

DEBTOR/CREDITOR

October 2005

Bankruptcy Reform Arrives

On April 20, 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”). Most of the changes made by BAPCPA take effect October 17, 2005. This and succeeding newsletters will highlight certain of these changes.

Reclamation. Under prior law, a seller of goods on credit, who becomes concerned that the purchaser will be unable to pay for the goods, may reclaim those goods by giving written notice within 10 days after the purchaser receives the goods. The statute has been amended to permit reclamation not later than 45 days after the insolvent purchaser receives the goods, but not more than 20 days after a bankruptcy case is commenced.

Congress also resolved a dispute over whether a lender with a security interest in the purchaser’s inventory or a reclaiming seller has superior rights to the goods. As a practical matter, the actual goods are rarely reclaimed. Rather, the goods are sold, and the reclaiming creditor and the lender each seek the proceeds from the sale of the goods. The new law clarifies that the lender gets the proceeds.

Preferences. The bankruptcy statute permits a trustee to recover certain payments made to creditors within 90 days prior to the commencement of the bankruptcy case. These recoverable payments are referred to as “preferences”.

Prior law provided several defenses that allowed a creditor to retain the payment. Among these defenses was the “ordinarily course of business” defense. A trustee could not recover a payment if the creditor proved three conditions: (1) the debt was incurred in the ordinary course of business of both the debtor and creditor, (2) the payment was made in the ordinary course of business of both the debtor and creditor, and (3) the payment was made according to ordinary business terms. Thus, a creditor sued by a trustee had to prove both that the payment within 90

days was consistent with prior payment practices of the debtor and that those prior payment practices were ordinary business terms in that particular industry. Usually, the creditor had to retain an expert to testify regarding ordinary payment terms in the industry.

The BAPCPA improves the creditor’s position by requiring the creditor to show only two conditions: (1) the debt was incurred in the ordinary course of business and (2) the repayment was on ordinary terms between the parties or on ordinary business terms. This change also spares the creditor from having to retain an expert, unless the payment received within 90 days departed from the prior course of conduct between the parties.

Congress also placed a \$5,000 minimum on transfers that may be recovered as preferences in business cases. The minimum amount remains \$600 in consumer cases.

Another facet of the prior law, which gave the trustee leverage in preference cases, was the ability to sue in the court where the main bankruptcy case was pending. This permitted the trustee to force out-of-state creditors to conduct litigation far from home, often over relatively small sums of money. Creditors with good defenses settled with trustees simply to avoid the legal fees involved. The BAPCPA now requires a trustee to sue in the district where the creditor resides for any non-insider business debt of less than \$10,000.

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This newsletter is intended to inform its readers of developments in the area of debtor/creditor relations. It is not legal advice or a legal opinion regarding any specific matter. You should consult a lawyer regarding any questions relating to your particular situation.

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