

The Credit Professional's Guide to the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

By

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THE CREDIT PROFESSIONAL'S GUIDE TO THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

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INTRODUCTION

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. This law contains the most significant and far-reaching changes to the bankruptcy laws since the enactment of the Bankruptcy Reform Act of 1978, which with relatively minor changes has determined the rights and liabilities of debtors and creditors in bankruptcy cases for the past 25 years.¹ Most of the provisions of the new law do not become effective until October 17, 2005, although a few of the provisions are effective now.

It is apparent both from a reading of the new law and its legislative history that Congress intended to clamp down on perceived abuses by debtors of all types. Most of the abuses focus on the individual debtor, but there are significant changes designed to deal with small business debtors and cases involving large, publicly traded companies, where news accounts have related stories of fraud by management, unreasonably large compensation packages to management and cases that seem to drag on forever.

The materials are designed to highlight for the credit professional those provisions that he or she will find most important and relevant in navigating through the new law. They are not intended to provide a thorough analysis of the new law or to cover every provision of the law. Moreover, the nature of new legislation – and particularly bankruptcy legislation – makes it impossible to answer all of the questions that the reader of these materials may have.

Many of the new law's provisions are vague or uncertain of interpretation. This, in part, is because some of the laws' uncertainties are intended to be filled in upon the adoption by the Supreme Court of amendments to the Federal Rules of Bankruptcy Procedure, and new Official Forms for use in bankruptcy proceedings. Still many of the issues raised by the new law will not be addressed by the Bankruptcy Rules or Forms, but instead will have to await judicial interpretation. Others that may appear to be clear may be interpreted differently by the courts, as they grapple with the effect of the law on "live" bankruptcy cases.

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¹ The Bankruptcy Reform Act of 1978 went into effect on October 1, 1979.

These materials, therefore, should be viewed as a starting point to help the credit professional to orient himself or herself to the new law. Attention should be paid as the law develops in the coming months so he or she can adapt policies and procedures to what certainly will be a rapidly changing landscape in the bankruptcy arena.

GENERAL PROVISIONS

Notices To and By Creditor

All notices given to creditors must contain the last four digits of the debtor's taxpayer identification number. If the notice concerns an amendment adding the creditor to the schedules, the notice must contain the full tax identification number, although the document filed with the court need include only the last four digits. If the notice is that schedules have been amended to add a creditor, then the notice to that creditor shall contain the complete taxpayer identification number, although the notice that is filed with the court shall only contain the last four digits.

If within 90 days prior to the filing of the bankruptcy petition a creditor sends the debtor at least two "communications" with the current account number and the address at which the creditor desires to receive correspondence, the debtor must send notices to that address and the notices must reference the account number. The term "communications" is not defined. Is it sufficient if the creditor's invoice or monthly statement contains a standard notice stating where all communications should be sent?

The foregoing applies to all cases. In an individual Chapter 7 or Chapter 13 case, the debtor and the court are required to send notices to any address contained in a notice of address *filed with the court and served on the debtor*. Such notice of address becomes effective five days after it is filed.

The new law now has a procedure to ensure that creditors repeatedly appearing in consumer bankruptcy cases have notices sent to one central address. To take advantage of this provision, the creditor would file a notice with the court of the address to which notices in all Chapter 7 and Chapter 13 individual cases should be sent.

The consequences of the failure to provide notices at the addresses to which the creditor has given notice are that a "monetary penalty" may not be imposed against the creditor for:

- Violating the automatic stay.
- Failing to turn over property of the estate to the trustee.
- Transferring property of the estate.

- Paying a debt it owes to the debtor directly to the debtor, rather than the trustee.

Ultimately, the consequences for failure to provide notice at the address required by the new amendments do not appear to be significant. First, it is doubtful that courts will be kind to creditors that take actions knowing of the bankruptcy, but resting on the technicality that they did not receive notice at the location specified in the statute. Second, the statute insulates the creditor from a “monetary penalty”, which is not a defined term. One could imagine that the court could require the creditor to pay compensatory damages, but not require the creditor to pay punitive damages.

Priorities

Three changes were made to what constitute prepetition priority claims:

- Allowed unsecured claims for domestic support obligations are now afforded first priority, even ahead of administrative claims (such as trustee’s and attorney’s fees).
- The limit on wage priority claims has been expanded in dollar amount from \$4,925 to \$10,000 and the time period during which unpaid wages will be afforded priority has been extended from 90 days to 180 days prior to the filing of the bankruptcy petition. The increase from 90 days to 180 days brings the timeframe in line with the timeframe used for determining the priority for employee benefits. The calculation of the amount of employee benefits entitled to priority has also been increased from \$4,925 to \$10,000. As in the past, the \$10,000 number is then multiplied by the number of employees and reduced by the total payments made on priority wage claims to arrive at the total amount of employee benefits entitled to priority.
- There has been a change in the way the time period for tax claims entitled to priority is calculated. This change should not affect the vast majority of cases.

Fraudulent Transfers

Generally speaking, a bankruptcy trustee or debtor-in-possession may set aside transfers made either (a) with intent to hinder, delay or defraud creditors; or (b) for less than fair consideration if the debtor was insolvent at the time of or immediately after the transfer. The problem is that transfers under section 548 of the Bankruptcy Code could be set aside only if they were made within one year prior to the bankruptcy filing. State fraudulent transfer laws, which may be applied in bankruptcy proceedings, carry with them a longer statute of limitations² but are marginally more debtor-friendly than the

² The exact amount of time is determined by the statute of limitations set by the state whose law is sought to be applied. A typical state law statute of limitations for a fraudulent transfer action is six years.

standards required by the Bankruptcy Code.³ The new amendments attempt to capture more of the transfers by making two significant changes to the look-back period. In most cases, transfers made within two years prior to the filing of the bankruptcy petition are subject to being set aside as a fraudulent transfer if they otherwise meet the test set forth in section 548 of the Bankruptcy Code. In addition, a new provision, intended to attack individual debtors who intentionally make themselves judgment proof, provides for a ten-year look-back period.⁴ In the latter case, the court will set aside a self-settled trust, where the following conditions are met:

- The debtor made the transfer to the trust;
- The debtor is the beneficiary of the trust; and
- The debtor made the transfer with actual intent to hinder, delay or defraud any entity to which the debtor was or became after the date of the transfer indebted.

Finally, there is now also a provision making payments to insiders under an employment contract fraudulent if they are out of the ordinary course of business. Such payments may be set aside regardless of the financial condition of the debtor at the time.

