



## 609 New Bankruptcy Code for Non-bankruptcy Lawyers

**Marjorie Chertok**  
*Senior Counsel*  
Telcordia Technologies, Incorporated

**Lynn K. Herrick**  
*Corporate Counsel*  
Guardian Industries Corporation

**Norbert W. Kaut**  
*General Counsel*  
Meredith Corporation

## Faculty Biographies

### Marjorie Chertok

Marjorie F. Chertok, is senior counsel at Telcordia Technologies, Inc. in Piscataway, New Jersey. Prior to that she was counsel to the firm Pitney, Hardin, Kipp & Szuch, L.L.P and a partner in Greenbaum Rowe Smith and Davis,LLC. Ms. Chertok has substantial experience in the technical and substantive aspects of computer and telecommunications law. She brings her expertise to bear in complex commercial transactions in the e-commerce, data and software licensing, and telecommunications arenas. She also has substantial litigation experience in the areas of antitrust, securities, creditors' rights, copyright, trademark, privacy, and high technology fraud law and is certified as a specialist in business bankruptcy law by the american bankruptcy board of certification.

Ms. Chertok is a member of the New Jersey and New York State Bar Associations, and the American Association of Board Certified Bankruptcy Specialists. She is also a former master in the New Jersey Bankruptcy Inn of Court. Ms. Chertok is a frequent lecturer and author of scholarly articles. Her articles have appeared in The American Bankruptcy Institute Law Review, St. John's University Law Review, The Financial Manager, The Computer Law Reporter, and other professional journals and publications. She is also frequent lecturer for organizations such as the New Jersey ICLE.

She received her B.A. from Brooklyn College and her J.D. from St. John's University School of Law.

### Lynn K. Herrick

Lynn K. Herrick is corporate counsel for Guardian Industries Corp., a privately-held manufacturing company located in Auburn Hills, Michigan. Her responsibilities include providing legal counsel to the automotive division of the company, supporting the glass manufacturing facilities in the United States, Canada, Mexico, Japan, and Thailand, and assisting with general corporate matters.

Prior to joining Guardian, Ms. Kantor practiced corporate and securities law at Ice Miller in Indianapolis, Indiana.

Ms. Kantor received a B.A. from the University of Michigan and graduated with honors from Indiana University School of Law.

### Norbert W. Kaut

Norbert W. Kaut serves as general counsel--corporate group at Meredith Corporation. Meredith is an NYSE-listed company that operates a television broadcast group and publishes websites, books, and magazines, including Better Homes and Gardens, Family Circle, Ladies Home Journal, Parents, American Baby, Fitness, and Successful Farming magazines. He manages legal services for and advises the company regarding corporate governance and securities, finance, acquisitions, employee benefits, information technology, employment law, and general corporate business. He also advises the company with respect to production & distribution, brand licensing, online media, and integrated marketing (custom publishing and marketing).

## APPENDIX A

October 31, 2006

Ms. Jane Lastname  
Manager of Accounts Payable  
United Customer-Debtor Company  
5XXX Post Road  
Hameln, IA 50309

**VIA FACSIMILE (61X) 792-XXXX EMAIL  
and OVERNIGHT DELIVERY**

RE: Exercise of Reclamation Rights

Dear Ms. Lastname:

Written demand for reclamation is hereby made by Creditor Corporation pursuant to its statutory, common law rights, and 11 U.S.C. § 546(c) (if applicable) for the return of the following goods:

Books shipped under the following invoices:

October 1, 2006	#57327	\$10,150.80 shipped to Jackson, Mississippi
October 10, 2006	#57328	4,009.80 shipped to Cincinnati, Ohio
October 16, 2006	#57329	12,107.43 shipped to Solon, Ohio
October 22, 2006	#57330	993.60 shipped to Wilmington, North Carolina

Please advise us promptly regarding when and where return of the goods will be made.

Sincerely,

Mike Cook

cc: Doug Gee, President, Book Division  
(via facsimile - 61X-792-XXXX)  
Norbert Kaut, Esq.



APPENDIX B

1716 Locust Street  
Des Moines, IA 50309-3023  
61-284-2201  
Email: norbert.kaut@meredith.com

Norbert W. Kaut  
General Counsel - Corporate Group

November 8, 2005

U.S. Bankruptcy Court  
Southern District of NY  
Attn: Claims Processing  
One Bowling Green, 6th Fl.  
New York, NY 10004-11408

RE: Debtor: [redacted] Inc., et al.  
Case No.: 05-[redacted]

Dear Clerk:

Enclosed are an original and one copy of Meredith Corporation's Proof of Claim and invoices supporting same in the amount of \$283,958.60 for the above-referenced bankruptcy.

Please file the original and return a file-stamped copy of the Proof of Claim in the enclosed postage paid self-addressed envelope.

Sincerely,

Norbert W. Kaut

Norbert W. Kaut  
General Counsel

NWK/hbg  
Enclosures

Magazine Publishing • Book Publishing • Television Broadcasting • Integrated Marketing

The claimant does not consent to the jurisdiction of the bankruptcy court over a counterclaim  
FORM B10 (Official Form 10) (04/05)

UNITED STATES BANKRUPTCY COURT Southern DISTRICT OF New York		PROOF OF CLAIM
Name of Debtor [redacted], Inc.	Case Number 05-[redacted]	<p>NOTE: This form should not be used to make a claim for an administrative expense arising after the commencement of the case. A "request" for payment of an administrative expense may be filed pursuant to 11 U.S.C. § 503.</p> <p><input type="checkbox"/> Check box if you are aware that anyone else has filed a proof of claim relating to your claim. Attach copy of statement giving particulars.</p> <p><input type="checkbox"/> Check box if you have never received any notices from the bankruptcy court in this case.</p> <p><input type="checkbox"/> Check box if the address differs from the address on the envelope sent to you by the court.</p>
Name of Creditor (The person or other entity to whom the debtor owes money or property): Meredith Corporation		
Name and address where notices should be sent: Attn: Heather Garcia 1716 Locust Street Des Moines, IA 50309-3023		<p>THIS SPACE IS FOR COURT USE ONLY</p>
Telephone number: 515-284-2254		
Account or other number by which creditor identifies debtor:	Check here <input type="checkbox"/> replaces if this claim a previously filed claim, dated: _____ <input type="checkbox"/> amends	
<p><b>1. Basis for Claim</b></p> <p><input type="checkbox"/> Goods sold</p> <p><input checked="" type="checkbox"/> Services performed - Advertising</p> <p><input type="checkbox"/> Money loaned</p> <p><input type="checkbox"/> Personal injury/wrongful death</p> <p><input type="checkbox"/> Taxes</p> <p><input type="checkbox"/> Other _____</p> <p><input type="checkbox"/> Retiree benefits as defined in 11 U.S.C. § 1114(a)</p> <p><input type="checkbox"/> Wages, salaries, and compensation (fill out below) Last four digits of SS #: _____ Unpaid compensation for services performed from _____ to _____ (date) (date)</p>		
<b>2. Date debt was incurred:</b> See attached invoices		<b>3. If court judgment, date obtained:</b>
<p><b>4. Total Amount of Claim at Time Case Filed:</b> \$ 283,958.60 (unsecured) (secured) (priority) (Total)</p> <p>If all or part of your claim is secured or entitled to priority, also complete Item 5 or 7 below.</p> <p><input type="checkbox"/> Check this box if claim includes interest or other charges in addition to the principal amount of the claim. Attach itemized statement of all interest or additional charges.</p>		
<p><b>5. Secured Claim.</b></p> <p><input type="checkbox"/> Check this box if your claim is secured by collateral (including a right of setoff).</p> <p>Brief Description of Collateral: <input type="checkbox"/> Real Estate <input type="checkbox"/> Motor Vehicle <input type="checkbox"/> Other _____</p> <p>Value of Collateral: \$ _____</p> <p>Amount of arrearage and other charges at time case filed included in secured claim, if any: \$ _____</p>		<p><b>7. Unsecured Priority Claim.</b></p> <p><input type="checkbox"/> Check this box if you have an unsecured priority claim</p> <p>Amount entitled to priority \$ _____</p> <p>Specify the priority of the claim: <input type="checkbox"/> Wages, salaries, or commissions (up to \$10,000)* earned within 180 days before filing of the bankruptcy petition or cessation of the debtor's business, whichever is earlier - 11 U.S.C. § 507(a)(3). <input type="checkbox"/> Contributions to an employee benefit plan - 11 U.S.C. § 507(a)(4). <input type="checkbox"/> Up to \$2,225* of deposits toward purchase, lease, or rental of property or services for personal, family, or household use - 11 U.S.C. § 507(a)(6). <input type="checkbox"/> Alimony, maintenance, or support owed to a spouse, former spouse, or child - 11 U.S.C. § 507(a)(7). <input type="checkbox"/> Taxes or penalties owed to governmental units - 11 U.S.C. § 507(a)(8). <input type="checkbox"/> Other - Specify applicable paragraph of 11 U.S.C. § 507(a)(____).</p> <p>*Amounts are subject to adjustment on 4/1/07 and every 3 years thereafter with respect to cases commenced on or after the date of adjustment. \$10,000 and 180-day limits apply to cases filed on or after 4/20/05. Pub. L. 109-8.</p>
<p><b>6. Unsecured Nonpriority Claim \$ _____</b></p> <p><input type="checkbox"/> Check this box if: a) there is no collateral or lien securing your claim, or b) your claim exceeds the value of the property securing it, or c) none or only part of your claim is entitled to priority.</p>		<p>THIS SPACE IS FOR COURT USE ONLY</p>
<p><b>8. Credits:</b> The amount of all payments on this claim has been credited and deducted for the purpose of making this proof of claim.</p> <p><b>9. Supporting Documents:</b> Attach copies of supporting documents, such as promissory notes, purchase orders, invoices, itemized statements of running accounts, contracts, court judgments, mortgages, security agreements, and evidence of perfection of lien. DO NOT SEND ORIGINAL DOCUMENTS. If the documents are not available, explain. If the documents are voluminous, attach a summary.</p> <p><b>10. Date-Stamped Copy:</b> To receive an acknowledgment of the filing of your claim, enclose a stamped, self-addressed envelope and copy of this proof of claim</p>		
Date 11-7-05	<p>Sign and print the name and title, if any, of the creditor or other person authorized to file this claim (attach copy of power of attorney, if any): Steven M. Cappaert, Controller</p>	

Penalty for presenting fraudulent claim: Fine of up to \$500,000 or imprisonment for up to 5 years, or both. 18 U.S.C. §§ 152 and 3571.

