



BANKRUPTCY-RELATED LIEN AVOIDANCE ISSUES

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BANKRUPTCY-RELATED LIEN AVOIDANCE ISSUES

(A) Preferential Transfers

Preferential transfers are dealt with under 11 U.S.C. §547. Basically, a preferential transfer is a transfer of property (usually the payment of money to a creditor) of at least a certain value (\$600 in a consumer case and \$5850 in a business case) on account of an antecedent debt which is made by an insolvent debtor (normally a given in most bankruptcy cases) within the applicable preference period (90 days prior to the filing of a bankruptcy with respect to a non-insider transferee and one year prior to the filing of a bankruptcy with respect to an insider transferee (generally a relative, partner, or person with a special relationship to the debtor making the transfer)).

- They belong to trustee in Chapter 7 and 13 cases
- They belong to debtor-in-possession in Chapter 11 cases
- They must be brought within (1) the later of (A) two years of the order for relief (generally the bankruptcy filing date) or (B) one year after appointment of trustee if appointed within two years of the order for relief; or (2) the time the case is closed. (See 11 USC § 546(a).)
- There are threshold minimum amounts (\$600 in consumer case and \$5,850 in non-consumer case). (See 11 USC §§ 547(c)(8) and (9).)
- There are different "reach back" periods: (a) one-year for insiders (see 11 USC § 101(31) for non-exclusive definition); and, (b) 90 days for non-insiders
- The five avoidance "elements" are found in 11 USC § 547(b):
 - (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 [11 USCS §§ 701, et seq.];
 - (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 [11 USCS §§ 101, et seq.].
- There are nine statutory affirmative defenses (see 11 USC §547(c)(1)-(9).) The most common “affirmative defenses” are “ordinary course of business” (11 USC § 547(c)(2)) and “new value” (11 USC §547(c)(4)).
 - Creation of a lien can constitute a preferential transfer.

B. Avoiding Liens Created by Orders of Examination

(See CCP § 708.110-708.205)

1. Proper service of the order of examination creates a lien on the personal property of the judgment debtor for a period of one year from the date of the order unless the court extends or shortens this period. (CCP § 708.110(d).)
2. What if a bankruptcy intervenes within the year? See USC § 108(c).
3. Creation of order of examination lien could be an avoidable preference.

C. Liens Created by Writs of Attachments

(See CCP 483.010-492.090 - generally deal with writs of attachments)

- Attachment liens are generally available only in conjunction with money claims based upon express/implied contracts. (CCP § 483.010(a).)
- If defendant is a “natural person” (e.g., an individual), the claim must arise out of the conduct of the defendant’s trade, business or profession. (CCP § 483.010(a).)
- The primary purpose is to establish earlier priority date for lien purposes (important for preference purposes) and restrict transfer of assets pending judgment.
- An individual defendant is entitled to claim exemptions. (CCP § 484.070.)

- What is the impact of bankruptcy filing after writ of attachment is issued, but before judgment is obtained?
 - A bankruptcy filing automatically terminates a writ of attachment lien created within 90 days of the filing. (CCP § 493.030(b).)
 - A writ of attachment created in favor of an insider within a year of the order for relief in bankruptcy could potentially be avoidable as a preferential transfer.
 - What is the effect of automatic stay?

11 USC § 362(b)(3) and
11 USC § 546(b)

D. Application of the Automatic Stay

- Application of stay is very broad. 11 USC § 362(a) reads as follows:

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title [11 USCS § 301, 302, or 303], or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970 [15 USCS § 78eee(a)(3)], operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

- 11 USC § 362(b) contains 28 exceptions to the application of the automatic stay, 5 of which are potentially applicable to the subject matter discussed.

(b) The filing of a petition under section 301, 302, or 303 of this title [11 USCS § 301, 302, or 303], or of an application under section 5(a)(3) of the Securities Investor Protection Act of 1970 [15 USCS § 78eee(a)(3)], does not operate as a stay—

...

(3) under subsection (a) of this section, of any act to perfect, or to maintain or continue the perfection of, an interest in property to the extent that the trustee's rights and powers are subject to such perfection under section 546(b) of this title [11 USCS § 546(b)] or to the extent that such act is accomplished within the period provided under section 547(e)(2)(A) of this title [11 USCS § 547(e)(2)(A)];

...

(10) under subsection (a) of this section, of any act by a lessor to the debtor under a lease of nonresidential real property that has terminated by the expiration of the stated term of the lease before the commencement of or during a case under this title to obtain possession of such property;

...

