

# Bankruptcy Update In The Midst Of COVID-19

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# 2019 Bankruptcy Code Amendments Summary

- Family Farmer Relief Act of 2019
- Small Business Bankruptcy Act of 2019 (SBRA)
  - Small business provisions
  - Avoidance action abusive practices relief
  - Preference venue changes

# ■ Family Farmer Relief Act Basic Provisions

- Monetary Eligibility For an Individual Or Individual and Spouse Engaged In a Farming Operation Has Been Increased to Aggregate Debts Not Exceeding \$10,000,000.
  - This change was brought about to account for the increased costs of modern farming equipment and the resultant debts increasing

# ■ SBRA Small Business Provisions

- Purpose is to Reduce Costs and Increase Efficiency
- The SBRA, Effective February 19, 2020, Permitted Any Business With Maximum Aggregate Debt of \$2,725,625 to File As a Small Business Chapter 11

# ■ SBRA Small Business Provisions

- Small Business Debtors Granted Chapter 11 Protections Subject to a Faster Timeline
- Elimination of Quarterly United States Trustee Fees
- Elimination of Creditors' Committees
- Appointment of Standing Chapter 11 Trustee With Some Oversight Authority to Assist in the Facilitation and Follow-Through of a Chapter 11 Plan
- Unique Plan Provisions (discussed in Plan Section below)

# SBRA's Changes To Preference Law To Avoid Abusive Practices

- Section 547(b) Amended to Add Following Due Diligence Requirement For Filing Preference Litigation
  - “(b) 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 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....”
  - Preference defendants still retain burden of proving preference defenses (discussed below)

# ■ Increased Venue Limits On Small Claims

- The Venue Provision That Forces a Trustee or Debtor-in-Possession to Commence Litigation on Smaller Claims in the District Court Where the Defendant Resides Has Been Increased From \$13,650 to \$25,000
  - Trustees/debtors-in-possession less likely to commence suit on preference and other claims seeking recovery of less than \$25,000
- Does the Increased Venue Limit Apply to Bankruptcy Cases Filed Before SBRA's Effective Date of February 19, 2020 ?
- Legislation Ignores Conflicting Decisions Over Applicability of Venue Limit to Preference/Other Avoidance Actions



# **CARES ACT INITIATIVES TO AID BUSINESSES, LARGE AND SMALL**



# ■ CARES Act Definition And Purpose

- The Coronavirus Aid, Relief and Economic Security Act (“CARES” Act) was Enacted March 27, 2020
- The Purpose of the CARES Act is to Provide emergency assistance and health care response for individuals, families and businesses affected by the 2020 coronavirus pandemic.

# ■ CARES Act Changes To The Bankruptcy Code

- The Maximum Aggregate Debt Limit for Small Businesses (excluding affiliates and insiders) has been increased to \$7,500,000, not less than 50 percent of which arose from the commercial or business activities of the debtor
- The intent is to enable small businesses to use chapter 11 to survive the pandemic and repay their debts without hardship

# CARES Act Additional Exclusion From The Definition Of “Current Monthly Income”

- Payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 *et seq.*) with respect to the coronavirus disease 2019 (COVID-19) are excluded
- This exclusion is a relief granted to Small Business Chapter 11 Debtors BUT it is also granted to Chapter 13 Debtors who may be small businesses, as well.
  - These payments are also excluded from “disposal income” with respect to Chapter 13 Debtors

## ■ CARES Act Impact On Plan Confirmation

- The CARES Act has amended various provisions of the Bankruptcy Code relating to Plan Confirmation of a Chapter 13. These will be discussed below.