FORM B10 (Official Form 10) (04/04)

**INSTRUCTIONS FOR PROOF OF CLAIM FORM**

The instructions and definitions below are general explanations of the law. In particular types of cases or circumstances, such as bankruptcy cases that are not filed voluntarily by a debtor, there may be exceptions to these general rules.

**DEFINITIONS**

**Debtor**

The person, corporation, or other entity that has filed a bankruptcy case is called the debtor.

**Creditor**

A creditor is any person, corporation, or other entity to whom the debtor owed a debt on the date that the bankruptcy case was filed.

**Proof of Claim**

A form telling the bankruptcy court how much the debtor owed a creditor at the time the bankruptcy case was filed (the amount of the creditor's claim). This form must be filed with the clerk of the bankruptcy court where the bankruptcy case was filed.

**Secured Claim**

A claim is a secured claim to the extent that the creditor has a lien on property of the debtor (collateral) that gives the creditor the right to be paid from that property before creditors who do not have liens on the property.

Examples of liens are a mortgage on real estate and a security interest in a car, truck, boat, television set, or other item of property. A lien may have been obtained through a court proceeding before the bankruptcy case began; in some states a court judgment is a lien. In addition, to the extent a creditor also owes money to the debtor (has a right of setoff), the creditor's claim may be a secured claim. (See also *Unsecured Claim*.)

**Unsecured Claim**

If a claim is not a secured claim it is an unsecured claim. A claim may be partly secured and partly unsecured if the property on which a creditor has a lien is not worth enough to pay the creditor in full.

**Unsecured Priority Claim**

Certain types of unsecured claims are given priority, so they are to be paid in bankruptcy cases before most other unsecured claims (if there is sufficient money or property available to pay these claims). The most common types of priority claims are listed on the proof of claim form. Unsecured claims that are not specifically given priority status by the bankruptcy laws are classified as *Unsecured Nonpriority Claims*.

**Items to be completed in Proof of Claim form (if not already filled in)**

**Court, Name of Debtor, and Case Number:**

Fill in the name of the federal judicial district where the bankruptcy case was filed (for example, Central District of California), the name of the debtor in the bankruptcy case, and the bankruptcy case number. If you received a notice of the case from the court, all of this information is near the top of the notice.

**Information about Creditor:**

Complete the section giving the name, address, and telephone number of the creditor to whom the debtor owes money or property, and the debtor's account number, if any. If anyone else has already filed a proof of claim relating to this debt, if you never received notices from the bankruptcy court about this case, if your address differs from that to which the court sent notice, or if this proof of claim replaces or changes a proof of claim that was already filed, check the appropriate box on the form.

**1. Basis for Claim:**

Check the type of debt for which the proof of claim is being filed. If the type of debt is not listed, check "Other" and briefly describe the type of debt. If you were an employee of the debtor, fill in the last four digits of your social security number and the dates of work for which you were not paid.

**2. Date Debt Incurred:**

Fill in the date when the debt first was owed by the debtor.

**3. Court Judgments:**

If you have a court judgment for this debt, state the date the court entered the judgment.

**4. Total Amount of Claim at Time Case Filed:**

Fill in the applicable amounts, including the total amount of the entire claim. If interest or other charges in addition to the principal amount of the claim are included, check the appropriate place on the form and attach an itemization of the interest and charges.

**5. Secured Claim:**

Check the appropriate place if the claim is a secured claim. You must state the type and value of property that is collateral for the claim, attach copies of the documentation of your lien, and state the amount past due on the claim as of the date the bankruptcy case was filed. A claim may be partly secured and partly unsecured. (See DEFINITIONS, above.)

**6. Unsecured Nonpriority Claim:**

Check the appropriate place if you have an unsecured nonpriority claim, sometimes referred to as a "general unsecured claim". (See DEFINITIONS, above.) If your claim is partly secured and partly unsecured, state here the amount that is unsecured. If part of your claim is entitled to priority, state here the amount not entitled to priority.

**7. Unsecured Priority Claim:**

Check the appropriate place if you have an unsecured priority claim, and state the amount entitled to priority. (See DEFINITIONS, above.) A claim may be partly priority and partly nonpriority if, for example, the claim is for more than the amount given priority by the law. Check the appropriate place to specify the type of priority claim.

**8. Credits:**

By signing this proof of claim, you are stating under oath that in calculating the amount of your claim you have given the debtor credit for all payments received from the debtor.

**9. Supporting Documents:**

You must attach to this proof of claim form copies of documents that show the debtor owes the debt claimed or, if the documents are too lengthy, a summary of those documents. If documents are not available, you must attach an explanation of why they are not available.



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Newark, NJ 07198-0032

Parent: [REDACTED] Inc  
Division: [REDACTED] Food Division  
Brand: [REDACTED]

Description	Item Amount	Net Amount
<b>Family Circle Magazine</b>		
P.O, Spacereserve Date: 01/10/05		
Issue : April. 1, 2005 One Page 4th Cover Four Color Full Run 1-28		
Net Amount Due	86,713.60	86,713.60
PAY THIS AMOUNT		86,713.60

**TERMS: NET 10 DAYS FROM INVOICE DATE-NO CASH DISCOUNT ALLOWED**  
**\*\* PLEASE NOTE OUR REMIT TO ADDRESS\*\***  
**PLEASE RETURN THIS INVOICE WITH YOUR REMITTANCE**



## Session 609 The New Bankruptcy Code for Non-Bankruptcy Lawyers

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## Faculty

Marjorie F. Chertok, Telcordia Technologies, Inc.

Lynn K. Herrick, Guardian Industries Corp.

Norbert W. Kaut, Meredith Corporation

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## Why corporate counsel care

- Compliance
- Minimizing risks
- Maximizing Leverage
- Avoiding loss
- Getting paid

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## What you will learn

- Intro: best preparatory practices
- The Automatic Stay
- Claims
- Executory contracts
- Avoidance actions
- Resources

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## Format

- The basics
- Pre-BAPCPA
- Post-BAPCPA

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## Identifying and Managing Troubled Customers

- Proactive management by credit group and sales department is critical
- Warning signs – establish a checklist and monitoring program
- Early identification of problems will minimize financial loss
- Develop strategy to deal with troubled customers and develop an action plan
- Pre- and Post-Bankruptcy planning will minimize your financial exposure

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## Early Warning Signs

- Late payments, requests for financing, and negotiation of payment terms
- Late deliveries to their customers or changes in product quality
- Failure to update technology systems
- Employing a variety of consultants
- Rumors in the industry

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## Pre-Bankruptcy Planning

- Carefully monitor outstanding balances
- Consider changing payment terms (cash in advance if possible)
- Ask for collateral or a guarantee
- Visit the company and ask to speak with finance group
- Review your contract terms and conditions in detail



## Post-Filing Planning

- Notify the appropriate people in the company (make sure business people are contacting you immediately)
- Hold or stop any pending shipments
- Change customers terms to cash in advance (this is your leverage)
- Review credit file for any collateral, guarantees, etc.
- Discuss possible reclamation actions



## The Automatic Stay

- A bankruptcy filing gives rise to an automatic stay of the commencement or continuation of action against the debtor to (generally) make a prepetition claim to enforce a judgment, obtain property, create, perfect or enforce a lien, collect a claim, or setoff a debt (11 USC 362).



## The Automatic Stay

- Post-BAPCPA
  - Notwithstanding the automatic stay, a utility may recover or setoff against a security deposit provided to it prepetition (11 USC 366)
  - Securities self-regulatory organizations may investigate and enforce regulations (including delisting the debtor) except for monetary sanctions (11 USC 362(b)(25))



## The Automatic Stay

- Post-BAPCPA
  - Master netting agreements
  - Narrowing of applicability of stay to U.S. Tax Court proceedings against the debtor (11 USC 362(a)(8))
  - Real estate
    - Single Asset Real Estate
    - Abusive filings



## The Automatic Stay

- Post-BAPCPA
  - Recovery of personal property easier by providing for automatic termination of stay for leases that are rejected (11 USC 365)



## Claims

- Reclamation (11 USC 546)
- General Unsecured
- Administrative Expense Priority



## Reclamation—Pre-BAPCPA

- Seller providing goods in ordinary course may reclaim goods while debtor is insolvent if seller makes written demand within 10 days or debtor's receipt or within 20 days of receipt if original 10-day period expires after filing (11 USC 546)
- Court may deny claim if it provides supplier with administrative expense priority claim or a lien.



## Reclamation: Post-BAPCPA

- Written demand not required
- Period extended from 10 to 45 days
- Court's ability to substitute administrative expense priority claim for right of reclamation appears to be curbed
- Practical effect: negotiated settlements
- Appendix A: sample letter



## General Unsecured Claims

- Proof of Claim form
  - Appendix B: sample POC
- Favored Creditors
  - Safe harbor contracts: damages for termination calculated on earlier of termination or rejection of safe harbor transaction



## Other Rights of Suppliers of Goods & Services

- Utility Service Providers (11 USC 366)
  - Pre-BAPCPA: Utility could discontinue service if it did not receive “adequate assurance” of payment—strong pre-bankruptcy cash flow, history of timely payments, administrative expense priority for post-petition service
  - Post-BAPCPA: “adequate assurance” bar raised: essentially requires pre-payment or security



## Other Rights of Suppliers of Goods & Services

- Warehouseman's Liens
  - Pre-BAPCPA: Warehouseman's lien for storage, transportation of other costs voidable as voidable statutory lien
  - Post-BAPCPA: In conformity with UCC, warehouseman holds lien on a depositor's goods in event of bankruptcy (11 USC 546)



## Rights & Claims of Employees

- Employee Priority Claims
  - Pre-BAPCPA: Priority for wages, salaries, commissions, vacation, severance, and sick pay earned within 90 days before filing
  - Post-BAPCPA: Extends earnings period to 180 days and increases cap (subject to CoL adjustments)
  - 11 USC 507(a)

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## Rights & Claims of Employees

- Retiree Benefit Plans
  - Pre-BAPCPA: Debtor may modify retiree benefit plans only through cumbersome procedures including obtaining permission from authorized retiree representative or court
  - Post-BAPCPA: Extends this requirement to 180-day period prior to filing
  - (11 USC 1114)

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## Executory Contracts

- Pre-BAPCPA
  - Debtor may only assume if it cures existing defaults or provides adequate assurance of prompt cure
  - Cure requirement does not apply to “any penalty rate or provision relating to a default arising from any failure ... to perform nonmonetary obligations”
  - Section 365

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## Executory Contracts

- Pre-BAPCPA
  - Debtor must assume or reject lease of commercial real estate within 60 days of filing or lease deemed rejected.
  - Court may extend “for cause” and many courts granted unlimited extensions so long as debtor remained current post-petition.