Preferences

Changes to Ordinary Course of Business

A trustee or debtor-in-possession may seek to have set aside any payments or other transfers made to debtors on legitimate debts if (a) the transfer was made within 90 days prior to the bankruptcy filing; (b) the transfer was on account of an antecedent (i.e., existing debt); (c) it was made while the debtor was insolvent; and (d) the transfer enabled the creditor to receive more than it would have received in a Chapter 7 case. One of the main defenses to a preference action is that the payment was made in the ordinary course of business. The creditor has the burden of proving that the payment is ordinary and, under current law, must prove both that the payment was consistent with the ordinary practices between the creditor and the debtor, *and* that the payment was made in accordance with industry standards. The existence of this two-prong test has often made it difficult for creditors to defend preference actions. In the least, it made the defense of the preference action more expensive. Under the new law, the creditor is relieved of some of this burden. Instead of proving that the payment was ordinary both as between

³ Under state law, the party seeking to set aside a transfer as fraudulent must show in most cases that a claim in existence at the time of the transfer is in existence at the time of the lawsuit. Transfers that otherwise might be harmful to a business, and thus to its creditors, would not be set aside if creditors in existence at the time were either paid off or settled out.

⁴ Along the same lines is a provision that reduces a debtor's homestead exemption if he or she fraudulently transferred nonexempt property into an exempt homestead within 10 years of the bankruptcy filing. See page 11.

the parties *and* in accordance with the industry, the creditor need meet only one of these tests. This will not only make it easier for creditors to defend preference actions, but it also raises an interesting strategy for creditors who are dealing with creditors on terms that are longer than industry standards but who desire to tighten up the terms as the debtor slides into bankruptcy. Couldn't a creditor reduce the payment terms to industry standards and still argue that the accelerated payment terms are ordinary?⁵

Changes Relating to Small Preference Claims

One of the major perceived abuses in the preference law is that plaintiffs in preference actions often brought small preference claims in jurisdictions that were far-removed from where the creditor was located. In short, the cost of defense of these actions was not justified by the amount in controversy, the result being that creditors would pay something just to get rid of the case. The amendments attempt to address this issue through two provisions, applicable only to non-insider preferences. First, if the aggregate amount of the transfers that constitute potential preferences is less than \$10,000, then a suit to recover the preference must be brought where the creditor is located, not where the bankruptcy case is pending, as is the current law. In addition, the new law provides that in a case involving a debtor whose debts are not primarily consumer debts, payments under \$5,000 each are not subject to avoidance if made to a non-insider. Note, however, that while the statute on its face applies the \$5,000 test to each payment, it is widely believed that the intent of the statute is to make allow actions to be brought where the payments were equal or greater to \$5,000 *in the aggregate*.

There is one important thing to keep in mind in applying the foregoing amendments of the preference law. In determining whether the threshold dollar amount has been met for bringing the action in the first place or for the venue of the action, the court will look only to the amount of transfers made on account of antecedent debts, without regard to whether any or all of those payments are subject to a defense. Thus, even if the creditor extended \$5,000 of undisputed subsequent new value in a case involving \$11,000 of transfers, the action could still be brought where the bankruptcy case is pending.

Other Changes

The law dealing with insider preferences has been changed to make it clear that a payment made to a non-insider creditor that benefited the creditor will be subject to possible repayment as a preference only if the payment was made within the 90-day period prior to the bankruptcy, applicable to non-insider preference claims. This change overrules a handful of decisions that were still holding that the one-year look-back period applied in these circumstances.

⁵ Of course, assuming that the creditor was in such a position, it still would have to litigate the issue of what industry standards are.

With regard to secured creditors, the new amendments allow the creditor 30 days to perfect its security interest, as opposed to the 10-day period allowed by current law. What this means is that if a secured creditor perfects its security interest within 30 days after the grant of the security interest by the debtor, the transfer will be deemed to occur on the date that the security interest is granted; otherwise, it will be on the date that the security interest is perfected. The result is that the grant of the security interest is less likely to be viewed as constituting a transfer on account of an antecedent debt or to come within the 90-day preference period in the first place.

Finally, in the consumer area, payments made by a consumer debtor as part of an alternative repayment schedule between the debtor and the creditor created by an approved credit counseling agency are not subject to avoidance. This provision is part of an overall scheme to encourage debtors to use credit counseling agencies and for creditors to negotiate settlements through these agencies.

Section 341 Meetings

Some jurisdictions have required creditors to attend section 341 meetings of creditors through counsel, making it more inconvenient and expensive for creditors to participate. The new law prohibits such rules in consumer cases. Creditors may now attend section 341 meetings of creditors in all jurisdictions without counsel, but only in consumer cases. In business cases, creditors still need to check the local rules of the court where the case is pending.

Pre-packaged Chapter 11 cases are those where acceptances of a plan of reorganization have been solicited from creditors prior to the filing of the Chapter 11 petition in accordance with certain rules prescribed by the Bankruptcy Code. One of the objectives of the pre-packaged case is to allow the debtor to get in and out of bankruptcy quickly, while still preserving essential rights of creditors. In order to promote this policy, the new law allows the court to dispense with the section 341 meeting of creditors in pre-packaged Chapter 11 cases.

Creditor Liability for Failure to Credit Payments

The willful failure of a creditor to credit payments received under a plan will constitute a violation of the discharge injunction if the debtor suffered material injury as a result of such failure. The exceptions are if the debtor defaulted under the plan or the confirmation order is revoked.

CONSUMER PROVISIONS

Credit Counseling

A central part of the consumer amendments is the requirement that the individual debtor submit to credit counseling both before and after the case is filed.

All individuals must submit to a “briefing” by “an approved nonprofit budget and credit counseling agency” within 180 days before the filing of a petition under *any* Chapter of the Bankruptcy Code. The counseling can be an individual or group briefing, including a briefing conducted over the telephone or internet. It must outline the opportunities for available credit counseling and assist the individual in performing a related budget analysis. There are certain limited exceptions to this requirement:

- The United States Trustee may determine that existing credit counseling agencies cannot take on the additional work. This determination must be reviewed yearly.
- The individual may not have to undergo the briefing if he or she requested the briefing and the agency was not able to provide it within 5 days, and if he or she can convince the court that exigent circumstances exist to waive the requirement. Debtors receiving a waiver under this provision are still required to undergo a briefing within 30 days after the bankruptcy petition is filed.
- The court may waive this requirement if the debtor is mentally incapacitated or physically disabled or is in active military service in a military combat zone.

The debtor in a Chapter 7 or a Chapter 13 case will not be granted a discharge unless he or she completes a course concerning personal financial management with a credit counseling agency approved by the United States Trustee.

