# Preference Update: SBRA's Due Diligence Requirement

Wednesday April 8, 2020 1:00 PM EST

Hosted by the **Young and New Member Committee**

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# Small Business Reorganization Act

# Introduction

- The Small Business Reorganization Act ("SBRA") was signed into law on August 23, 2019 and became effective on February 19, 2020
- The SBRA was result of the work of the National Bankruptcy Conference and the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11
- The primary effect of the SBRA is the creation of a subchapter to Chapter 11 for small business debtors
  - The term "small business debtor" is defined (11 U.S.C "The term "small business debtor" is defined (11 U.S.C. §101(51D)) to mean debtors with no more $2,725,625 in aggregate noncontingent liquidated secured and unsecured debts as of the petition date; however, this debt threshold was temporarily increased to $7,500,000 on March 23, 2020 by the CARES Act"
- The SBRA also made changes effecting how and where preference actions may be brought

# 11 U.S.C. § 547(b) – The Update!

Except as provided in subsections (c) and (i) of this section, the trustee may, ***based 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)***, 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;

(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.

# New Statute, New Questions

- What is “reasonable due diligence in the circumstances of the case”?
- What is “a known or reasonably knowable affirmative defense”?
- What happens if a court finds that these conditions have not been met?
- Where can young and new ABI members (and others) find answers?

# What is “Reasonable Due Diligence”?

# Does the Pre-SBRA Bankruptcy Code Shed Light?

## Plain Text of the Bankruptcy Code

- Prior to the SBRA, the Bankruptcy Code did not contain any section using the phrase “reasonable diligence.”
- However, that phrase has been employed by courts in interpreting certain sections of the Code and provide some helpful guidance.

# Does the Pre-SBRA Bankruptcy Code Shed Light?

## Code Sections Dealing with Notice to Creditors

- The phrase "reasonable diligence" is seen most often in cases addressing disputes hinging on whether the creditor should have received notice of the bankruptcy or something that occurred in the bankruptcy:
  - whether a debt should be discharged under Section 523(a)(3) (which provides for the discharge of debts that have been scheduled)
  - whether a late-filed proof of claim should be allowed
  - whether a party may later object to a court order for which they did not receive notice.

# Does the Pre-SBRA Bankruptcy Code Shed Light?

## What Constitutes "Reasonable Diligence" In the Context of Providing Notice to Creditors?

- A "creditor's identity is 'reasonably ascertainable' " if that creditor can be identified through "reasonably diligent efforts." *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 798, 103 S.Ct. 2706, 77 L.Ed.2d 180 n.4 (1983)).

- "Reasonable diligence does not necessitate impracticable and extended searches ... in the name of due process. Instead, reasonable diligence involves a search focusing on the debtor's own books and records." *In re Ritchie Risk-Linked Strategies Trading (Ireland), Ltd.*, 471 B.R. 331, 339–40 (Bankr. S.D.N.Y. 2012).

# Does the Pre-SBRA Bankruptcy Code Shed Light?

## What Constitutes "Reasonable Diligence" In the Context of Notice of a Sale?

- Holding of *Ritchie-Risk*:

"Here, the record clearly reveals that the Debtor made reasonably diligent efforts to search through its books and records to identify creditors, yet Bancorp's interests did not become apparent as a result of such efforts. Specifically, the Debtors undertook a review of "hundreds of thousands of pages of documents," as well as all the policies that the Debtors provided to potential bidders. Moreover, it appears the Debtors conducted this review with an aim towards providing "all known creditors of the Debtors [as well as] all persons or entities known or reasonably believed to have asserted a Lien on any of the Assets" with a reasonable opportunity to object or be heard."

# How to Address This New Requirement?

# SBRA Venue Amendment

# 28 U.S.C. § 1409(b)

Except as provided in subsection (d) of this section, a trustee in a case under title 11 may commence a proceeding arising in or related to such case to recover a money judgment of or property worth less than $1,000 or a consumer debt of less than $15,000, or a debt (excluding a consumer debt) against a noninsider of less than *$25,000*, only in the district court for the district in which the defendant resides.

# QUESTIONS?