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## Executory Contracts

- Post-BAPCPA
  - Debtor has 120 days to review commercial real estate leases
  - Absent written consent of lessor, extensions limited to additional 90 days
  - That is--210 days maximum to assume or reject

## Executory Contracts

- Post-BAPCPA
  - Nonmonetary defaults that constitute a penalty such as late payment or penalties for nonmonetary defaults need not be cured when the lease or contract is assumed.
  - Nonmonetary defaults do not leave a claim “impaired” for the purposes of Section 1124 of the Code



## Avoidance Actions

- One of Code's goals is to maximize value of estate and ensure equitable distribution of assets
- To this end, Code permits avoidance of preferential or fraudulent transfers



## Preference Law

- Under normal circumstances, a debtor can prefer one creditor over another when paying debts (pay your "friends" first)
- Once a debtor declares bankruptcy, the trustee can void transfers made by the debtor that favored one creditor over another in the 90 days prior to the filing (one year for insiders)
- Justifications: (1) prevents debtor from favoring certain creditors, and (2) discourages creditors from engaging in "eve-of-bankruptcy asset grabbing" from the debtor
- Trustees use preference claims to bring money into the bankruptcy estate. This has become big business.



## Elements of a Voidable Preference

- A trustee may recover a payment made to a creditor if the transfer establishes the following five elements:
    - Was to or for the benefit of a creditor
    - Was made while the debtor was insolvent
    - Occurred within 90 days of the bankruptcy filing
    - Was on account of an antecedent debt (obligation arose before the transfer was made); and
    - Enabled the creditor to receive more than it would have received if the transfer hadn't been made
- \*\* change under BACPA, trustee cannot sue for less than \$5000 and if trustee sues for less than \$10,000, the trustee must sue the creditor in the district where the creditor is located \*\*



## Preference Action Defenses

- There are 3 statutory defenses to a preference claim.
  - Contemporaneous exchange for new value: where the transfer was intended by the debtor and creditor as a contemporaneous exchange for new value given to the debtor by the creditor (no rule as to how long b/w exchange)
  - Ordinary Course of Business: protects transactions that are made in the ordinary course of business of the parties or the industry (the longer the payment history the better) \*\* this is a change under the BACPA – previously you had to prove that transactions were made in the ordinary course of business of the parties and the industry\*\*
  - Subsequent New Value: the creditor must provide goods to the debtor after the alleged preferential transfer was made (transfer occurs when check is delivered)



## Case Study of a Preference Action

- Destitute, Inc. filed Chapter 11 Bankruptcy in December of 2002, converted to a Chapter 7 Bankruptcy and sold its assets in June of 2003.
- Creditor wrote off its \$156,000 receivable from Destitute, Inc. in September of 2004.
- Creditor received a letter in November of 2004 from the Trustee seeking to recover preference payments made to Creditor in the amount of \$239,000.
- Creditor sent the Trustee a letter rejecting the preference claim and claiming ordinary course of business defense.
- Trustee responded with a Tolling Agreement granting an extension of time for both sides to analyze the claim



## Case Study - Continued

- Creditor reviewed its payment history for the 12 months leading up to the petition date (good record keeping and ability to retrieve records was very important).
- Creditor reviewed the information and determined that it could use the Ordinary Course of Business Defense because its prior historical dealings with Destitute, Inc. were remarkably consistent with its dealings during the Preference Period (90 days prior to filing bankruptcy petition).



## Ordinary Course of Business Defense

- Courts generally compare transfers made before the preference period and during the preference period and weigh the following five factors:
  - The length of time the parties were doing business together
  - Whether the amount or form of payments differed from past practices
  - Whether the creditor engaged in any unusual collection activity
  - Whether the creditor took advantage of the debtor's deteriorating financial condition
  - The timing of payments



## Assessing Creditor's Case

- Creditor had been selling to Destitute, Inc. for well over 5 years.
- Destitute, Inc. made all of its payments to Creditor by check delivered via Federal Express (common practice).
- Creditor did not engage in any unusual collection activity against Destitute, Inc.
- The timing of payments became the big issue of dispute.



## It Is a Question of Timing

In the 9 months before the bankruptcy filing:

- The average payment delay was 43 days.
- Approximately 65% of the payments were received between 28-58 days of the issuance of the underlying invoice (within 15 days of the historical average).
- With only isolated exceptions, most payments made during the preference period fell within 15 days of the historical average and in the narrowly defined range of 28-58 days.
- These payment delays were consistent with the historical dealings between the parties.
- Creditor also provided proof of subsequent new value during the preference period which voided a large amount of the claim.



## The Negotiations

- Even though Creditor had a strong claim, it offered to settle for \$2500 and a waiver of the proof of claim for the original outstanding amount owed by Destitute, Inc. (it was an arbitrary number).
- Trustee responded with argument that the ordinary course of business (28-58 days) was too long. They also claimed that they did not receive new value for a payment of \$14,619 (subsequent New Value Defense). They counter-offered to settle for \$14,000 and a waiver of the claim.
- By proving what time of day Creditor received a check from Destitute, Inc. and at what time the truck left the loading dock Creditor was able to void the remaining \$14,619. Creditor felt its proof was pretty good and its defense was strong so it offered \$1500 with a waiver of the claim.
- To avoid further legal fees, Creditor settled for \$2,000 and a waiver of the claim (\$500 less than its original offer and \$237,000 less than the preference claim).



## Avoidance Actions—Post-BAPCPA

- Easier to assert “ordinary course of business defense” by providing a creditor has only to prove that the payment in question was made in ordinary course of business or financial affairs of the parties or according to ordinary business terms, not both
- De minimus transfers
- Timing of transfers

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## Avoidance Actions—Post-BAPCPA

- Section 546- a trustee cannot avoid a set-off or transfer of a swap agreement as a preference absent a showing of fraud
- Section 548-For value in connection with a master netting agreement means.....

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## Conclusion and Q&A

Effective for about a year now (since October 17, 2005), the BAPCPA makes numerous changes that are relevant to business bankruptcies.

- These changes generally disadvantage debtors and shift leverage on important restructuring issues to creditors.
- They also tend to restrict or eliminate judicial discretion on a wide range of matters.



## Conclusion and Q&A

Appendix C: Lowenstein Sandler, BAPCPA: Landmark Business and Other Bankruptcy Changes

(<http://www.lowenstein.com/files/Publication/ba3c5224-4d3e-4f67-ae67-35c335571163/Presentation/PublicationAttachment/9588a9a1-ae53-4be9-8161-4263d7d23fa0/LSBA%20-%20BSN,%20SC%20&%20JMY,%2005-05-05.pdf#search=%22Lowenstein%20Sandler%20bankruptcy%20abuse%20prevention%22>)





**BANKRUPTCY ABUSE PREVENTION  
AND CONSUMER PROTECTION ACT  
OF 2005: LANDMARK BUSINESS AND OTHER  
BANKRUPTCY CHANGES**

## Resources

- Bankruptcy Code:  
[http://www4.law.cornell.edu/uscode/html/uscode11/usc\\_sup\\_01\\_11.html](http://www4.law.cornell.edu/uscode/html/uscode11/usc_sup_01_11.html)
- ACC online materials
- American Bankruptcy Institute:  
<http://www.abiworld.org/>

**BANKRUPTCY ABUSE PREVENTION  
AND CONSUMER PROTECTION ACT OF 2005:  
LANDMARK BUSINESS AND OTHER BANKRUPTCY CHANGES**

President George W. Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 into law. The legislation will result in the most significant change in bankruptcy law since the Bankruptcy Code was first enacted in 1978.

Most of the publicity surrounds the consumer changes. However, the legislation also makes many significant business bankruptcy changes. This memorandum summarizes some of the significant business bankruptcy changes and other changes that might impact the business credit grantor.

**I. Reclamation and Return of Goods**

Credit grantors should be especially pleased by the legislation's expansion of reclamation rights.

**A. Expanded Reclamation Rights and New Administrative Claim For Trade Creditors**

Modifies Section 546(c) to provide that a trustee's avoidance powers are subject to the rights of a seller of goods to reclaim goods sold to the debtor in the ordinary course of the seller's business if the debtor received the goods, while insolvent, within 45 days of the commencement of the bankruptcy case and if the seller makes a written reclamation demand:

- (i) no later than 45 days from the debtor's receipt of the goods; or
- (ii) no later than 20 days after the commencement of the bankruptcy case, if the 45 day period expires after the commencement of the bankruptcy case.

A seller's reclamation rights are subject to the prior rights of a creditor with a security interest in such goods.

If the creditor fails to make a timely written reclamation demand as required above, or otherwise has no reclamation rights, the creditor may still assert an administrative expense claim pursuant to a newly enacted Section 503(b)(9). New Section 503(b)(9) provides that, after notice and a hearing, the creditor shall be granted an allowed administrative expense claim for the value of goods (but not services) received by a debtor within 20 days prior to the commencement of the bankruptcy case for goods sold to the debtor in the ordinary course of the debtor's business.

The modifications to Section 546(c) and the addition of Section 503(b)(9) represent a significant enhancement of a seller's ability to exercise its reclamation rights. The amendments change existing law by extending the time requirements for which written demand must be made to the debtor:

- (i) from 10 days after receipt of goods by the debtor (under existing law) to 45 days from receipt of goods; and
- (ii) from 20 days after receipt of goods by the debtor, if the 10-day reclamation period had not expired when the bankruptcy case was commenced (under existing law), to 20 days after the commencement of the bankruptcy case (if the 45 day period had not expired when the bankruptcy case commenced).