(20) under subsection (a), of any act to enforce any lien against or security interest in real property following entry of the order under subsection (d)(4) as to such real property in any prior case under this

title, for a period of 2 years after the date of the entry of such an order, except that the debtor, in a subsequent case under this title, may move for relief from such order based upon changed circumstances or for other good cause shown, after notice and a hearing;

(21) under subsection (a), of any act to enforce any lien against or security interest in real property—

(A) if the debtor is ineligible under section 109(g) to be a debtor in a case under this title; or

(B) if the case under this title was filed in violation of a bankruptcy court order in a prior case under this title prohibiting the debtor from being a debtor in another case under this title;

(22) subject to subsection (l), under subsection (a)(3), of the continuation of any eviction, unlawful detainer action, or similar proceeding by a lessor against a debtor involving residential property in which the debtor resides as a tenant under a lease or rental agreement and with respect to which the lessor has obtained before the date of the filing of the bankruptcy petition, a judgment for possession of such property against the debtor;

(23) subject to subsection (m), under subsection (a)(3), of an eviction action that seeks possession of the residential property in which the debtor resides as a tenant under a lease or rental agreement based on endangerment of such property or the illegal use of controlled substances on such property, but only if the lessor files with the court, and serves upon the debtor, a certification under penalty of perjury that such an eviction action has been filed, or that the debtor, during the 30-day period preceding the date of the filing of the certification, has endangered property or illegally used or allowed to be used a controlled substance on the property;

E. Fraudulent Conveyances

The Bankruptcy Fraudulent Conveyance statute is found at 11 U.S.C. §548. The federal fraudulent transfer statute is very similar to the California fraudulent transfer statute. However, the federal statute covers transfers occurring within two years before the filing date, while the state fraudulent conveyance statute sometimes allows you to "reach back" more than two years.

There are two types of fraudulent transfers, those made with actual intent to defraud, hinder or delay a creditor and those made while the debtor: (a) was insolvent as of the date of transfer or became insolvent as a result of the transfer; (b) was engaged in a business transaction or about to engage in a business transaction for which the debtor's remaining property is insufficient to fund the business transaction;

(c) intended to incur debts beyond the debtor's ability to pay as the debt matured; or (d) made such a transfer to or for the benefit of an insider or incurred such obligation to or for the benefit of an insider under an employment contract and not in the ordinary course of business. Exceptions exist for certain charitable contributions.

Under 11 U.S.C.S. § 544(b), the filing of a bankruptcy petition does not strip creditors of state-created rights to avoid transfers; it merely shifts that right to the creditors' representative. The mere fact that § 544(b) gives a Chapter 7 trustee standing in a representative capacity to assert a creditor's claim for a period of time does not act to destroy the creditor's rights. When a case is closed in which the trustee did not pursue a fraudulent conveyance cause of action pursuant to § 544(b), the right to pursue the state law cause of action reposes once again in whomever is able to assert it. In other words, the filing of a bankruptcy petition does not strip a creditor of standing to pursue a fraudulent transfer action if the trustee abandons it, particularly where the debtor's discharge has been denied. Rather, the creditor is stayed from prosecuting the claim, and unless the trustee opts to intervene or to file his or her own fraudulent transfer action, the creditor may pursue the cause of action upon closing of the bankruptcy estate (unless the matter has become moot because the creditor's claim has been discharged).

Hanlin v. Frazer (In re Vandevort), 2009 Bankr. LEXIS 4535, 1 (B.A.P. 9th Cir. Sept. 8, 2009)

Section 548 establishes power to avoid fraudulent transfers, which usually may only be asserted by a trustee or, under Section 1107(a) of the Code, by a Chapter 11 debtor-in-possession. ... Individual creditors generally have no remedy to institute such an action except through the trustee or debtor-in-possession. * * * If a creditor is dissatisfied with lack of action on the part of the debtor-in-possession, the creditor may move to replace the debtor-in-possession with a Chapter 11 trustee; or to convert the Chapter 11 case to one under Chapter 7; move to dismiss the Chapter 11 case; or petition the court to compel the debtor-in-possession to act or to gain court permission to institute the action itself.

In re Curry & Sorensen, 57 B.R. 824, 827-828 (B.A.P. 9th Cir. Cal. 1986)

Section 544(b) provides that, upon commencement of a case under the Bankruptcy Code, a trustee or debtor in possession "may avoid any transfer of an interest of the debtor in property or any obligation incurred by the debtor that is voidable under applicable law by a creditor holding an unsecured claim that is allowable" under the Bankruptcy Code. 11 U.S.C. § 544(b). In other words, § 544(b) places the debtor in possession in the shoes of its creditors, giving it the right to prosecute individual creditors' fraudulent transfer claims for the benefit of the bankruptcy estate. This provision of the Bankruptcy Code is consistent with its objective of equitable distribution. See *N.L.R.B. v. Martin Arsham Sewing Co.*, 873 F.2d 884, 888 (6th Cir. 1989) (noting that "[t]o allow a creditor of the bankrupt to pursue his remedy against third parties on a fraudulent transfer theory would

undermine the Bankruptcy Code policy of equitable distribution by allowing the creditor 'to push its way to the front of the line of creditors'") (quoting *In re Cent. Heating & Air Conditioning, Inc.*, 64 B.R. 733, 737 (N.D. Ohio 1986)); see also *Moore v. Bay*, 284 U.S. 4, 5, 52 S.Ct. 3, 76 L. Ed. 133 (1931) (observing that what is recovered for benefit of bankrupt's estate is to be distributed in equal parts among allowed unsecured claims that lack priority).

Guttman v. Fabian (In re Fabian), 458 B.R. 235, 257 (Bankr. D. Md. 2011)

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