Means Test

Chapter 7 cases must be dismissed or, with the consent of the debtor, converted to Chapter 11 or Chapter 13, if the court finds that the debtor owes primarily consumer debts and that he or she has abused the provisions of the Bankruptcy Code. The basic concept of dismissal for abuse is not new. What is new is the so-called “presumption of abuse” and the means test that governs it. Essentially, the court will consider that there is a presumption of abuse if the debtor’s current monthly income reduced by monthly allowable expenses (defined in great detail in the amendments⁶) and multiplied by 60 is not less than the lesser of (a) \$10,000 or (b) the greater of 25 percent of the debtor’s general unsecured claims or \$6,000. Put another way, if the debtor has at least \$166.67

⁶ With limited exceptions, the allowable monthly expenses are restricted to those specified under the National Standards and the Local Standards and the categories specified as Other Necessary Expenses issued by the Internal Revenue Service for the area in which the debtor resides.

left over each month there will be a presumption of abuse. That number can be even lower if the total of the general unsecured claims asserted against the debtor is less than \$40,000. In any case, where the debtor's projected annual income is equal to or less than the median income for the state, the case cannot be dismissed based on a presumption of abuse.

The clerk of the court must provide creditors with notice that a presumption of abuse exists within 10 days of the date of filing of the petition, in all cases where the presumption of abuse arises.

Even though it is the clerk that makes the initial determination as to whether a presumption of abuse exists, it is the actions of the Chapter 7 trustee that triggers off events that could result in the dismissal or conversion of the case. Within 10 days after the section 341 meeting of creditors, the Chapter 7 trustee must file a report with the court stating whether a presumption of abuse exists. Within five days after the statement is filed, the court is required to provide all creditors with a copy of the statement. Within 30 days after the trustee files a report stating that a presumption of abuse exists, the United States Trustee must file a motion to dismiss the case or a statement why such a motion is not appropriate. Creditors may rely on, but are not bound by, the decision of the United States Trustee. In most cases any party in interest may move to dismiss a case for abuse.

The presumption of abuse can only be rebutted by showing special circumstances, such as a serious medical condition or a call to active military duty. Even then, the debtor must show that the adjustments to his or her income or expenses will cause the net amount to fall below the threshold for finding abuse.

If the court finds that there has been abuse, it may surcharge the debtor's attorney for the costs incurred by the trustee in pursuing the matter. If the court finds that there has not been abuse, the court may surcharge the party bringing the motion for the expenses incurred by the debtor in defending it if the court finds that the motion was not well founded.

Dismissal and Conversion of Consumer Cases for Other Reasons

The debtor is required to file with the court his or her schedules of debt and property, a statement of financial affairs, copies of all pay stubs or other evidence of payment made by the debtor's employer within 60 days prior to the bankruptcy filing, a statement of the amount of monthly net income, and a statement disclosing any reasonably anticipated increase in income or expenditures over the 12-month period. If the debtor fails to do any of these within 45 days after the case is filed, the case will be dismissed automatically, provided however, that the debtor may request up to an additional 45 days to file these papers but only if the request is made before the expiration of the 45-day period. The trustee also has the right to request an extension if such extension would be in the best interests of creditors.

Taxing authorities have the right to request a dismissal or conversion of a case if the debtor does not file timely his or her tax returns. If the debtor does not file the returns within 90 days of the request by the taxing authority, the court must dismiss or convert the case, whichever is in the best interests of creditors. (Obviously, if the case is already in Chapter 7, the only remedy would be for the court to dismiss the case.)

Discharge

A few changes have been made to the provisions governing what debts are not discharged. The most significant are:

- Existing law provides that debts for extensions of credit obtained through fraud are not dischargeable. It also establishes a presumption that the extension of credit was obtained through fraud if luxury goods or services in a certain amount were obtained shortly before the bankruptcy filing. The amendments now make it easier for the creditor to prove that the debt should not be discharged by increasing the time period prior to the bankruptcy filing and by reducing the amount of the purchase that triggers the presumption of fraud. The dollar threshold for the presumption to apply has been reduced from \$1,225 to \$500 and the time period for the presumption to apply has been extended from 60 days to 90 days prior to the filing of the bankruptcy petition. Thus, under the new law, debts owed to a single creditor aggregating more than \$500 for luxury goods or services incurred on or within 90 days prior to the filing of the bankruptcy petition are presumed to be nondischargeable.
- Debts incurred to pay a tax claim that would not be dischargeable are not themselves dischargeable.
- Loans on ERISA-qualified pension plans are not dischargeable.

In addition two significant changes to the provisions as to whether a debtor will be allowed a discharge at all have been enacted:

- A debtor may not receive a discharge in a Chapter 7 case if he or she received a discharge in a Chapter 7 or 11 case that was filed less than eight years prior to the filing of the current petition. This time period has been extended from six years.
- In order for the debtor to receive a discharge, he or she must complete an instructional course concerning personal financial management.

Reaffirmation Agreements

Significant changes have been made to the law regarding reaffirmation agreements. These agreements allow a creditor to continue to collect from the debtor after discharge

without the creditor having to prove that the debt is of a kind that should not be discharged. Reaffirmation may only occur if the agreement will not create an undue hardship on the debtor and certain procedures specified by the Bankruptcy Code are followed.

In order for a reaffirmation agreement to be valid under the new law, the creditor must provide to the debtor extensive disclosures at or before the debtor signs the agreement, laid out in precise detail in the statute. Those disclosures are set out verbatim in the Appendix hereto.

There is a presumption that the reaffirmation agreement presents an undue hardship to the debtor if the difference between the debtor's monthly income and monthly expenses is less than the amount of the payment required under the reaffirmation agreement. The court may review the income and expenses for a period of 60 days after the reaffirmation agreement is filed and, for cause, may extend the period beyond 60 days. The amendments appear to add a testing period that did not otherwise exist before. While many courts would not approve reaffirmation agreements where the debtor's income and expenses did not allow for the payments, that determination was made as of the date the reaffirmation agreement came up to the court for review.

Finally, there is a provision under the new law stating that it is permissible for creditors to accept payments from a debtor before and after the filing of a reaffirmation agreement. The statute goes on to state that the creditor may accept payments from a debtor under a reaffirmation agreement that the creditor believes in good faith to be effective. Since reaffirmation agreements must be filed with the court to be effective, it is unclear what the statute means. One possibility is that creditors may accept payments before the filing of a reaffirmation agreement if all of the other requirements for effectiveness of a reaffirmation agreement have been met.