Under existing law, a creditor's failure to make a timely written demand and otherwise satisfy the requirements for reclamation extinguishes its right to any remedy on account of its reclamation claim (e.g., return of the goods, a replacement lien or an administrative claim in the amount of the reclamation claim). The amended Section 546(c) eliminates the remedy of granting a seller a lien or an administrative priority claim if the court declines to order return of the goods. Because reclamation rights are subject to the rights of a secured lender in the goods, it is questionable whether a secured lender will ever consent to the debtor's return of goods free of its security interest, absent which the reclaiming creditor may have no recourse to its goods. Alternatively, the debtor may be induced to pay for the goods.

New Section 546(c)(2) also expressly provides that, notwithstanding a creditor's failure to make a timely written reclamation demand, or if its claim is otherwise denied, the creditor is still entitled to an administrative expense claim for the value of any goods received by the debtor in the ordinary course of the debtor's business within 20 days of the commencement of the bankruptcy case. Section 503(b)(9) adds this as a new category of administrative expense claims that provides unsecured creditors a safety net in the form of an administrative claim for goods sold on credit and received by the debtor within 20 days of the commencement of the debtor's bankruptcy case. There is no requirement for insolvency, a written reclamation demand or goods remaining on hand as would be the case for a reclamation claim.

These changes should enhance the recovery of unpaid suppliers of goods and make it more expensive for a debtor to remain in and exit from Chapter 11. The changes might also affect the composition of creditors' committees by reducing participation by trade creditors that are the beneficiaries of the above-mentioned changes.

**B. Amendment to Section 546 - Return of Goods Provision**

Reassigns the second section currently designated as Bankruptcy Code Section 546(g)\* to Section 546(h). Under current law, a bankruptcy court may approve the debtor's return of goods shipped by a creditor to the debtor before the commencement of the bankruptcy case, provided the creditor consents to the relief, and offsets the purchase price of such goods against any claim the creditor has against the debtor that arose prior to the commencement of the bankruptcy case. The new Section 546(h) modifies existing law by making the return of goods subject to the prior rights of holders of security interests in the goods or the proceeds of the goods.

Section 546 is further modified by adding a new Section 546(i), which provides that a trustee may not avoid a warehousemen's lien for storage, transportation or other costs incidental to the

storage and handling of goods. The prohibition against avoidance of such warehousemen's and similar liens must be applied in a manner consistent with any state statute similar to UCC 7-209, which deals with warehousemen's liens and security interests for charges and expenses. This modification serves to further limit a trustee's avoidance power by exempting warehousemen's liens and similar liens from a trustee's Section 545 lien avoidance powers.

## II. Preferences and Venue

The legislation includes expanded protections in the area of preferences.

### A. Definitions

The definition of "transfer" in Section 101 of the Bankruptcy Code has been changed to include the creation of a lien or security interest.

### B. Ordinary Course of Business Defense

Section 547(c)(2) of the Bankruptcy Code, dealing with the ordinary course of business defense, is amended to provide that a creditor can defend against a preference claim by establishing that a transfer was made in payment of a debt incurred by the debtor in the ordinary course of the business or financial affairs of the debtor and the transferee and such transfer was made either: (i) in the ordinary course of the debtor's and the transferee's financial affairs or business; or (ii) in accordance with ordinary business terms. The net effect of the change is to allow creditors the option of using either prong of the requirement and make it easier to prove the ordinary course of business defense. Under the current bankruptcy statute, creditors are required to prove both prongs in order to satisfy the ordinary course of business defense.

### C. Small Preference Defense

The legislation has also added a new defense to preference claims in business transactions, Section 547(c)(9). A plaintiff cannot sue a transferee to recover a preference where the aggregate amount of all property constituting or affected by the transfer is less than \$5,000.

### D. Venue of Certain Proceedings

A trustee frequently commences an action (or at least threatens to commence an action) to recover a small preference with the anticipation that a creditor will make payment rather than spend the time and money to defend the preference action in a distant bankruptcy court. Section 1409(b) of Title 28 of the United States Code, which deals with venue for preference actions, is modified by the legislation to set monetary and jurisdictional limits for preference actions both in the commercial and consumer arena. With some limited exceptions, preference actions (or any action by a trustee to recover a money judgment) for recovery of less than \$10,000 against

creditors in business cases can be commenced only in the jurisdiction where that creditor is located.

### E. Effective Date of Transfer for Security Interests

Section 547(e)(2) is modified to expand the effective date of perfection of a security interest from 10 to 30 days. A transfer occurs at the time of the transfer between a debtor and creditor if perfection takes place at or within 30 days. If perfection takes place after 30 days, then the transfer is deemed to be made when perfection takes place. If perfection has not taken place within 30 days, and a bankruptcy case is subsequently filed, then the transfer occurs for preference purposes, immediately before the date of the commencement of the bankruptcy case.

### F. Valid Purchase Money Security Interests

Under the legislation, Section 547(c)(3)(B) expands the perfection period for purchase money security interests from 20 days to 30 days.

### G. Insider Preferences/Complete Repeal of *Deprizio*

Under the legislation, Section 547 of the Bankruptcy Code is modified to protect a noninsider creditor who received certain transfers from a debtor, which benefited an insider, between 90 days and one year prior to the commencement of the case. This completely eliminates preference risk to noninsider creditors with insider guarantees that arose under the Seventh Circuit's holding in the *Deprizio* case.

Under existing law, a trustee might avoid, as a preference, a security interest or lien granted to a noninsider creditor holding an insider's guaranty during the expanded 1 year preference period. The legislation addresses this risk by allowing a trustee to avoid the transfer, made between 90 days and 1 year before the date of the commencement of a bankruptcy case, by a debtor to the noninsider creditor for the benefit of the insider creditor, but such transfer is considered to be avoided under this section only with respect to the insider creditor.

## III. Chapter 11 Administration/Plan Process

### A. Creditors and Equity Security Holders Committees

The legislation modifies Section 1102(a) of the Bankruptcy Code to increase the bankruptcy court's powers relative to committees. The court will now have the power to determine any disputes with respect to membership on a committee. At the request of an interested party or parties, and after notice and a hearing, the bankruptcy court will now have the power to direct the United States Trustee to change the membership of a committee so that a committee's membership is made up of an adequate number of creditors or equity security holders in the Chapter 11 case.

The change also specifically allows the United States Trustee to add a small business concern to a creditors' committee if the court determines that such creditor's claim is of the kind represented by the committee and is disproportionately large when compared to the creditor's annual gross revenue. This is designed to enable small businesses to play a larger role in Chapter 11 cases.

In addition, the revisions require that a committee provide access to information for creditors who hold claims of the kind represented by that committee and who are not appointed to the committee. The committee is also required to solicit and receive comments from those creditors holding claims of the kind represented by that committee and who are not appointed to the committee. The legislation also enables the court to order the committee to provide additional information, disclosure or a report to those creditors holding claims of the kind represented by that committee and who are not appointed to the committee. This all raises confidentiality issues and might make it more difficult for a committee to obtain information from a debtor.

#### B. Appointment of Elected Trustee

Modifies Section 1104(b) (which permits creditors to elect a Chapter 11 trustee), to elaborate on the election procedure. It requires that the United States Trustee file a report certifying the election of a trustee by creditors in a Chapter 11 case. The trustee will be considered selected and appointed, and any previously appointed Chapter 11 trustee would be terminated, as of the date the report is filed. The court must also resolve any dispute arising out of the election of a trustee by creditors.

This subsection to Section 1104(b) is new.

#### C. Scheduling Conferences

Amends Bankruptcy Code Section 105(d) to provide that a bankruptcy court "shall" hold such status conferences as are necessary to further the expeditious and economical resolution of a case. Under existing law the bankruptcy court is given discretion over whether to hold status conferences regarding any case or proceeding under the Bankruptcy Code.

#### D. Expanded Grounds for Dismissal or Conversion and Appointment of Trustee

Modifies Section 1112(b) by expanding the grounds that a court can rely upon to dismiss a Chapter 11 case, convert a Chapter 11 case to a case under Chapter 7, or appoint a trustee or examiner in a Chapter 11 case. While this provision is included among the small business changes, it applies to all Chapter 11 cases.

A court is required to convert or dismiss a case (whichever is in the best interest of the estate) if a movant establishes "cause". The amended Section 1112(b) provides a non-exhaustive list of 16 factors that may be a basis for finding "cause." These are:

- (i) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;
- (ii) gross mismanagement of the estate;
- (iii) failure to maintain appropriate insurance that poses a risk to the estate or to the public;
- (iv) unauthorized use of cash collateral substantially harmful to 1 or more creditors;
- (v) failure to comply with an order of the court;
- (vi) unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;
- (vii) failure to attend the meeting of creditors convened under Section 341(a) or an examination ordered under Rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;
- (viii) failure to timely provide information or attend meetings reasonable requested by the United States Trustee (or the bankruptcy administrator, if any);
- (ix) failure to timely pay taxes owed after the commencement of the bankruptcy or to file tax returns due thereafter;
- (x) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by the Bankruptcy Code or by order of the court;
- (xi) failure to pay any fees or charges required under chapter 123 of title 28;
- (xii) revocation of an order of confirmation under Section 1144 of the Bankruptcy Code;
- (xiii) inability to effectuate substantial consummation of a confirmed plan;
- (xiv) material default by the debtor with respect to a confirmed plan;
- (xv) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and
- (xvi) failure of the debtor to pay any domestic support obligation that first become payable after the date of the filing of the bankruptcy case.

If the movant does establish cause, the court may only deny a motion to convert or dismiss the case if the debtor, or another party in interest, objects and establishes: (i) there is a reasonable likelihood that a plan will be confirmed within applicable timeframes; (ii) the grounds for

granting the relief include an act or omission for which there exists a reasonable justification; and (iii) such act or omission will be cured in a reasonable time, and the court identifies unusual circumstances that establish that conversion or dismissal is not in the best interests of creditors and the estate. However, where the “cause” is substantial and continuing loss or diminution of the estate and the absence of a reasonable likelihood of rehabilitation, the court cannot deny dismissal or conversion. This is a far more difficult burden of proof for debtors to satisfy to overcome a conversion/dismissal motion.

