

Updates

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Eight Circuit BAP Determines Junior Lienholders Receive Preference Protection

A junior lienholder that receives a payment to release its "out of the money" lien may not have to repay it if their borrower files for bankruptcy shortly thereafter as decided recently in *Lauter v. Wells Fargo Bank (In re Gas-Mart USA, Inc.)*. Settlements with owners of distressed assets secured by layers of liens were always challenging since the release of a junior lender's lien is often needed for a senior lender to successfully work out the debt with a struggling debtor. The senior lender may accept less than full payment in exchange for the release of its lien and doing so can leave some cash to motivate the junior lender to also release their lien.

The junior lienholder may forfeit that payment if the owner finds itself in bankruptcy within 90 days because a bankruptcy trustee may sue to recover the "preferential payment." One defense to that lawsuit would be that the payment was a "contemporaneous exchange for new value." If there was no collateral value above the senior's lien, how could the junior lienholder actually provide the debtor with "new value"? The U.S. Court of Appeals for the Eighth Circuit's Bankruptcy Appellate Panel (BAP) found that the "contemporaneous exchange of new value" defense was applicable in this exact situation and shielded payments to a junior lienholder up to the value of the property, minus payments made to the senior lienholder.

In re Gas-Mart USA, Inc.

In *Lauter v. Wells Fargo Bank (In re Gas-Mart USA, Inc.)*, No. 19-6013 (B.A.P. 8th Cir. March 19, 2020), the debtor owned and operated gas stations and convenience stores in several states. Gas-Mart agreed to sell 19 of its locations before filing its bankruptcy case. Its senior lender, Sun Life, voluntarily released its liens on the debtor's assets (including personal property) in exchange for sale proceeds of \$14 million. Wells Fargo, the junior lienholder on the debtor's personal property, received \$1.3 million of the sale proceeds to partially satisfy its debt. Gas-Mart paid Wells Fargo \$100,000 as an advance sale payment one day before the closing and Wells Fargo released its lien to allow the sale to take place free and clear of any liens.

Gas-Mart filed for Chapter 11 relief shortly thereafter and the trustee of its creditors trust sued Wells Fargo claiming that the payments were preferential under Section 547. Wells Fargo argued that the payments were unavoidable under the "contemporaneous exchange of new value" defense in Section 547(c). Both the Bankruptcy Court and the BAP ruled in favor of Wells Fargo and found that the "contemporaneous exchange of new value" defense applied to both transfers.

The "new value" defense protects the payment "to the extent that such transfer was — (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and (B) in fact a substantially contemporaneous exchange" The court noted that the release of a lien can constitute new value in the Eighth Circuit, citing *Velde v. Kirsch*, 543 F.3d 469, 474 (8th Cir. 2008) and *Velde v. Reinhardt*, 294 Fed. Appx. 242, 243 (8th Cir. 2008). The BAP held that when a senior lender voluntarily releases its liens for less than full payment and a junior lienholder subsequently releases its liens, the junior lienholder has provided the debtor with "new value" under Section 547(c)(1). It ruled that Sun Life provided Wells Fargo with new value when Sun Life waived full payment on its liens, and Wells Fargo, in turn, provided the debtor with new value. The BAP further found that the \$100,000 payment to Wells Fargo was "contemporaneous," even though it was made a day before the sale closed. The BAP saw no clear error in the Bankruptcy Court's finding that the transactions were all made as part of the April 30 sale.

Takeaways

Secured creditors know that a workout attempt often precedes a bankruptcy. They need confidence that their deal will not be clawed back should the borrower find itself in bankruptcy within 90 days. *Gas-Mart* provides some comfort for junior lienholders dealing with a debtor located in the Eighth Circuit. They can accept partial payments on their liens knowing that those payments are unlikely to be avoided. *Gas-Mart* is also a win for senior lienholders since junior lienholder deals are often part of complicated settlements.

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