## ■ SUNSET Provisions

- The relief granted to Small Business Chapter 11 Debtors and Chapter 13 Debtors, will expire/Sunset one year from the date of Enactment; i.e. March 27, 2021

# ■ Small Business Debtor Chapter 11 Plan Filing

## ■ Exclusivity

- Only the debtor may file a plan
- The Small Business Debtor has 90 days within which to file its Plan
  - The court may extend the 90-day period if the need for the extension is attributable to circumstances beyond the control of the Small Business Debtor

# Contents Of A Plan In A Small Business Debtor Chapter 11

- The Plan Shall Include
  - A brief history of the operations of the debtor
  - A Liquidation Analysis
  - Projections showing the ability of the debtor to make payments under the plan
- The Plan Shall Provide
  - For the submission of all or such portion of future income of the debtor to the supervision and control of the trustee as is necessary for the execution of the plan

# Disclosure Statement In A Small Business Chapter 11

- Unless the Court, For Cause, Orders Otherwise, There Is No Requirement for a Separate Disclosure Statement in a Small Business Chapter 11
- There are Substantial Requirements for the Contents of a Plan, However, as Shown in the Preceding Slides.



# No Statutory Deadline For Plan Acceptance In A Small Business Chapter 11 Proceeding

- There is No Statutory Deadline for Acceptances of a Plan in a Small Business Chapter 11 as the Deadlines in Section 1121 are no longer applicable to Small Business Debtor Reorganizations.

# Small Business Chapter 11 Plan Confirmation

- Small Business Chapter 11 Plan Can Be Confirmed Notwithstanding Rejection By All Classes of Impaired Claims
- Absolute Priority Rule Eliminated; Equity Can Retain Interest Even If Unsecured Creditor Class Is Not Paid In Full And Rejects Plan If All of Debtor's Projected Disposable Income Over 3-5 Years Is Used to Make Chapter 11 Plan Payments
- Payments Due to Creditors With Administrative Claims Can Be Stretched Out Over the Plan Term
- Discharge Limits
  - On confirmation for consensual plan
  - On completion of plan payments for non-consensual plan

# Post-Confirmation Modification Of A Small Business Chapter 11 Plan

- Before Substantial Consummation But Only If the Plan Still Meets the Requirements For Confirmation
- After Substantial Consummation At Any Time Within 3 Years, Or Such Longer Time Not to Exceed 5 Years
  - As long as the modified plan still meets the requirements for confirmation
  - Debtor must show circumstances warrant such modification
- There Must Be a Notice of Hearing So That the Court May Confirm the Modified Plan

# ■ Preference: Elements Of Claim

- Any Transfer of an Interest of the Debtor in Property;
- To or for the Benefit of a Creditor;
- On Account of an Antecedent Debt Owed by Debtor Before Transfer:
  - CIA payment not a preference
- Made While the Debtor was Insolvent;
  - On or within 90 days before bankruptcy filing; or
  - Between 90 days and one year before bankruptcy filing for transfers to insider creditors; and

## ■ Preference: Elements Of Claim

- 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; and
  - Such creditor received payment to the extent provided by other provisions of Title 11.
  - The greater than liquidation recovery requirement

# Preference Defenses: Contemporaneous Exchange For New Value (COD)

- Transfer was *Intended* by Debtor and Creditor to be Contemporaneous Exchange for New Value; and
- Transfer was Substantially Contemporaneous Exchange
- Examples:
  - COD transaction: payment tendered for delivery of goods
    - Risk of bounced COD check/ACH payment; replacement payment not subject to this defense

## ■ Preference Defenses: New Value

- Creditor Extending Credit to Debtor After Payment, that was Not Secured and Not Paid by Otherwise Unavoidable Transfer
- Goods Shipped/Services Provided on Credit Terms Following Payment Reduce Preference Exposure
- New Value Cannot Be Applied to Subsequent Payments

# ■ Preference Defenses: Paid For New Value

- Paid for New Value May Count to Reduce Preference Exposure
- U.S. Circuit Courts of Appeal are Divided on Whether Paid New Value Counts, though Trend is Toward Allowing Paid New Value:
  - 4<sup>th</sup>, 5<sup>th</sup>, 8<sup>th</sup>, 9<sup>th</sup>, and most recently 11<sup>th</sup> say Yes!
  - 7<sup>th</sup> says No!
  - 3<sup>rd</sup> Circuit's prior "No" is now in question – Likely open
  - Other Circuits open