Exemptions

Under current law, the debtor is entitled to claim the exemptions of the state in which he or she lived for the greater part of the 180-day period prior to the filing of the bankruptcy petition. This provision allowed debtors to establish residency in debtor-friendly states shortly before the filing of a bankruptcy petition. Under the amendments, in order for the debtor to take advantage of a state's liberal exemption laws, he or she must have lived in that state for the entirety of two years (730 days) before the bankruptcy filing. If the debtor did not live in one state for that entire period, then the court will look to where the debtor lived for the greater portion of the 180-day period prior to the beginning of the 730-day period. In other words, the court could look as far out as 2-1/2 years before the bankruptcy filing to determine which state's exemption laws to apply.

Notwithstanding the foregoing provision, which applies the law of a state based on length of residency, to the extent the property in question is real estate, the debtor's exemption is limited to \$125,000 unless the debtor acquired the property more than 1,215 days

(approximately three years and four months) before the bankruptcy filing. Even if the debtor acquired the property more than 1,215 days prior to the filing of the bankruptcy petition, the court may limit the debtor's exemption to \$125,000 if the debtor was convicted of a felony which demonstrates that the filing was an abuse of the provisions of the Bankruptcy Code, if the debtor owes a debt for violation of the securities laws, or if the debtor owes a debt for intentionally or recklessly causing serious physical harm or death to an individual.

Exemptions of amounts in IRA's are limited to \$1 million, without regard to amounts rolled over from ERISA-qualified pension plans.

The amount of the debtor's homestead exemption shall be reduced to the extent that such value is attributable to any portion of property that the debtor disposed of within 10 years prior to the petition date, with intent to hinder, delay or defraud creditors if the debtor could not exempt that property on the date of transfer.

Determination of Amount of Secured Claim

The value of a secured claim is determined in individual Chapter 7 and Chapter 13 cases by the replacement value of the collateral. If the replacement value of the collateral is greater than the amount of the debt, then the creditor will be entitled to payment in full. If the replacement value is less than the amount of the debt, then the creditor will have a secured claim based on the replacement value, with the balance of the debt being treated as an unsecured claim. This amendment resolves a hotly-contested area of consumer bankruptcy law, where the debtor would often contend that the value of the collateral should be set at liquidation, which is a significantly lower value. Liquidation value can still be used in business cases and in individual Chapter 11 cases in appropriate circumstances.

Assumption of Personal Property Leases By Individual Debtors

A procedure has been set up to allow an individual debtor in a Chapter 7 case to assume a personal property lease without obligating the estate. The procedure is for the debtor to notify the lessor in writing of its desire to assume the lease. The lessor then has the option of notifying the debtor that it is willing to have the lease assumed and to condition such assumption on the cure of outstanding defaults. The debtor then has 30 days to notify the lessor that it is assuming the lease, in which case it is deemed assumed without further court order.

Rights of Mortgage Holders Post Discharge

The Bankruptcy Code has been amended to expressly allow the holder of a mortgage on the debtor's principal residence to contact the debtor regarding payments if the

underlying debt has been discharged, as long as the mortgage is valid and the contact is in the ordinary course of business between the creditor and the debtor.

Penalty for Creditor's Refusal to Negotiate Payment Prior to Filing of Petition

The court is authorized to reduce the claim of a creditor by up to 20 percent if the creditor unreasonably refused to negotiate a reasonable alternative repayment schedule proposed on behalf of the debtor by an approved nonprofit budgeting and credit counseling agency. The offer, however, must have been made at least 60 days prior to the bankruptcy filing and have provided for repayment of at least 60 percent of the debt over a period not to exceed the repayment period of the loan or a reasonable extension thereof. This provision also does not apply if the debt is not dischargeable.

Miscellaneous Rights of Creditors In Consumer Cases

In an individual Chapter 7 or Chapter 13 case, the court must provide the creditor with a copy of the petition, schedules and statement of financial affairs if the creditor files a request with the court for them.⁷

The debtor is required to provide the trustee with a copy of his or her federal income tax return for the most recent tax year. Creditors are entitled to obtain a copy of the tax return from the debtor, if requested. If the debtor fails to provide the tax return to the creditor the court is required to dismiss the case unless the debtor can demonstrate that the failure to provide the return was outside of his or her control.

Chapter 13

Chapter 13 Plan Confirmation

The amendments attempt to provide greater protection to creditors, both as to the content of a Chapter 13 plan and as to the procedures relating to confirmation.

Chapter 13 plans will now have to contain the following provisions not required under current law:

- The debtor must commit all of his or her disposable income during the plan period. In determining allowable expenses, the court will look to the standards

⁷ Interestingly, a similar provision requiring the court to provide a copy of the Chapter 13 plan sets five days as the deadline for the court to provide it and allows for a reasonable fee. The provision relating to schedules and statement of financial affairs in Chapter 7 cases does not set a deadline for providing them or a fee for obtaining them.

used in the means test in Chapter 7 cases.⁸

- If the projected annual income of the debtor and the debtor's spouse is less than the median income for the state, then the plan may not exceed three years. Otherwise, as under existing law, the plan may go for up to five years.
- Payments on secured claims under Chapter 13 plans must be sufficient to provide adequate protection to the secured creditor. If periodic payments are to be made on the secured debt, the payments must be in equal monthly installments.
- Secured claims involving purchase money security interests may not be stripped down in a Chapter 13 case if the debt is for a vehicle loan and it was incurred within the 910-day period (just short of 2-1/2 years) preceding the petition date, or the debt was incurred to purchase any other thing of value during the one-year period prior to the bankruptcy filing.
- A plan cannot alter the terms of repayment of a loan from a pension plan. Repayments on the loan shall not be considered to be available as disposable income for purposes of determining the amount of payments that the debtor should make under the plan.

Other conditions to confirmation are:

- There is now a good faith requirement for confirmation of a Chapter 13 plan.
- The debtor must be current post-petition on domestic support obligations
- The debtor must be current post-petition in filing tax returns.

Provisions have been added to ensure that the Chapter 13 debtor acts with reasonable speed, both in moving toward confirmation of the plan and making payments under it.

Under the amendments, the confirmation hearing must be held between 20 and 45 days after the meeting of creditors unless the court determines that it is in the interests of creditors and the estate to hold the hearing at an earlier date and there is no objection to the earlier date. The current law contains no date restrictions for the confirmation hearing. The change in the law is an attempt to assure a speedy confirmation while at the same time giving creditors a sufficient amount of time to review and object to the plan, if appropriate.⁹

⁸ See footnote 6.

⁹ Some courts currently hold confirmation hearings on the same day or soon after the section 341 meeting.