The legislation also expedites the disposition of conversion/dismissal motions. It requires the court to commence a hearing on a motion to dismiss or convert a Chapter 11 case not later than 30 days after the date the motion is filed. The court must decide the motion within 15 days after the commencement of the hearing. However, such hearing and ruling may be continued if: (i) the movant expressly consents to the continuance for a specific time; or (ii) compelling circumstances prevent the court from meeting these time requirements.

This amendment also modifies Section 1104(a) to permit a court to appoint a Chapter 11 trustee or examiner if grounds exist to convert or dismiss the Chapter 11 case under Section 1112 (as amended), and the court determines that the appointment of a trustee or examiner is in the best interests of creditors and the estate.

#### E. Committee Member Administrative Expenses

Modifies Section 503(b)(4) to exclude as administrative expenses, claims made by a member of a creditors’ or equity committee for professional services rendered by an attorney or an accountant retained by such a member. The existing caselaw is not clear whether committee members are entitled to administrative expense claims for fees associated with professional services (*i.e.*, legal and accounting) that were rendered to such member in connection with service on the committee.

#### F. No Section 341 Meeting In Prepackaged Chapter 11

Adds a new Section 341(e) to permit the court, on the request of a party in interest, after notice and a hearing, and for cause, to order the United States Trustee not to convene a Section 341 meeting of creditors or equity security holders if the debtor has filed a prepackaged plan for which the debtor had solicited acceptances prior to the commencement of the bankruptcy case.

#### G. Adequate Information For Disclosure Statement

Amends Section 1125(a)(1) to require that when a bankruptcy court considers whether a debtor’s disclosure statement contains adequate information, it must take into account the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost associated with providing any additional information. The disclosure statement must also discuss the potential federal tax consequences of the plan to the debtor, any successor of the debtor, and a hypothetical investor typical of the holders of claims or interests in the case that would enable such a hypothetical investor of the relevant class to make an informed judgment about the plan.

#### H. Postpetition Disclosure and Solicitation of Prepackaged Plans

Modifies Section 1125 to add a new Section 1125(g) to permit an entity to solicit acceptances or rejections of a plan from a holder of a claim or interest if the holder of such claim or interest was solicited before commencement of the bankruptcy case in a manner complying with applicable nonbankruptcy law, and to continue soliciting acceptances subsequent to the bankruptcy filing.

Under existing law, the solicitation of acceptances or rejections of a plan can be made after the bankruptcy filing only if such solicitation is accompanied by a court approved disclosure statement. This provision provides explicit statutory authority for a party to solicit acceptances or rejections prior to and after a bankruptcy case being filed, as is frequently done in a “prepackaged” Chapter 11 case.

#### I. Deadlines for Exclusivity Periods for Filing And Soliciting Chapter 11 Plan

Modifies Section 1121(d) by: (i) limiting the time for a debtor in a Chapter 11 case to have the exclusive right to file a Chapter 11 plan up to a maximum of 18 months following the commencement of the bankruptcy case; and (ii) limiting the time for a Chapter 11 debtor to have the exclusive right to solicit acceptances of a Chapter 11 plan the debtor had filed during its exclusivity period up to a maximum of 20 months. These deadlines cannot be further extended by the court.

Under current law, there is no statutorily imposed outside time limits for exclusivity period extensions that a court may grant. Upon the request of a party in interest, the court may reduce or increase the 120 day and 180 day periods during which only the debtor may file and solicit acceptances to the debtor’s plan. The court may grant requests for extensions of time of the exclusive periods for “cause”. While extensions of the exclusivity period still require a showing of “cause”, under amended Section 1121(d), the exclusivity period cannot be extended beyond the aforementioned 18 month and 20 month deadlines for filing and soliciting approval of a debtor’s plan.

This change may enhance the leverage of creditors seeking to take control of the plan process and the bankruptcy case by terminating exclusivity after the 18 and 20 month periods.

#### J. Modification of Plan

The legislation adds a new Section 1127(f) that clarifies that any modification of a plan must satisfy Sections 1121 through 1128 and the requirements of Section 1129. It further provides that the modified plan shall become the plan only after there has been disclosure as the court may direct under Section 1125, notice and a hearing on the modification, and court approval of the modification.

#### IV. Other Creditor Groups Favorably Impacted By The Legislation

##### A. Expanded Rights For Utilities

Modifies Section 366 to provide a more detailed definition of “assurance of payment” for purposes of what a debtor must provide to a utility in exchange for the utility’s continued service. Under a new subsection 366(c)(1)(A) “assurance of payment” means: (i) a cash deposit; (ii) a letter of credit; (iii) a certificate of deposit; (iv) a surety bond; (v) a prepayment of utility consumption; or (vi) another form of security agreed to by the utility and the debtor. It also states that an administrative expense claim does not constitute an adequate assurance of payment. The legislation allows a utility to alter, refuse or discontinue service, after 20 or 30 days (there is an inconsistency in Section 366) from the commencement of a Chapter 11 bankruptcy case if the utility does not receive adequate assurance of payment satisfactory to the utility.

On request of a party in interest, the court may order modification of the amount of an assurance of payment. However, in making such a determination of the adequacy of such payment, the court may not consider: (i) the absence of security before the commencement of the bankruptcy case; (ii) the debtor’s timely payments to the utility prior to the commencement of the bankruptcy case; or (iii) the availability of an administrative expense priority.

The amendment allows a utility involved in Chapter 11 cases to recover or set off its prepetition claim against any security deposit held by the utility prior to the date of commencement of the debtor’s Chapter 11 case, without notice or order of the court.

This amendment represents a significant modification to existing law concerning utility service to a Chapter 11 debtor. Under existing law, courts have established, through case law, the meaning of “assurance of payment.” In determining the meaning of this phrase, a significant number of jurisdictions have considered a debtor’s payment history prior to the commencement of the bankruptcy case, as well as any security deposits held by the utility providers. Often courts have determined that a utility’s protection through an existing cash deposit and the administrative expense claim a utility is entitled to for providing postpetition services amount to adequate assurance of payment. The legislation overrules this entire line of cases and afford utility providers far greater protections. It will also likely force debtors to increase payments to utilities.

##### B. Expanded Employee Wage and Benefit Priorities

Modifies Section 507(a)(3) and (a)(4) to increase the cap on the amount of the priority claims for employees’ wages, salaries, commissions and employee benefits, up to \$10,000. It also extends the period for determining such employees’ priority claims to compensation and benefits earned within 180 days of the commencement of the bankruptcy case or the date of cessation of the debtor’s business (whichever occurred first).

Under existing law, such employee wage, salary, commissions and benefit claims are afforded a priority status, subject to a \$4,925 cap, and only for the period 90 days prior to the

commencement of the bankruptcy case or the date of cessation of the debtor’s business (whichever occurred first).

The legislation provides a new first priority administrative expense claim to certain domestic support obligations, which is applicable only to individual debtors. Accordingly, all of the existing categories of priority claims (*e.g.*, administrative expenses, unsecured claims associated with the gap period in involuntary cases, employee claims, tax claims) have been moved down one level in priority. Existing Bankruptcy Code Section 507(a)(3) has been redesignated as Section 507(a)(4) and wages, salary and commissions claims subject to that section have been afforded a fourth priority and existing Section 507(a)(4) has been redesignated as Section 507(a)(5) and employee benefit claims subject to that section have been accorded a fifth priority.

##### C. Expanded Protection of Insurance Benefits to Retired Employees

Amends Bankruptcy Code Section 1114 by limiting a debtor’s ability to modify its retiree benefits plan in the 180-day period prior to the debtor commencing a bankruptcy case. The amendment adds a new subsection (l) to Section 1114, which provides that if the debtor modified the retiree benefits plan in the 180-day period prior to the commencement of the bankruptcy case, and the debtor was insolvent on the date the retiree benefits plan was modified, then a party in interest may bring a motion for an order reinstating the benefits. The bankruptcy court may issue an order reinstating the benefits as of the date the modifications were made, unless the bankruptcy court finds that the balance of the equities clearly favor such modifications. This change is designed to discourage debtors from evading the requirements of Section 1114 for modifying retiree benefits.

##### D. Nonresidential Real Property Lessors (See VI, C-D.)

#### V. Small Business Provisions

The small business changes are intended to expedite the disposition of the cases. They are in response to the expense of Chapter 11 and the inability of a small business to rehabilitate itself if it is burdened with a lengthy and expensive Chapter 11.

##### A. “Small Business”

The legislation modifies Section 101 of the Bankruptcy Code to define a “small business debtor” as a person engaged in commercial or business activities (excluding a person whose primary activity is owning or operating real property) and having noninsider/nonaffiliate, noncontingent liquidated secured and unsecured debts of not more than \$2 million as of the date of commencement of the bankruptcy case. However, “small business” status is lost if a creditors’ committee is appointed and remains active.

Under existing law, a small business may elect to be considered a small business. There is no such election provision under the amended Section 1121(e).

#### B. Flexible Rules for Disclosure Statement and Plan

Modifies Section 1125(a)(1) of the Bankruptcy Code by making certain procedures easier for small business cases that will speed up the case. This section allows the bankruptcy court to dispense with the requirement of a disclosure statement in cases in which: (i) the debtor is classified as a small business; and (ii) when the debtor's plan itself provides adequate information. In a small business case, the court may approve a disclosure statement that has been submitted on standard forms approved by the court or adopted under 28 U.S.C. § 2075, may conditionally approve a disclosure statement to be submitted to creditors with the plan and ballot subject to final approval after notice and a hearing, and may combine the hearing on approval of the disclosure statement with the confirmation hearing. A small business debtor could also solicit acceptances or rejections of a plan based on a conditionally approved disclosure statement, provided it is mailed not later than 25 days prior to the confirmation hearing.

#### C. Standard Form Disclosure Statement and Plan

Under the legislation, the Judicial Conference of the United States is directed to propose standard forms for use in disclosure statements and reorganization plans for small business filers.

#### D. Uniform National Reporting Requirements

Adds a new Bankruptcy Code Section 308, instituting supplemental reporting requirements for small business debtors. A small business debtor will now be required to file periodic financial and other reports containing information that includes: (i) the debtor's profitability; (ii) the debtor's projected cash receipts and disbursements over a reasonable period; and (iii) comparisons of actual cash receipts and disbursements with projections in prior reports. A small business debtor must also state in the report whether it is in compliance with all applicable bankruptcy laws and whether it is timely filing tax returns and required government filings. Additionally, a small business debtor must report if it is timely paying taxes and other administrative expenses when due.