# ■ 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?
  - U.S. Court of Appeals 3<sup>rd</sup> Circuit 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 – A snap shot as of the petition date.
  - Other U.S. Circuit Courts of Appeal have not ruled on this issue
  - Other lower courts have disqualified new value paid post-petition
  - Suggestion: Critical vendor order should either release preference claims against vendor or preserve new value defense
    - Might be hard to obtain, unless creditor has great leverage

# Ordinary Course Of Business Preference Defense

- 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) Prong of Ordinary Course of Business Defense

# Subjective Component of Ordinary Course Of Business Defense

- Courts Have Been Inconsistent and Unpredictable in Applying Subjective Component of Ordinary Course of Business Defense
- Each Side Can Pick a Methodology to Support its Position
- Encourages Expensive Litigation

# Ordinary Course of Business: Subjective – Litigated Issues

## ■ Range of Views

- How long of a payment history?
  - 1 Year?
  - 2 Years? Bankruptcy Court, Southern District, New York decision: *Quebecor World*
  - Longer?

# Ordinary Course of Business: Subjective – Baseline For Comparing Preference vs. Prior Payment

- Range of Payments
  - All payments?
  - Modified range?
  - Payments only when Debtor is healthy? (*Circuit City* Bankruptcy Court decision in Eastern District, Virginia)
- *Sparrer Sausage Co.* – 7<sup>th</sup> Circuit U.S. Court of Appeals Decision
  - 7<sup>th</sup> Circuit rejected Bankruptcy Court’s use of historical (pre-preference period) baseline of only 64% of invoices paid
  - Court accepted historical baseline of 88% of invoices paid (more generous to creditor)
  - Like *Circuit City*, did not overturn Bankruptcy Court’s refusal to consider payments within 7 months of start of preference period when the Debtor was not “financially healthy”

# Ordinary Course of Business: Subjective – Baseline For Comparing Preference vs. Prior Payments

- Comparison of Average Days to Pay/Days Late Prior to and During Preference Period
- *Archway Cookies* Bankruptcy and District Court decisions in Delaware –
  - Payments subject to subjective ordinary course defense, notwithstanding approximately 5 day difference in average days to payment during historical period (42.3 days) compared to preference period (47.2 days)
- Bucket Analysis – Examining Payments by Grouping – Accepted – *Quebecor World*, Bankruptcy Court, Southern District of New York
  - Risk of skewed analysis

# Sierra Concrete Design Inc.; United States Bankruptcy Court, Delaware: Comparing Preference vs. Prior Payments

- *Quebecor World*, Bankruptcy Court, Southern District of New York – Subjective Ordinary Course of Business Defense Inapplicable
  - 30 days off average [27.56 average days outstanding prior to preference period vs. 57.16 average days outstanding during preference period] too much
    - Court relied on weighted average – not disputed

# Sierra Concrete Design Inc.; United States Bankruptcy Court, Delaware: Comparing Preference vs. Prior Payments

- *Sierra Concrete Design*, Bankruptcy Court, Delaware - Defendant Proved Subjective Ordinary Course of Business Defense After Trial
  - Did not matter that debtor paid invoices 27.9 days faster during preference period
    - Average days-to-pay prior to preference period was 55.22 days
    - Average days-to-pay during preference period was 27.3 days



# First Time Transactions May Fall Within Subjective Ordinary Course Of Business Defense

- Decision of U.S. Court of Appeals for 10<sup>th</sup> Circuit – *In re C.W. Mining Co.*
  - Payment on account of first time transaction between debtor and creditor might satisfy the subjective part of ordinary course of business defense
    - Payment made 2 days before due date (within terms)
    - No evidence of creditor collection activity
- 6<sup>th</sup>, 7<sup>th</sup> and 9<sup>th</sup> Circuits Agree

# Subjective Ordinary Course of Business Preference Defense – Facts That Defeat Subjective Ordinary Course of Business On The Numbers