One very significant change is the requirement for the debtor to start making plan payments to the Chapter 13 trustee within 30 days after the commencement of the case.¹⁰ Since section 341 meetings typically are held approximately one month after the case is commenced and since the court cannot hold a confirmation hearing until 20 days after the section 341 meeting, Chapter 13 debtors will invariably be required to begin making plan payments before the plan is confirmed.

Related to this provision is the requirement that within 30 days after the commencement of the case,¹¹ the debtor must begin making payments directly to personal property lessors and holders of purchase money security interests for the amount coming due post-petition.

The court is required to provide a creditor with a copy of the Chapter 13 plan if the creditor files a request with the court for it.¹²

Chapter 13 Discharge

Until the passage of the new law, the exceptions to discharge of debts in a Chapter 13 case were limited. While still less than in a Chapter 7 case, the exceptions have been greatly expanded. Some of the new exceptions are:

- Withholding taxes.
- Taxes where the return was not filed or was fraudulent.
- Debts for money, property, services or an extension or renewal of credit obtained by fraud or false pretenses.
- Debts for fraud or defalcation while acting in a fiduciary duty.
- Domestic support obligations.
- Student loans.

¹⁰ The amendments actually provide that payments must start on the earlier of 30 days after the filing of the Chapter 13 plan or the entry of an order for relief. Since the order for relief marks the beginning of a Chapter 13 case, the plan filing date seems superfluous.

¹¹ See footnote 10.

¹² Interestingly, the provision requiring the court to provide a copy of the Chapter 13 plan sets five days as the deadline for the court to provide it and allows for a reasonable fee. A similar provision relating to schedules and statement of financial affairs in Chapter 7 cases does not contain similar language.

- Claims arising out of death or personal injury for drunk driving, drunk boating and drunk flying.

A discharge will not be granted in a Chapter 13 case if the debtor received a discharge in a Chapter 7, 11 or 12 case within the four-year period prior to the filing of the Chapter 13 petition or a discharge in a Chapter 13 petition within the two-year period prior to the filing of the petition.

Dismissal or Conversion of Chapter 13 Cases

Two additional grounds for dismissal of a Chapter 13 case or conversion to Chapter 7 have been added:

- The failure of the debtor to pay domestic support obligations.
- The failure of the debtor to file prepetition tax returns by the date of the section 341 meeting of creditors.

Under current law, debtors may reduce the amount of an undersecured claim to the value of the collateral, treating the excess as an unsecured claim. When cases were dismissed or converted to Chapter 7, the debtor would argue that the claim should remain in its “stripped down” state. Under the amendments, the debtor will no longer be able to take this position. If a Chapter 13 case is dismissed or converted to Chapter 7, a secured creditor will retain its lien to the extent recognized by applicable nonbankruptcy law, reduced in amount only by the payments made by the debtor in the Chapter 13 case.

Other Chapter 13 Provisions

The debtor is required to file with the court on an annual basis a statement of income and expenditures during the tax year most recently concluded and of the monthly income of the debtor.

The court is required to provide a creditor with a copy of the Chapter 13 plan if the creditor files a request with the court for it.¹³

¹³ Interestingly, the provision requiring the court to provide a copy of the Chapter 13 plan sets five days as the deadline for the court to provide it and allows for a reasonable fee. A similar provision relating to schedules and statement of financial affairs in Chapter 7 cases does not contain similar language.

THE AUTOMATIC STAY

Serial and Abusive Filings

An important part of the new legislation is an effort by Congress to prevent serial filings. These provisions are applicable in individual cases and in small business cases. The serial filings provisions manifest themselves most prominently in the changes to the automatic stay provisions of the Bankruptcy Code.

Consumer Cases

If an individual files a Chapter 7 case within a year of the dismissal of a case under Chapter 7, 11 or 13, the automatic stay shall terminate 30 days after the filing of the petition with respect to the action against any collateral or any lease. If a case under any chapter is filed in a year in which two or more cases were pending and then dismissed, the stay will not go into effect in that case as to any matter to which the automatic stay otherwise would apply. Any party may move to continue the stay as to any or all creditors if the party demonstrates that the filing is in good faith as to the creditors stayed.

A mortgage holder may obtain relief from the stay if it can show that the bankruptcy filing was part of a scheme to delay, hinder or defraud creditors that involved either multiple bankruptcy filings or the transfer of all or part ownership of the property without the consent of the secured creditor or court approval. If the court grants relief from the stay on these grounds the order shall be effective in any bankruptcy case filed within two years, except that the debtor in the subsequent case may move for relief from the order based on changed circumstances.

Small Business Cases

The automatic stay does not apply in the following instances involving a small business:¹⁴

- Where the debtor is a debtor in a small business bankruptcy pending at the time the petition is filed.
- Where the debtor was a debtor in a small business case that was dismissed for any reason within two years before the current bankruptcy filing.
- Where the debtor was a debtor in a small business case where a plan was confirmed in the preceding two years.

¹⁴ For the definition of what constitutes a small business and other provisions relating to small business bankruptcies, see pages 19-21 of these materials.

- Where the debtor is an entity that has acquired substantially all of the assets or business of a small business debtor, unless such entity establishes that it acquired the assets or business in good faith.

These provisions do not apply to non-collusive involuntary bankruptcies or if the debtor proves that the filing of the petition resulted from circumstances beyond its control and that it is more likely than not that it will be able to confirm a nonliquidating plan within a reasonable period of time.

Single Asset Real Estate Cases

A single asset real estate case is one where the assets consist of real estate constituting a single property or project, other than residential real property with fewer than four residential units, and where no substantial business is being conducted other than the operation of the real estate. The definition of a single asset real estate case has changed to eliminate the requirement that there be no more than \$4 million of noncontingent, liquidate secured debts. Under the new law, there is no debt ceiling.

The characterization of a case as a single asset real estate case is significant for purposes of the automatic stay. Under both the current and new laws, the automatic stay will terminate as to the real estate unless the debtor begins making monthly interest payments to the secured creditor within a certain amount of time after the case is commenced. While the new law expands the definition of single asset real estate, two out of the three other changes make it easier for debtors to deal with the monthly interest requirement. The principal changes in the law in this regard are:

- Payments of interest must begin the later of 90 days after the entry of the order for relief or 30 days after the court determines that the case is a single asset real estate case. The 30-day provision is new.
- The interest payments may be made from rents or other income generated from the property. In the past, secured creditors would claim that they had a security interest in the rents and that the interest payments need to be made from a separate source.
- The interest rate that must be paid is the contract rate. Under current law, the interest is the current fair market rate, which often is lower than the contract rate.

