settlement of Preference Actions
- Mandatory in some Courts (Per Bankruptcy Court Local Rules)
 - E.G., Delaware Bankruptcy Court Standing Order of April 7, 2004, as amended, requires mediation of all preference actions as follows:
 - Parties have 120 days after filing of answer to file mediation order
 - If parties fail to meet deadline, bankruptcy court appoints a mediator
 - Bankruptcy estate must pay mediator's fee and costs

MEDIATION

- Many Courts Have Local Rules Allowing Mediation Subject to Court Approval
- Beware of Mediation Motions That Adversely Impact Preference Defendant's Positions
- Limits mediator choice to friends of trustee
- Discovery stayed (pro and con)
- Discovery stayed (pro and con)
- Mandatory attendance at mediation
- Penalty for non-attendance at mediation

OBJECTIONS TO CLAIMS

- Debtor/Trustee May File Objection To Creditor's Proof Of Claim With Bankruptcy Court
- Grounds:
 - Debtor's records show no debt
 - Debtor's records show lesser amount of debt
 - Duplicate claim
 - Claims filed against multiple Debtors

OBJECTIONS TO CLAIMS

- Creditor Must Timely Respond Or Risk Reduction Or Elimination Of Claim
- Supporting Documentation to Provide:
 - Invoices
 - Proof of delivery
 - Guaranty

STOPPAGE OF DELIVERY

- Creditor's right to stop delivery of goods to Debtor due to insolvency or breach governed by UCC-2-702, 2-703 and 2-705
 - Withholding delivery of goods in creditor's possession
 - Stopping delivery of goods in possession of carrier/warehouse/other third party

STOPPAGE OF DELIVERY

- Notice must be given to carrier/warehouse and Debtor
- Following notice, carrier, warehouse/other third party must hold and deliver goods according to creditor/seller's direction
 - Seller liable for charges or damages

STOPPAGE OF DELIVERY

- Right of stoppage of delivery cut off by any of the following:
- Debtor's receipt of goods
- Acknowledgment by warehouse that it is holding goods for Debtor
- Acknowledgment by carrier that it is holding goods for Debtor by reshipping/holding
- Negotiation to Debtor of negotiable bill of lading or warehouse receipt

STOPPAGE OF DELIVERY

- Rights vs. Secured inventory lender
 - Stoppage of delivery rights superior to secured inventory lender's rights
 - In contrast, reclamation rights are subordinate to secured inventory lender's rights

STOPPAGE OF DELIVERY

- Passage of title/risk of loss to buyer does not cut off stoppage of delivery right
- Automatic stay arising from buyer's bankruptcy filing does not stay creditor's exercise of stoppage of delivery rights
- But creditor must seek relief from stay/ bankruptcy court approval for recovery and disposition of goods subject to stoppage of delivery