- Consistency In Timing of Payments Prior to and During Preference Period Alone Might Not Be Sufficient to Prove Subjective Component of Ordinary Course of Business Defense
- Threats to Subjective Component
  - Change in the form of payment during preference period (regular check to wire, ACH, etc.)
  - 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; imposition of credit holds
  - Change in mode of delivery (regular mail to Federal Express or hand delivery)

# Ordinary Course Of Business Preference Defense – Ordinary Business Terms Alternative: Objective Component

- Proof Requirement Is Currently Evolving
- General Standard? Transfer Was Not So Unusual or Idiosyncratic As To Render it an Aberration in the Relevant Industry
- Which Industry to Consider?
  - Creditor's industry?
  - Debtor's industry?
  - Industry based on companies similar to creditor selling to companies similar to Debtor?
  - General business standards/sound business practice?

# Ordinary Course Of Business Preference Defense – Ordinary Business Terms Alternative: Objective Component

- Includes Range of Industry Terms
  - No need to prove single set of business terms within an industry
  - Ordinary Business Terms may vary widely across industries
  
- Creditor's Changing of Business Terms Does Not Necessarily Result in Loss of Objective Ordinary Course of Business Defense
  - Are new terms frequently used in industry?

# Ordinary Course Of Business: Objective (Ordinary Business Terms)

- Proper Methodology For Determining a Payment's Consistency with Industry Practices is Evolving
- Example: *In re Waterford Wedgewood, Inc.* (Bankruptcy Court, Southern District of New York)
  - Proper method for determining whether a payment is made in accordance with ordinary business terms: whether payment occurred within one standard deviation of the industry average
- Contrast with *Hayes Lemmerz International Inc.* (Bankruptcy Court, Delaware)
  - Court rejected expert testimony proffered by Trustee limiting industry practice to median range of payments for middle 50% of surveyed companies

# ■ Ordinary Business Terms Information Sources

- MFM/BCCA
- Credit Research Foundation – National Summary of Domestic Trade Receivables
- Risk Management Association
- S&P Capital IQ
- D&B Industry Reports
- CreditRiskMonitor ([www.crmz.com](http://www.crmz.com))
- Trade Associations / Trade Credit Groups

# ■ Ordinary Business Terms Information Sources

- NACM Expert Witnesses
- American Society of Association Executives ([www.asaenet.org](http://www.asaenet.org))
- Thomson Reuters Expert Witness Services
- Outside Expert Witness Services
- Lay Witness With Either:
  - Specific knowledge of industry practices, or
  - Objective information gained outside subjective experiences as employee of creditor/defendant

## ■ Small Preference Defense

- Section 547(c)(9) – Trustee May Not Avoid a Transfer Involving Aggregate Value of Property That is Less Than
  - \$6,425 for bankruptcy cases filed from 4/1/2016 through 3/31/2019
  - \$6,825 for bankruptcy cases filed on and after 4/1/2019



# ■ Another Preference Defense

- Delaware Bankruptcy Court Decision: *Quantum Foods*
  - Court approved, apparently for first time, a creditor's setoff of its unpaid allowed Chapter 11 administrative expense claim for goods sold and delivered post petition to reduce creditor's preference liability on a dollar for dollar basis
  - Both creditor's administrative claim and preference claim against the creditor arose post-petition satisfying mutuality requirement for setoff
- Conflicting Holding Rejecting Setoff Preference Defense – *1984 Georgia Steel Holding* – Bankruptcy Court, Middle District of Georgia

# ■ Prepare To Defend Against The Preference Attack

- At the Time of the Bankruptcy Filing – Gather and Preserve All Data
  - Download and save all electronic files of payment history up to two to three years before the commencement of the 90 day preference period
  - Save invoice copies, both paid and unpaid and all Statements of Account
  - Obtain and save all delivery receipts and/or bills of lading
    - Get delivery receipts from common carrier at inception of case
  - Save entire credit file, including credit application, contracts, if any, and all financial information available.
    - Preserve all notes in file, correspondence and emails
  - Begin the review of potential defenses