In addition, like the provision applicable to individual bankruptcy cases, if the court finds that the filing of the bankruptcy petition was part of a scheme to hinder, delay or defraud creditors involving either multiple bankruptcy filings or the transfer of all or part ownership of the property without the consent of the secured creditor or court approval, then relief from the stay may be entered, applicable to the current case and any case filed in the following two years.

Other Automatic Stay Provisions

Provisions Applicable to All Cases

The following actions are no longer stayed, whether in a consumer case or a business case:

- Proceedings before the tax court to determine tax liability.
- Any acts to enforce a lien against real property if the debtor's case was dismissed within six months for willful failure to obey a court order or if the court had entered an order in a prior case prohibiting the debtor to file another bankruptcy petition.
- The setoff by the government of a tax refund.

There is a provision allowing for a creditor to obtain a confirmatory order that the stay has automatically terminated, but in those instances where the Bankruptcy Code provides for the automatic termination of the stay it is not required that such an order be obtained.

Provisions Applicable to Individual Cases

The following actions are no longer stayed in individual cases:

- Many domestic relations proceedings, such as proceedings to establish paternity or concerning child custody or visitation, or for dissolution of marriage. Proceedings to establish or modify a support obligation are not stayed, but proceedings that involve property division are stayed.
- The withholding of income for support obligations.
- The withholding of income from a debtor's wages under an agreement authorizing the withholding of wages for the benefit of a pension or profit-sharing plan to the extent that the amounts withheld are used solely to repay a loan from the plan.
- Proceedings to evict a residential tenant if a judgment for possession was obtained prior to the filing of the petition, provided that if applicable nonbankruptcy law so provides, the debtor may reinstate the stay if it files a certification with regard to the cure of the default within 30 days after the filing of the bankruptcy petition. In connection herewith, the debtor is required to certify in the bankruptcy petition itself whether there are any judgments for possession outstanding.

Note that the bankruptcy provisions appear to be in conflict, leading to the possibility that the stay is not lifted until 30 days after the filing of the petition.

Section 362(b)(22), which states that the stay does not apply if a judgment for possession was obtained, appears to state that the stay does not apply upon the filing of the petition. Section 362(l)(4), however, could be interpreted to make the lifting of the stay effective only after the passage of 30 days, thus giving the debtor a chance to file a certification with regard to the cure of the default.

- Proceedings to evict a residential tenant based on an endangerment of the property or illegal use of controlled substances, but only if the landlord provides the debtor with a certification that such a proceeding has been filed or that the debtor has endangered the property or illegally used drugs within the previous 30 days. If the landlord files and serves the certification, then the automatic stay will be lifted 15 days thereafter. There are provisions giving the debtor the ability to contest the certification.
- The automatic stay terminates as to leased personal property or personal property serving as collateral for a loan in individual cases if the debtor fails to file timely its statement of intentions with regard to that property or, if having timely filed its statement of intentions, fails timely to perform its statement of intention. The one exception is if the debtor chooses to reaffirm and the creditor refuses to agree to the reaffirmation “on such terms.” The debtor may amend the statement of intentions before the time of performance. Under existing law, which has not changed under the amendments, the debtor has 30 days after the petition is filed to file his or her statement of intentions (subject to extension by the court) and 30 days after the section 341 meeting of creditors (subject to extension by the court) to perform his or her intentions. The lifting of the automatic stay for failure to timely perform is further subject to the rights of the trustee to keep the stay in place if the property is not of inconsequential value to the estate.
- Where property is subject to a purchase money security interest and the debtor is an individual, the automatic stay will terminate if the debtor, within 45 days after the section 341 meeting of creditors, does not either redeem the collateral or enter into a reaffirmation agreement. Note that under this provision, there is no relief given to the debtor if the creditor refuses to enter into the reaffirmation agreement. The stay, however, will not terminate if within the 45-day period the trustee files a motion seeking to keep the stay in place on the ground that the property is not of inconsequential value.

SMALL BUSINESS BANKRUPTCIES

There are special provisions applicable to Chapter 11 cases where the debtor is a small business. A small business is defined as a business with \$2 million or less in noncontingent liquidated debts and where, in addition, a creditors’ committee has not been appointed or, if appointed, the court finds that the committee “is not sufficiently active and representative to provide effective oversight of the debtor.” The tying in of the

concept of an active creditors' committee (or rather the lack of an active creditors' committee) to the definition of small business is new. The general thrust of the small business provisions is to provide special oversight and an accelerated process where a business is small and a creditors' committee is not active. Note that based on the definition, the status of a debtor as a small business can change based on whether a committee exists and whether the court finds it to be sufficiently active.

Among other things, a small business debtor is required to file periodic financial and other reports containing "information," which includes:

- The debtor's profitability.
- Reasonable approximations of the debtor's projected cash receipts and cash disbursements over a reasonable period.
- Comparisons of actual cash receipts and disbursements with projections in prior reports.
- Whether the debtor is in compliance with its obligations to file tax returns, to pay taxes and to comply with other postpetition requirements imposed by the Bankruptcy Code and the Federal Rules of Bankruptcy Procedure. If the debtor is not in compliance when and at what cost it will come into compliance.
- Such other matters as are in the best interests of the debtor and creditors, and "in the public interest in fair and efficient procedures under chapter 11 of this title."

In addition, the small business debtor must allow the United States Trustee to inspect its business premises and books and records at reasonable times, after prior written notice.

The small business debtor has 180 days in which it has the exclusive right to file a plan of reorganization. This compares to the initial period of 120 days provided to other Chapter 11 debtors. Unlike other Chapter 11 cases, however, there is a deadline whereby the small business debtor *must* file its plan. If it does not do so within 300 days after the commencement of the case (or in an involuntary case, after the court grants the petition), then the court must dismiss the case or convert it to Chapter 7, unless the court finds that the interests of creditors and the estate would be better served by the appointment of a trustee. Once the plan is filed, the court has 45 days to confirm it. The foregoing deadlines may be extended if the debtor demonstrates that it is more likely than not that the court will confirm a plan within a reasonable period of time.

The court may dispense with the requirement of a disclosure statement in a small business case if it determines that the plan itself provides adequate information or it may approve a disclosure statement submitted on standard forms. If a disclosure statement is filed, the court may dispense with a disclosure statement hearing and defer consideration of the disclosure statement to the confirmation hearing. In such cases, the court would conditionally approve the disclosure statement before it was mailed to creditors.

CHAPTER 11 PROVISIONS

Creditors' Committees

Historically, creditors' committees have consisted of the largest of the debtor's unsecured creditors. Under the amendments, the court may order the United States Trustee to put on the committee a member that is a small business concern if the court determines that the creditor holds claims of a kind represented by the committee where the aggregate amount of the claims is disproportionately large when compared to the annual gross revenue of that creditor.