If a small business debtor is not timely making required government filings and/or required tax and other administrative payments, the debtor must report this and state how, at what cost, and when the debtor intends to remedy the default. The effective date of this provision is 60 days after the date of promulgation of the Bankruptcy Rules required under this provision.

#### E. Duties in Small Business Cases

The legislation adds a new Section 1116 to Chapter 11 that mandates additional duties for a debtor in a small business case. The additional duties for a small business filer are:

- (i) the most recent balance sheet, statement of operations, cash-flow statement and federal income tax return must be filed with a voluntary chapter 11 petition. Alternatively, a statement under penalty of perjury must be filed stating that no

balance sheet, statement of operations, or cash-flow statement has been prepared and no federal income tax return has been filed;

- (ii) the debtor must attend meetings scheduled by the court or the United States Trustee, including the initial debtor interview by the United States Trustee, the meeting of creditors, and scheduling conferences, unless the court, after notice and hearing, waives this requirement;
- (iii) the debtor timely file all schedules and statements of financial affairs, unless the court grants an extension of not more than 30 days, and any extension beyond 30 days must be based on extraordinary and compelling circumstances;
- (iv) the debtor file all postpetition financial and other reports required by the Bankruptcy Rules or local rules;
- (v) the debtor maintain insurance customary and appropriate to the debtor's industry;
- (vi) the debtor timely file tax returns and other required government filings;
- (vii) the debtor timely pay all taxes except those being appropriately contested; and
- (viii) the debtor allow the United States Trustee, or a designated representative, to inspect the debtor's premises, books and records at reasonable times and upon reasonable notice.

#### F. Plan Filing and Confirmation Deadlines

Modifies Section 1121(e) regarding the period of time for a small business debtor to file and confirm a plan. It provides that a small business debtor has the exclusive right to file a plan for the first 180 days following the commencement of the bankruptcy case. This period may be extended after a notice of hearing if: (i) the debtor demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time; (ii) a new deadline is imposed at the time the extension is granted; and (iii) the order extending the time is approved before expiration of the existing deadline. Alternatively, the 180 day period may be extended if the court so orders "for cause", an easier standard. The amendment further requires that a small business debtor must file a plan and a disclosure statement (if any) within 300 days of the commencement of the bankruptcy case, subject to extension only if the small business debtor satisfies the tougher requirements contained in (i), (ii) and (iii) above. The passage of these deadlines would result in the debtor's inability to confirm a plan and be grounds for conversion of the case to Chapter 7 or dismissal.

Under existing law, only the debtor may file a plan for the first 100 days following the date of the commencement of the bankruptcy case and all plans must be filed within 160 days after of the date of the commencement of the bankruptcy case. The 100 day and 160 day time periods may be reduced by the court, for cause, upon the request of a party in interest made within the respective periods. The court may increase the 100 day exclusive period if the debtor shows that

the need for an increase was caused by circumstances for which the debtor should not be held accountable.

#### G. Plan Confirmation Deadline

Modifies Section 1129 by requiring that the court confirm a plan in a small business case not later than 45 days from the date the plan is filed, provided the plan complies with all applicable provisions of the Bankruptcy Code. This 45 day period may only be extended if: (i) the debtor demonstrates by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time; (ii) a new deadline is imposed at the time the extension is granted; and (iii) the order extending the time is signed before the existing deadline expires.

This is a new subsection to Section 1129. Under current law there is no provision that specifically provides a deadline for plan confirmation in a small business case.

#### H. Serial Filer Provisions

The legislation amends Section 362 of the Bankruptcy Code by adding a new subsection (n), applicable only to small business cases. The amendment provides the automatic stay does not apply in a case in which the debtor: (i) is a debtor in a small business case; (ii) was a debtor in a small business case that was dismissed by an order that became final in the two-year period ending on the commencement of the current bankruptcy case; (iii) was a debtor in a small business case in which a plan was confirmed in the two-year period ending on the commencement date of the current bankruptcy case; or (iv) is an entity that acquired substantially all the assets or business of a small business debtor described in (i) through (iii), above (unless the entity can establish that it acquired substantially all of such assets or such business in good faith).

However, the new subsection (n) does not apply to an involuntary bankruptcy filing where there was no collusion between the debtor and petitioning creditors, or where the debtor can prove: (i) the filing of the petition resulted from circumstances beyond the control of the debtor not foreseeable at the time the case then pending was filed; and (ii) it is more likely than not that the court will confirm a feasible plan, but not a liquidating plan, within a reasonable period of time.

### VI. Leases and Executory Contracts

#### A. Personal Property Leases

Modifies Bankruptcy Code Section 365 by adding a new subparagraph (p), which automatically terminates the automatic stay with respect to a lease of personal property that is rejected or not timely assumed by the debtor under Bankruptcy Code Section 365(d).

For individuals filing Chapter 7 cases, the debtor may notify the creditor, in writing, that the debtor intends to assume the lease of personal property. The creditor may, at its option, notify

the debtor that the creditor is willing to have the lease assumed and may condition the assumption on the cure of any outstanding default by the terms set forth in the lease contract.

For cases under Chapter 11 where the debtor is an individual (and in Chapter 13 cases), if the debtor is a lessee of personal property and the lease is not assumed by the plan, then the lease is deemed rejected at the conclusion of the confirmation hearing.

#### B. Defaults Based on Nonmonetary Obligations

Modifies Section 365(b)(1)(A) by providing that a debtor need not cure a nonmonetary default arising from a debtor's failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure the default by performing such nonmonetary acts at and after the time of assumption. However, if a default arises from the debtor's failure to operate in accordance with a nonresidential real property lease (such as a going dark clause that prohibits a debtor from suspending its business at the premises), the default must be cured by performance at and after assumption in accordance with the lease (*e.g.* resumption of business), and all pecuniary losses from such default must be compensated in accordance with Section 365(b)(1).

The legislation further provides in Section 365(b)(2)(D) that a debtor's obligation to cure defaults under an assumed executory contract or lease does not apply to a debtor's breach of a penalty rate or penalty provision relating to a default arising from the debtor's failure to perform nonmonetary obligations under an executory contract or lease. There appears to be an inconsistency between Section (b)(1)(A), which requires the cure of a default for the failure to operate in accordance with a non-residential real property lease at the time of assumption, and Section 365(b)(2)(D), which provides that such default does not have to be cured as a condition to assumption. There is also a question whether this provision deals with the line of cases that preclude a debtor's assumption of an executory contract where there were prepetition nonmonetary defaults that are impossible to cure.

The legislation also modifies Bankruptcy Code Section 1124(2)(a) to allow as "unimpaired", for plan purposes, claims that meet the requirements above regarding nonmonetary defaults (*i.e.*, where such nonmonetary defaults do not have to be cured). A claim that arises by reason of a debtor's failure to perform a nonmonetary obligation is impaired unless the creditor is compensated for any actual pecuniary loss arising from such failure, and with respect to a nonmonetary default arising from the breach of a nonresidential real property lease, also, unless such default is cured by performance at and after assumption in accordance with the lease.

The amendment also makes technical amendments to Section 365 by deleting provisions relating to aircraft leases, which are no longer effective.

#### C. Limitation on Extension of Time To Assume or Reject Non-Residential Real Property Leases

Modifies Section 365(d)(4) to provide that a debtor must assume or reject an unexpired lease of nonresidential real property by the earlier of: (i) 120 days from the date of the commencement of the bankruptcy case; and (ii) the date of confirmation of a plan. The debtor's failure to assume or reject a lease by such date will result in the lease being deemed rejected. A court may extend



the deadline set forth above for up to one additional 90 day period, upon motion of the debtor or lessor, for cause shown. Such extension must be granted prior to the expiration of the original 120 day period. The court may only grant subsequent extensions upon the prior written consent of the lessor for each such extension.

Under existing law, a debtor has 60 days from the commencement of the bankruptcy case to assume or reject a nonresidential real property lease. This 60 day period can be extended for cause, giving the court virtually carte blanche power to grant multiple extensions. If the debtor does not assume or reject such lease within the initial 60 day or any extended period, the lease will be deemed rejected. There is currently no outside limit on the amount of time the initial 60 day period can be extended or how many extensions a bankruptcy court may grant. Moreover, under current law, the court may grant an extension of time for a debtor to assume or reject a lease over the objection of a lessor. It has become common practice in large Chapter 11 cases for a court to extend the debtor's time to assume or reject a nonresidential real property lease until the confirmation of a plan.

The legislation strips the bankruptcy court of the authority to grant extensions of time to assume or reject a nonresidential real property lease outside the 210 day period absent the lessors' written agreement. This will greatly expand a lessor's ability to force a debtor to decide early in a case whether to assume or reject commercial leases by denying the court any discretion to extend the debtor's time to assume or reject the lease after the maximum 210 day period, without the lessor's written consent. This could make it far more difficult for a debtor, particularly a retail debtor, to reorganize, forcing a premature decision to either assume burdensome leases that, if later rejected, could saddle the estate with substantial administrative debt, or reject valuable leases.

In addition, the legislation modifies Bankruptcy Code Section 365(f)(1) to clarify that in order for a debtor to assign a contract or lease under Section 365, the debtor must comply with the assumption requirements under Section 365(b), such as complying with use clauses where a lease of real property in a shopping center is assumed or assigned.

#### D. Limits On Administrative Priority Claim For Landlords On Assumed Leases

Modifies Section 503(b) to add a new Section 503(b)(7) that contains a new administrative expense claim related to a nonresidential real property lease that is assumed under Section 365 and subsequently rejected. The amount of the allowed administrative claim arising from the debtor's rejection of a previously assumed nonresidential real property lease is equal to all monetary obligations due (excluding those relating to failure to operate or a penalty provision) for a period of two years following the later of: (i) the rejection date; or (ii) the date of actual turnover of the premises. Such claim cannot be subject to reduction or setoff for any reason, except for amounts actually received or to be received from a nondebtor entity. The lessor's claim for the balance of rejection damages beyond this 2-year period will be treated as a general unsecured claim subject to the cap contained in Section 502(b)(6).

This is a new provision. Under existing Section 365(g)(2), all sums due under an assumed and subsequently rejected lease could be granted an administrative priority status.

