

**BANKRUPTCY REFORM AND COMMERCIAL CREDITORS: WHAT DOES IT ALL MEAN?**

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The U.S. Bankruptcy Code was significantly overhauled with passage of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"). Most of the provisions of the 2005 Act are effective on October 17, 2005. The media has focused almost exclusively on the effects that the 2005 Act will have on consumers. While important, the 2005 Act also has a significant impact upon commercial creditors.

Buried within the 2005 Act are important changes to the preference laws contained in the U.S. Bankruptcy Code. The preference laws allow a bankruptcy trustee to avoid payments made to vendors within 90 days of the bankruptcy petition. Bankruptcy trustees commonly exercise these powers by filing an adversary proceeding (a type of lawsuit) against the creditor receiving payments in the state where the debtor's bankruptcy petition was filed.

The old preference laws were frustrating to commercial creditors. First, as a creditor, you are likely owed money by your former customer for goods they have received that is unlikely to be paid. Second, the bankruptcy trustee demanded that you repay money that you have already received. Third, even if you have legal defenses to the preference action, the cost of retaining counsel and litigating the claim is often cost prohibitive.

The 2005 Act provides some relief by amending key aspects of the preference laws. The 2005 Act sets a minimum threshold of \$5,000 before a preference action may be pursued in a commercial bankruptcy. Thus, if a creditor received less than \$5,000 total in the 90 days before a commercial bankruptcy petition a bankruptcy trustee cannot bring a preference action. This change will limit previous abusive litigation tactics.

The 2005 Act also amends the venue provisions of the law. Now, for amounts of more than \$5,000 but less than \$10,000, a bankruptcy trustee in Delaware, for example, cannot file an adversary proceeding in the Delaware bankruptcy court. Instead, the bankruptcy trustee must file the adversary proceeding where the creditor has its principal place of business.

The most sweeping change is also the simplest. Under the old preference laws, a creditor commonly asserted what is known as the "ordinary course of business defense." To prove the defense a commercial creditor was required to show that any payments received in the preference period were paid according to the agreement between the parties, and that the payment was ordinary in relation to prevailing business standards. The 2005 Act amends the preference laws to require a creditor to only show that the payment was paid according to the business agreements between the parties or according to prevailing business standards. This change will make it easier for a commercial creditor to assert the defense and will eliminate the cost and expense of experts common in preference litigation under the old laws.

Prudent business owners should carefully evaluate existing terms and conditions and credit policies to ensure that the policies and forms accurately define the ordinary course of business with their customers. In addition, carefully monitoring account aging statements and proactively addressing outstanding accounts in excess of \$5,000 will help to avoid or limit exposure to preference avoidance actions.

While not completely eliminating the risk, the 2005 Act makes some important changes benefiting commercial creditors. The revisions to the preference laws by the 2005 Act are just a few of the many changes that will impact commercial creditors. Other revisions to consider include expanded reclamation rights. To take advantage of the revised Bankruptcy Code a commercial creditor should act now to modify their existing forms and practices. Otherwise, many of the benefits contained within the 2005 Act may be lost when a customer or vendor files an unanticipated bankruptcy petition.