The committee must provide "access to information" for creditors of the kind it represents who are not members of the committee. On its face, any creditor of the type represented by the committee should be able to request and obtain any information that the committee has. This new provision brings into question how debtors and creditors' committees will treat information that the debtor wants to be kept confidential.

The committee must also "solicit and receive comments" from creditors of the type it represents and be subject to a court order compelling an additional report or disclosure to be made to the constituent creditors. The amendments do not define what "solicit and receive comments" means. Does the committee have to poll the creditor body? Only a selection of creditors? Who makes the determination as to who is consulted? Will creditors or the debtor be able to censure a committee on a subject because it did not "solicit and receive comments" on a particular issue before the court?

Conversion, Dismissal and Appointment of Chapter 11 Trustees

Under the amendments, if cause exists, the court is required to convert a Chapter 11 case to Chapter 7 or dismiss the case, whichever is in the best interests of creditors and the estate. The amendments have greatly expanded the examples of what constitutes cause for conversion or dismissal. The complete list of what constitutes cause, with the major changes highlighted in italics, is as follows:

- Substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation.
- *Gross mismanagement of the estate.*
- *Failure to maintain appropriate insurance that poses a risk to the estate or to the public.*
- *Unauthorized use of cash collateral substantially harmful to one or more creditors.*
- *Failure to comply with an order of the court.*

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- *Unexcused failure to satisfy timely any filing or reporting requirement established by the Bankruptcy Code or by any rule applicable to a Chapter 11 case.*
 - *Failure to attend the section 341 meeting of creditors or an examination under Rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown.*
 - *Failure timely to provide information or to attend meetings reasonably requested by the United States Trustee.*
 - *Failure timely to pay taxes owed after the commencement of the case (or in an involuntary case, after the petition is granted) or to file tax returns after that date.*
 - *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.*
 - Failure to pay any fees or charges mandated by statute.
 - Revocation of an order of confirmation.
 - Inability to effectuate substantial confirmation of a confirmed plan.
 - Material default by the debtor with respect to a confirmed plan.
 - Termination of a confirmed plan by reason of the occurrence of a condition specified in the plan.
 - *Failure of the debtor to pay any domestic support obligation that first became due after the petition was filed.*

The above list, while lengthy, is not intended to be exhaustive. If cause does exist, the court must dismiss the case or convert it to Chapter 7 unless the court identifies “unusual circumstances” that establish that conversion or dismissal is not in the best interests of creditors and the estate. The amendments do not define “unusual circumstances.” They do state, however, that the court must dismiss or convert the case unless the debtor or another party opposing dismissal or conversion establishes:

- There is a reasonable likelihood that a plan will be confirmed within a reasonable period of time (or if a small business case, within the time periods established by the Bankruptcy Code);
- There exists a reasonable justification for the act or omission; and
- The act or omission will be cured within a reasonable period of time fixed by the court.

The amendments appear to require dismissal of the case if there is a substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation. In other words, if this condition exists, the court is not given the opportunity of finding “unusual circumstances.”

Despite the foregoing mandate for the court to dismiss or convert the case, the court may instead appoint a Chapter 11 trustee or examiner if it finds that it is in the best interests of creditors and the estate to do so.

Debtor’s Period of Exclusivity for Filing and Confirming Chapter 11 Plan

Under existing law, a debtor has 120 days in which it has the exclusive right to file a plan of reorganization and 180 days in which it has the right to obtain acceptances of the plan. Once these deadlines pass, any party in interest may file a plan. These time periods can be extended and, in fact, are extended as a matter of course, sometimes for years in large cases. The 120- and 180-day periods remain under the amendments, but the court is prohibited from extending the exclusive periods for filing a plan and obtaining acceptances beyond 18 months and 20 months, respectively, from the date of the order for relief.

Insider Compensation

Key Employee Retention Programs (KERP) are not allowed, except to the extent that the court finds:

- The transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
- The services provided by the person are essential to the operation of the business; and
- Either the amount of the KERP is no greater than 10 times the average paid to nonmanagement employees for similar purposes during the calendar year, or if there were no payments to nonmanagement employees, no greater than 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which the KERP is made or promised.

The KERP provisions are an obvious reaction to widely reported lucrative compensation packages paid to executives of bankrupt companies to keep them on board during the Chapter 11 case. Whether or not one agrees with the wisdom of limiting KERPs, the provisions – particularly the requirement that the executive have received a job offer from another business at the same or greater rate of compensation – have been widely

criticized among the bankruptcy bar and judges as not making sense. Look for both the bar and the courts to find ways to get around this provision.

Besides the KERP provisions, changes have been made to the amount of severance pay that may be paid to the debtor's executives. Under the amendments, no severance payments may be made to insiders unless they are part of an overall plan for payment of severance to all full-time employees, and the severance payment is no greater than 10 times the average paid to nonmanagement employees during the calendar year.

There is a catch-all prohibiting payment to insiders "outside of the ordinary course of business and not justified by the facts and circumstances of the case." This provision applies not only to management but also to consultants hired by the company.

As mentioned earlier, payments made to an insider under an employment contract are now subject to avoidance as a fraudulent transfer if the payments were not made or the obligations not incurred in the ordinary course of business.

Pre-Disclosure Statement Solicitation in Partially Completed Prepackaged Cases

A prepackaged Chapter 11 case is one where the debtor obtains the required acceptances of a plan before the filing of a case. The court will confirm a plan if it finds that the solicitation substantially complies with the disclosure statement requirements in a standard Chapter 11 case and the other requirements for confirmation are met. Under the amendments, if such a solicitation occurs before the case is filed, the debtor may continue to solicit the endorsement of a creditor who was solicited prior to the commencement of the case even though the court has not yet approved the disclosure statement.

Individual Chapter 11 Provisions

Property of the estate in a Chapter 11 case of an individual includes all property acquired after the commencement of the case and all earnings from services performed after the commencement of the case. This provision mirrors changes made in Chapter 13 cases.

Chapter 11 plans for individual debtors must provide for the payment to creditors of all or such portion of earnings from personal services as is necessary for the execution of the plan. The requirements for confirmation of a Chapter 11 case now include a special provision for individuals, which requires that the individual commit to the plan property of a value that is not less than his or her projected disposable income over the five-year period beginning on the date that the first payment is due under the plan. Discharges to individual Chapter 11 debtors must await completion of payments under the plan.