#### VII. Other Significant Real Estate Provisions

##### A. New Definition of Single Asset Real Estate. The Single Asset Real Estate Provision Will Now Cover Larger Real Estate Developments

The legislation amends Section 101(51B) of the Bankruptcy Code by discarding the prior \$4.0 million debt cap. "Single asset real estate" is now defined as real property constituting a single property or project, other than residential real property, with fewer than 4 residential units, which generates substantially all of the gross income of a debtor that is not a family farmer and on which no substantial business is being conducted by a debtor other than the business of operating the real property and related activities.

##### B. New Section 362(d) Ground For Relief of the Automatic Stay

The legislation amends Section 362(d) of the Bankruptcy Code to reduce abusive filings. It adds new grounds for a creditor whose claim is secured by an interest in real property to obtain relief from the automatic stay if the court finds that the filing was done as part of a scheme to delay, hinder and defraud creditors that involves either: (i) a transfer of all or part of an ownership interest in real property without the creditor's consent or without court approval; or (ii) multiple bankruptcy filings affecting the real property. If a court order entered under this new section has been recorded properly under applicable state law, the order is binding in any other bankruptcy case for 2 years from the date of entry of the order. However, a debtor may move for relief from such order if it can show changed circumstances or good cause.

##### C. Amendment to Section 362(d)(3) of the Bankruptcy Code

The legislation amends Section 362(d)(3) of the Bankruptcy Code by requiring a court to grant relief from the automatic stay within the later of a new 30 day period after it has determined the debtor to be a "single asset real estate" entity or the existing 90 day period after commencement of the bankruptcy case. Unless, (i) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or (ii) the debtor has commenced monthly payments. The legislation also amends Section 362(d)(3) by providing that monthly payments made to each of the debtor's creditors who hold liens on the debtor's real property (excluding claims secured by a judgment lien or unmatured statutory lien) must be in amounts equal to interest at the then applicable non-default contract rate of interest on the value of the creditor's interest in the real estate. This represents a change from current law where the interest payments are based on the current fair market value of the creditor's interest in the real property. The debtor is permitted to make these payments from either rents or other proceeds that are generated by the real property.

##### D. Amendment to Section 362(b) of the Bankruptcy Code

Modifies Section 362(b) to expand the existing exceptions to the automatic stay, which comes into existence upon the commencement of a bankruptcy case. The amendment excepts from the automatic stay, under limited circumstances, the continuation of any eviction proceeding or

similar action by a lessor against a residential tenant debtor, which involves a lease or rental agreement, for which the lessor had obtained (prior to the commencement of the bankruptcy case) a judgment for possession of the property. The amendment provides a detailed procedure for a debtor to oppose the continuation of eviction and procedures for lessors to respond to such opposition.

#### VIII. Bankruptcy Abuse Prevention

##### A. New Two-Year Residency Requirement To Determine Exemptions.

New Section 522(b)(3) states that the state or local law governing a debtor's exemptions is where the debtor was domiciled for the 730 days before the commencement of the bankruptcy case, and if the debtor was not domiciled in a single state for that period, where the debtor was domiciled for the majority of the 180-day period preceding the 730<sup>th</sup> day.

##### B. Reduction of Homestead Exemption for Fraud

Under the legislation, Section 522 of the Bankruptcy Code is amended by reducing the value of a debtor's interest in the following properties that could be claimed as exempt in certain circumstances:

- (i) Real or personal property that the debtor (or a dependent of the debtor) uses as a residence;
- (ii) A cooperative that owns property, that the debtor (or a dependent of a debtor) uses as a residence;
- (iii) A burial plot for the debtor (or a dependent of the debtor);
- (iv) Real or personal property that the debtor or a dependent of the debtor claims as a homestead; and
- (v) Retirement funds that are exempt from taxation under sections 401, 403, 408, 408A, 414, 457, or 501(a) of the Internal Revenue Code of 1996.

The legislation states that when nonexempt property has been converted into exempt property within 10 years preceding a bankruptcy filing, the exemption must be reduced to the extent such value was acquired with the "intent to hinder, delay, or defraud a creditor".

##### C. Limitations on Homestead Exemption

A debtor will still have the ability to choose state or local law exemptions rather than federal exemptions when filing its Chapter 7 case. For those debtors choosing state exemptions, Section 522 of the Bankruptcy Code is modified to provide:

"...a debtor may not exempt any amount of interest that was acquired by the debtor during the 1215-day period preceding the date of the filing of the petition that exceeds in the aggregate \$125,000 in value in—

- (A) real or personal property that the debtor or a dependent of the debtor uses as a residence;
- (B) a cooperative that owns property that the debtor or a dependent of the debtor uses as a residence;
- (C) a burial plot for the debtor or a dependent of the debtor; or
- (D) real or personal property that the debtor or dependent of the debtor claims as a homestead."

This limitation does not apply to a family farmer for the principal residence of such farmer.

Further, this limitation does not apply to any interest of the debtor in a prior principal place of residence (acquired prior to the 1215 day period) which is transferred into the current principal place of residence of the debtor.

If a debtor chooses its local or state law exemptions, which may be more expansive than the federal exemptions, the Bankruptcy Code is modified so that a debtor may not claim more than \$125,000 as a homestead exemption if:

- (i) (A) the court determines, after notice and a hearing, that the debtor has been convicted of a felony, which under the circumstances, demonstrates that the filing of the case was an abuse of the provisions of this title; or
- (ii) (B) the debtor owes a debt arising from—

(a) any violation of the Federal securities laws (as defined in section 3(a)(47) of the Securities Exchange Act of 1934), any State Securities laws, or any regulation or order issued under Federal securities laws or State Securities laws;

(b) fraud, deceit, or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under section 12 or 15(d) of the Securities Exchange Act of 1934 or under section 6 of the Securities Act of 1933;

(c) any civil remedy under section 1964 of title 18; or

(d) any criminal act, intentional tort, or willful or reckless misconduct that caused serious physical injury or death to another individual in the preceding 5 years.

#### D. Limitation on Luxury Goods

The Bankruptcy Code is modified to provide specific limits for assets of a debtor that are deemed to be luxury goods. Luxury goods that are now presumed to be nondischargeable include:

- (i) consumer debts owed to a single creditor and aggregating more than \$500 for luxury goods or services incurred by an individual debtor on or within 90 days before the commencement of the bankruptcy case; and
- (ii) cash advances aggregating more than \$750 that are extensions of consumer credit under an open end credit plan obtained by an individual debtor on or within 70 days before the commencement of the bankruptcy case.

#### E. Extension of Period Between Bankruptcy Discharges

Section 727(a)(8) of the Bankruptcy Code is amended to increase the period of time that must pass before a debtor may be granted a subsequent Chapter 7 discharge, after having been previously granted a chapter 7 or 11 discharge, from six years to eight years.

#### F. Delay of Discharge During Pendency of Certain Proceedings

The Bankruptcy Code is modified by amending Section 727(a) to provide that in the event the court finds that any of the fraud, deceit, violations of securities laws or any criminal or intentional act (as contained in new Section 522(q)), exists or if there is a proceeding to determine same, then the debtor will not be granted a discharge during the pendency of that proceeding.

#### G. Limitation on Retention Bonuses, Severance Pay, and Certain Other Payments

The legislation imposes severe restrictions on postpetition compensation, bonuses and severance known as "Key Employee Retention Plans" or "KERPs". It modifies Section 503 to restrict the circumstances under which transfers may be made to, or for the benefit of, an insider (e.g., officer, director) of the debtor in order to induce such insider to remain with the debtor's business. The legislation requires that, prior to such transfer being allowed or paid, the court must find: (i) the transfer is essential to retention because the insider has a *bona fide* job offer from another business (at the same or greater compensation rate); (ii) the services of the insider are essential to the survival of the business; and (iii) either:

- (x) the transfer is not greater than 10 times the amount of the mean transfer or obligation of a similar kind given to non-management employees during the calendar year in which the transfer is made or obligation is incurred; or
- (y) if no such non-management transfers were made, the amount of the transfer to the insider is not more than 25% of any similar transfer or obligation made to or incurred for the benefit of

such insider during the calendar year prior to the year in which the transfer is made or obligation is incurred.

The legislation further modifies Section 503 by disallowing severance payments to an insider unless: (i) the severance payment is part of a program generally applicable to all full-time employees; and (ii) the severance amount is not more than 10 times the amount of mean severance pay given to non-management employees during the calendar year in which this payment is made.

The legislation further prohibits any other transfers or obligations that are outside the ordinary course of business and not justified by the circumstances of the case (including transfers to officers, managers or consultants hired after the date of the commencement of the bankruptcy case). This is designed to limit compensation to turnaround firms that often install their employees as officers and other management personnel.

#### H. Fraudulent Transfers and Obligations

Modifies Section 548 of the Bankruptcy Code by enabling the trustee to recover avoidable transfers and excessive prepetition compensation, such as bonuses, paid to insiders of a debtor. It effectuates two changes to current law that would make it easier for a trustee to avoid prepetition transfers as fraudulent conveyances. First, it extends Section 548's one-year reach-back period for fraudulent conveyances to two years. It also amends Section 548(a) to clarify that it permits the recovery of any transfer to or an obligation incurred for the benefit of an insider under an employment contract, and not in the ordinary course of business, if the debtor did not receive reasonably equivalent value.

The legislation further modifies Section 548 by adding a new subparagraph (e) to allow a debtor to use its Chapter 5 avoidance powers to avoid any transfer of an interest of the debtor in property that was made within 10 years of the date of commencement of the bankruptcy case if the: (i) transfer was made to a self-settled trust or similar device; (ii) transfer was made by the debtor; (iii) debtor was a beneficiary of the trust; and (iv) debtor made the transfer with actual intent to hinder, delay or defraud a present or future creditor. The amendment clarifies that a transfer avoidable by this new subsection includes transfers in anticipation of a money judgment, settlement, civil penalty or fine for violation of securities laws, regulations or order or in connection with the purchase or sale of a security under specified provisions of federal security laws.