# React and Respond To Initial Preference Demand Letter

- DO NOT IGNORE DEMAND
- Request a List Of All Checks That Make Up Payment Claim and Copies of Cancelled Checks Or Proof of Wire Transfers With Remittance Instructions
- Confirm All Payments Were Received
  - Check for NSF, return to maker, etc. checks
  - If payments not actually received, tell the trustee immediately and preference demand may disappear
- Confirm the Date When Each Payment Cleared the Debtor's Bank
  - If more than 90 days, there is no preference

# React and Respond To Initial Preference Demand Letter (*cont'd*)

- Statute of Limitations: Has It Expired Or Is It About To Expire
- Can the Trustee Actually Sue You
  - No preference actions can be commenced on claims totaling less than \$6,825 in the aggregate in cases filed on or after April 1, 2019, and on claims totaling less than \$6,425 in the aggregate in cases filed prior to April 1, 2019
    - Trustees most likely to send demand letter anyway

# Pre-suit Preference Checklist

- Review Defense Strategy With Management
- Develop a Preference Analysis Including New Value and Ordinary Course of Business Defenses
- Develop a Game Plan and Negotiation Thresholds
- Consult With Your Bankruptcy Attorney
- Communicate Defenses To Trustee
- NOTE: Pre Lawsuit Discussions Might Not Happen If Close To Expiration of Statute Of Limitations As Trustee May Not Have Time To Negotiate If Deadline Is Near
- Was the Debtor Insolvent At the Time of the Bankruptcy Filing?
  - Check the bankruptcy schedules
  - Check any financial statements you may have received from debtor

# ■ Preparing Your Preference Defense Analysis

- Unique Aspects of New Value Analysis
- New Value Must Follow Received Payment
- When Was the Payment Delivered/When Did You Actually Receive the Payment?
  - Wire
  - Check
- When Did You Actually Release New Goods?
  - Must be after receipt of payment
  - Same day?

# Preference Checklist Once Lawsuit Commenced

- Check All Dates
  - Was the lawsuit commenced before the Statute of Limitations expired
  - Determine your answer deadline (often 30 days)
    - DO NOT ALLOW A DEFAULT TO BE TAKEN
- Try to Obtain An Extension Of Time To Answer the Complaint To Provide an Opportunity For You To Demonstrate Defenses And Resolve Lawsuit
- Timely Contact Your Bankruptcy Attorney If An Extension Is Not Granted To Timely Answer the Complaint and Not Allow a Default To Be Taken



# ADDITIONAL CHANGES TO THE BANKRUPTCY CODE EFFECTED BY THE CARES ACT



## ■ Exclusion From “Current Monthly Income”

- “Payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 *et seq.*) with respect to the coronavirus disease 2019 (COVID-19)” have been eliminated/excluded from the definition of “current monthly income” in 11 U.S.C. 101(10A)(B)(ii)

# ■ Exclusion From “Disposable Income”

- Each Chapter 13 Debtor must submit all or such portion of his/her future earnings or other future income as is necessary for the execution of a plan.
- If the trustee or creditor objects to the plan, the court may not approve the plan over that/those objection(s) unless the debtor submits all its projected disposable income to the plan payments.
  - The CARES Act has excluded from that disposable income “Payments made under Federal law relating to the national emergency declared by the President under the National Emergencies Act (50 U.S.C. 1601 *et seq.*) with respect to the coronavirus disease 2019 (COVID-19)”

# CARES Act Changes To Modification Of Chapter 13 Plan After Confirmation

- A Chapter 13 Plan confirmed prior to March 27, 2020 may be modified upon request of the Debtor if
  - “(A) the debtor is experiencing or has experienced a material financial hardship due, directly or indirectly, to the coronavirus disease 2019 (COVID-19) pandemic; and
  - (B) the modification is approved by the Court after notice and a hearing.
- A Plan modified under this section may not provide for payments over a period that expires more than 7 years after the time that the first payment under the original confirmed plan was due