#### I. Appointment of a Chapter 11 Trustee in Cases of Suspected Fraud

Modifies Section 1104 by adding a new subsection (e) that requires the United States Trustee to make a motion for the appointment of a trustee in a Chapter 11 case if there are reasonable grounds to suspect that:

- (i) current members of the debtor's governing body;

- (ii) the debtor's CEO or CFO; or
- (iii) the members of the governing body who selected the debtor's CEO or CFO

participated in actual fraud, dishonesty or criminal conduct in the management of the debtor or the debtor's public financial reporting. This requirement is new and is in response to cases like Enron, WorldCom and Adelphia, where allegations of fraud by prepetition management were raised.

#### J. Expanded Grounds To Object to Dischargeability Of Claims Against Individual Debtors

Expands Section 523(a)(19), which makes nondischargeable certain debts that result from the violation of any federal securities law, state securities, law, or any regulation or order issued under such federal or state securities law, as follows:

##### § 523. Exceptions to discharge

(a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt--

(19) that—

(B) results from—, before, on, or after the date on which the petition was filed, from—

- (i) any judgment, order, consent order, or decree entered in any Federal or State judicial or administrative proceeding;
- (ii) any settlement agreement entered into by the debtor; or
- (iii) any court or administrative order for any damages, fine, penalty, citation, restitutionary payment, disgorgement payment, attorney fee, cost, or other payment owed by the debtor.

Section 523(a)(19) was originally added by the Sarbanes-Oxley Act in 2002. The effective date of this amendment is unclear. The specific section of the legislation that modifies Section 523(a)(19) makes the amendment retroactively effective to July 30, 2002 (the date of enactment of the Sarbanes-Oxley Act). However, the provision of the legislation concerning effective dates provides that Section 523(a)(19) is effective on the date of the legislation's enactment, as discussed below.

#### IX. Effective Date of Statute

Sections 1406 and 1501 of the legislation address the effective date of the legislation.

Generally, the effective date of the additions and amendments made to the Bankruptcy Code by the legislation will become effective on **October 17, 2005** (180 days after the date of enactment of the legislation). The date of enactment is April 20, 2005, the date President Bush signed the legislation into law. This transition period could induce struggling companies to file Chapter 11 under the existing more pro-debtor statute.

For the most part, the legislation has no retroactive effect. Therefore, virtually all additions and amendments to the Bankruptcy Code only impact those cases filed on or after October 17, 2005.

There are some exceptions to the general effective date of the statute, a few of which are of interest to commercial credit grantors:

- (i) The homestead exemption reductions and limitations, as a result of fraud or bankruptcy abuse, are effective April 20, 2005;
- (ii) The filing requirements for small business debtors takes effect 60 days after the enactment of the Bankruptcy Rules governing such requirements. This is a time period afforded to enable new forms to be properly created for compliance with the filing requirements;
- (iii) The provision permitting the recovery of a preference involving an insider only from that insider, and not from a noninsider creditor, applies to any case that is pending or commenced on or after April 20, 2005;
- (iv) The provision expanding the fraudulent transfer provision under Bankruptcy Code Section 548 from one year to two years applies only to cases filed one year after April 20, 2005. The avoidability of improper transfers to insiders under an employment contract is effective on April 20, 2005 and applies to cases filed on and after that date.
- (v) The provision requiring the United States Trustee to move for the appointment of a trustee in the case of fraud, criminal conduct or dishonesty by corporate officers is effective on April 20, 2005, but applicable only to cases filed on or after that date.
- (vi) The provision regarding involuntary cases (see X below); and
- (vii) The increase in the wage and benefits priority cap to \$10,000 for earnings and benefits within the expanded 180 day period is effective on April 20, 2005 for cases filed on or after that date.

#### X. Involuntary Proceedings

Modifies Section 303 to define eligibility requirements for a creditor to qualify to file an involuntary bankruptcy petition. The amendment provides that for cases in which there are more than 12 creditors of the potential debtor, where three or more creditors may file an involuntary petition, each such creditor must hold a claim that is not contingent as to liability and not the subject of a bona fide dispute "as to liability or amount." Such "noncontingent, undisputed" claims must total at least \$12,300 more than any liens securing such claims. The amendment changes existing law by requiring such claims to be undisputed, noncontingent, and not subject to bona fide dispute as to liability or amount.

This amendment takes effect on April 20, 2005 and applies to all cases commenced before, on or after that date. Significantly, this will retroactively apply to pending involuntary cases.

XI. Miscellaneous

A. Dismissal or Conversion of Chapter 7 – The Means Test

The primary focus of, and much of the publicity surrounding, the legislation is in the consumer provisions and, in particular, the means test that debtors must pass in order to qualify for Chapter 7 and the ultimate prize for debtors: the bankruptcy discharge. The trustee or any creditor can obtain dismissal of an individual debtor's Chapter 7 case, or with the debtor's consent, conversion to a Chapter 11 or 13 case, based on a showing that the bankruptcy filing was an "abuse" of the provisions of the Chapter 7. Very briefly, pursuant to Section 707(b) "abuse" is presumed if an individual debtor's income exceeds the median income of the debtor's state and either: (i) the debtor has available net income, calculated based on the debtor's average monthly income during a defined 6 month period and then deducting specified sums, and then multiplying that net amount by 60, for repayment to creditors totaling at least \$10,000 over 5 years; or (ii) if such available net income for repayment to creditors over 5 years is between \$6,000 and \$10,000, such available net income is more than 25% of nonpriority unsecured claims.

The presumption of abuse is subject to rebuttal if the debtor proves "special circumstances" that decrease income or increase expenses to allow the debtor to satisfy the "means test".

B. Consumer Privacy Ombudsman In Connection With Bankruptcy Sales Involving Privacy Issues

Over the last several years, there has been an increased concern that a sale of assets of a debtor could have a negative impact on consumers. This issue began to emerge as proprietary lists of customers became a popular asset of a debtor that could be sold at great value. Many of the issues concern the rights of individuals to have their personal information remain private.

Section 363 of the Bankruptcy Code (that governs bankruptcy sales) is now modified to add a provision for the appointment and compensation of a consumer privacy ombudsman when a hearing is to be held on a sale or lease of a debtor's assets that could impact these privacy rights.

The ombudsman may appear at the hearing and will be expected to provide the court with information to assist the court in the determination of whether to approve a sale of assets. The information to be provided to the court will generally describe the facts, circumstances and conditions of the proposed sale or lease of personally identifiable property. It is anticipated that the report of the ombudsman will include the following type of data:

- (i) the debtor's privacy policy;
- (ii) the potential losses or gains of privacy to consumers if such sale or such lease is approved by the court;
- (iii) the potential costs or benefits to consumers if such sale or such lease is approved by the court; and

- (iv) the potential alternatives that would mitigate potential privacy losses or potential costs to consumers.

It is important to note that the personally identifiable information that is obtained by the ombudsman will not be publicly disclosed. The impact that this change will have on commercial grantors remains to be seen. However, it is the hope that this modification will enable Chapter 11 debtors to sell or lease their property without contested battles in the court because of the protections afforded by this consumer privacy ombudsman.

C. Giving Creditors Fair Notice in Chapter 7 and 13 Cases

Modifies Section 342 to significantly expand the noticing obligations that a debtor has to its creditors. It requires that, if within 90 days of the commencement of the bankruptcy case, a creditor supplies the debtor in at least 2 communications sent to the debtor with the current account number of the debtor and the address at which such creditor requests to receive such correspondence, then any notice the debtor may be required to send to such creditor must be sent to such address and include such account number.

For Chapter 7 and Chapter 13 cases, where the debtor is an individual, a creditor may at any time both file with the court and serve on the debtor a notice of address to be used to provide notice to the creditor in the case.

A monetary penalty may not be imposed on a creditor for a violation of the automatic stay provisions of Section 362(a) unless the conduct that is the basis for such violation occurs after the creditor receives notice in accordance with the procedures outlined above.

The legislation also modifies Section 521 by adding a new subparagraph (e), which requires an individual debtor in a Chapter 7 or Chapter 13 case to provide to the trustee, not later than 7 days prior to the first meeting of creditors, a copy of the debtor's federal income tax return for the most recent tax year ending immediately before the commencement of the bankruptcy case and for which a federal income tax return was filed. The debtor is also required to simultaneously provide copies of such tax returns to any creditor that makes a timely request of the debtor. The debtor, at the request of the court, United States Trustee, or any party in interest, must also provide copies of federal tax returns and amendments filed with the taxing authority that were not filed for the three year period preceding the date of commencement of the bankruptcy case.

In Chapter 13's, there is also an expanded disclosure requirement concerning a debtor's income and expenditures in the prior tax year and the debtor's monthly income.

D. Sense of Congress Regarding Expansion of Rule 9011 of the Federal Rules of Bankruptcy Procedure

Not a specific amendment, but instead expresses the sense of Congress that Bankruptcy Rule 9011 should be modified to require all documents (including schedules), signed and unsigned, submitted to the court or to a trustee, by *pro se* debtors and debtors represented by attorneys, be

submitted only after a debtor or its attorney makes reasonable inquiry to verify that information in such document is:

- (i) well grounded in fact; and
- (ii) warranted by existing law or a good faith argument for the extension, modification, or reversal of existing law.

E. Creditor Representation at First Meeting of Creditors

Modifies Section 341(c) to provide that a creditor holding a consumer debt (or any representative of the creditor) is permitted to appear at or participate in the meeting of creditors in a case under Chapter 7 or Chapter 11, either alone or in conjunction with an attorney for such creditor. This provision applies notwithstanding any local rule or applicable nonbankruptcy law or other requirement that representation at a meeting of creditors be by an attorney. The amendment clarifies that nothing in Section 341(c), as modified, shall be construed to require any creditor to be represented by an attorney at any meeting of creditors.

F. Ancillary and Other Cross-Border Cases

The legislation provides for a new Chapter 15 to the Bankruptcy Code to address issues concerning multinational bankruptcy cases. The new Chapter 15 incorporates the Model Law on Cross-Border Insolvency, which was promulgated by the United Nations, to provide mechanisms to deal with cross-border insolvency. Chapter 15 is intended to establish cooperation between United States courts, trustees and debtors and their foreign counterparts. It also prescribes guidelines for: (i) access of foreign representatives and creditors to federal and state courts; (ii) recognition of a foreign proceeding and relief; (iii) cooperation and communication with foreign courts and representatives; and (iv) concurrent proceedings and the coordination of foreign and domestic proceedings. As a result of this change, more foreign companies might utilize the United States Bankruptcy Courts.

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