# ■ Bankruptcy Court Operation During COVID-19

- State and Federal Courts Throughout the Country Remain Open For Business, But on Limited Basis
- Bankruptcy Courts Are No Different
  - Hearings and conferences not in person

# ■ Bankruptcy Court Operation During COVID-19

- General Orders Entered in Most Jurisdictions Outlining Temporary Operating Procedures – Each Jurisdiction Has Different Rules and Procedures – General Orders Posted on Court Websites
  - In person appearances not permitted except on approval of the court
  - Hearings and conferences held by telephone or video conference
  - In some jurisdictions, only time sensitive hearings are being held

# ■ Bankruptcy Court Operation During COVID-19

- General Orders Entered in Most Jurisdictions Outlining Temporary Operating Procedures – Each Jurisdiction Has Different Rules and Procedures – General Orders Posted on Court Websites (*cont'd*)
  - Evidentiary hearings may be held by video conference in discretion of presiding judge. Method of submitting evidence to be determined by the court on a case-by-case basis
  - Limited in-person access to the clerk's office. Hours have been shortened and some court's have access only by appointment. Clerk's office is available by phone, e-mail and drop boxes. ECF is available for electronic filing

# Other Unique Actions In Chapter 11 Proceedings

- Section 105 of the Bankruptcy Code grants the Court Broad Discretion to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions” of the Bankruptcy Code.

# ■ Special Protocols In Pending Bankruptcy Cases

- Modells (Bankr. N.J.)
  - Order entered suspending case for 30 days due to inability to conduct GOB sales
- CraftWorks (Bankr. DE.)
  - Special Procedures Order entered addressing handling of case
- Pier 1 (Bankr. E.D. Va.)
  - Order staying Debtor's payment of non-critical administrative claims during coronavirus limited operating period of at least 30 days



# Unique Rulings Regarding Individuals as Small Business Debtors

- *In re Wright*, 20-01035, 2020 WL 2193240 (Bankr. D.S.C. April 27, 2020)
  - Judge Helen B. Burris held that the personal guarantor of business debts (the business itself was defunct) qualified to file as a Small Business Debtor as long as the criteria in §1802(1) were met
- *In re Blanchard*, 19-12440 (Bankr. E.D. La. July 16, 2020)
  - Judge Meredith S. Grabill held that two individuals who owned several businesses and owed substantial debt as a result of personally guarantying those business debts qualified as small business debtors under the SBRA

 **QUESTIONS?**

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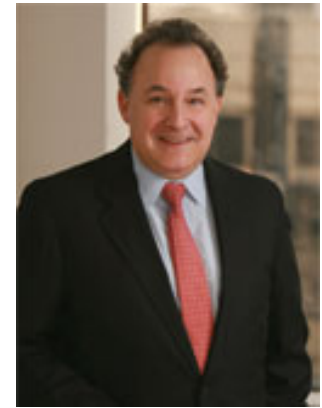
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Bruce S. Nathan is a partner in Lowenstein Sandler's Bankruptcy, Financial Reorganization & Creditors' Rights Department. Bruce has over more than 35 years' experience in the bankruptcy and insolvency field, and is a recognized national expert on trade creditor rights and the representation of trade creditors in bankruptcy and other legal matters. Bruce has represented trade and other unsecured creditors, unsecured creditors' committees, secured creditors, and other interested parties in many of the larger Chapter 11 cases that have been filed. Bruce also handles letters of credit, guarantees, security, consignment, bailment, tolling, and other agreements for the credit departments of institutional clients.

Among his various legal recognitions, Bruce received the Top Hat Award in 2011, a prestigious annual award honoring extraordinary executives and professionals in the credit industry. He was co-chair of the Avoiding Powers Committee that worked with the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 and also participated in ABI's Great Debates at their 2010 Annual Spring Meeting, arguing against repeal of the special BAPCPA protections for goods providers and commercial lessors, and was a panelist for a session sponsored by the American Bankruptcy Institute. He is a frequent presenter at industry conferences throughout the country, as well as a prolific author regarding bankruptcy and creditors' rights topics in various legal and trade publications.



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