OTHER BUSINESS PROVISIONS

Claims for Goods Sold Shortly Before Bankruptcy Filing

An entirely new concept under the amendments is the grant of an administrative claim to creditors who are owed money for goods sold and delivered to the debtor in the ordinary course of business within 20 days before the bankruptcy filing. This provision both affords some protection for creditors selling to a debtor shortly before a bankruptcy filing, and also increases the amount of administrative claims that must be paid in the case. There is nothing in the law that states when the administrative claim must be paid. Will these claims be treated as claims entitled to immediate payment or simply priority claims entitled to payment in full at confirmation?

In addition to granting sellers of goods an administrative priority claim, creditors may now assert reclamation claims for any goods delivered within 45 days prior to the bankruptcy filing – an increase from 10 days under existing law. The other requirements for reclamation still apply, such as the requirement that the goods be on hand and identifiable, and that the reclamation claim is subject to the prior rights of a creditor with a blanket security interest in inventory. Because of these limitations, creditors will likely find the administrative claim described above to be more valuable than their reclamation rights. For goods sold more than 20 and less than 46 days prior to a bankruptcy filing, reclamation may be the supplier's only hope of getting priority treatment.

Real Property Leases

The new law makes it clear that defaults in leases of real property that are incapable of being cured are exempt from being cured as a condition to assumption of the contract. Prior to the new law, there was a split in the courts on this issue.

A significant change in the law – and one that will have a profound impact on retail cases – is the requirement that real property leases be assumed or rejected within 120 days after the filing of the bankruptcy petition. The court can extend this period up to another 90 days. After that, the extension can only be with the written consent of the lessor.

Under current law, there is no limit on how far out the deadline to assume or reject could be extended. Debtors often would seek extensions up to the date of confirmation of the plan, leaving open all of their options while at the same time leaving the landlord up in the air for several months, perhaps years, as to what the debtor would be doing with the lease.

Absent assumption within the time period, the lease will be deemed to be rejected and the property surrendered to the lessor. If a real property lease is assumed but later rejected, the administrative claim arising therefrom shall be limited to two years from the later of the date of rejection or the turnover of the property

Utilities

Utilities have always been entitled to assurance of payment as a condition to providing service. Under the present law, assurance must be provided within 20 days after the order for relief is entered at the commencement of the case. Under the new law, the time for providing such assurance in Chapter 11 cases is set at 30 days, but kept at 20 days for other cases. The amendments restrict what can constitute adequate assurance of payment. The principal change is that a history of prompt payment or the grant of an administrative expense claim for nonpayment can no longer constitute adequate assurance. The parties may, of course, agree on a form of security, but absent agreement, only a cash deposit, letter of credit, certificate of deposit, a surety bond or prepayment can be considered by the court to constitute adequate assurance of future payment. If adequate assurance is not timely received, the utility may discontinue service without a court order. The utility may also set off a prepetition claim against a security deposit without obtaining court permission to do so.

Involuntary Bankruptcies

To be a petitioning creditor, the claim may not be in dispute as to liability *or* amount. The generally-not-paying-debts-as-they-become-due test also contains the requirement that the debts not be in bona fide dispute as to liability or amount. Under current law, the claim simply did not have to be in dispute. As a result, many courts held that if a portion of the debt was not in dispute, then the creditor qualified as a petitioning creditor. Note that there is no explicit materiality requirement in the notion of a disputed amount. Must, in fact, the entire debt to the penny not be in dispute? What if the principal amount of the debt is admitted but the debtor disputes the creditor's claim of counsel fees? May a creditor get around this provision by waiving the disputed portion of the claim before filing the involuntary petition? If so, should that waiver be made prior to the filing of the petition or is it sufficient if it is waived simultaneously with the filing?

Health Care Provisions

A Chapter 7 trustee of a health care facility is required to use "all reasonable and best efforts" to transfer patients to "an appropriate health care business" that is in the vicinity of the business being closed down, provides the patient with substantially similar services and maintains a reasonable quality of care. The actual and necessary costs of closing a health care business constitute an administrative expense claim. These costs include the costs of transferring patients and disposing of patient records. There are provisions for appointing a patient care ombudsman to ensure protection of the patients' interests.

EFFECTIVE DATE

Most of the provisions of the new law become effective on October 17, 2005. The following provisions become effective on other dates:

The homestead reductions and limitations became effective on April 20, 2005.

The filing requirements for small business debtors take effect 60 days after the enactment of Bankruptcy Rules governing such requirements.

The change in the law that limits the avoidance period for preferences to 90 days for payments made to insiders, whether or not an insider benefited from the payment, was effective on April 20, 2005.

The provision expanding the look-back for fraudulent transfers from one year to two years applies to cases filed on and after April 20, 2006.

The fraudulent transfer change that allows for the avoidance of payments made to insiders outside of the ordinary course of business was effective on April 20, 2005.

The changes with regard to involuntary bankruptcy petitions were effective on April 20, 2005 as to all cases filed before or after that date.

The increase in the wage and benefits priority cap and the expansion to 180 days for wage priorities was effective on April 20, 2005 for cases filed on or after that date.

APPENDIX

Reaffirmation Disclosures

The following is the statute's language on the new disclosure requirements in connection with reaffirmation agreements.

(k) (1) The disclosures required under subsection (c)(2) shall consist of the disclosure statement described in paragraph (3), completed as required in that paragraph, together with the agreement specified in subsection (c), statement, declaration, motion and order described, respectively, in paragraphs (4) through (8), and shall be the only disclosures required in connection with entering into such agreement.

(2) Disclosures made under paragraph (1) shall be made clearly and conspicuously and in writing. The terms "Amount Reaffirmed" and "Annual Percentage Rate" shall be disclosed more conspicuously than other terms, data or information provided in connection with this disclosure, except that the phrases "Before agreeing to reaffirm a debt, review these important disclosures" and "Summary of Reaffirmation Agreement" may be equally conspicuous. Disclosures may be made in a different order and may use terminology different from that set forth in paragraphs (2) through (8), except that the terms "Amount Reaffirmed" and "Annual Percentage Rate" must be used where indicated.

(3) The disclosure statement required under this paragraph shall consist of the following:

(A) The statement: "Part A: Before agreeing to reaffirm a debt, review these important disclosures:";

(B) Under the heading "Summary of Reaffirmation Agreement", the statement: "This Summary is made pursuant to the requirements of the Bankruptcy Code";

(C) The "Amount Reaffirmed", using that term, which shall be –

(i) the total amount of debt that the debtor agrees to reaffirm by entering into an agreement of the kind specified in subsection (c), and

(ii) the total of any fees and costs accrued as of the date of the disclosure statement, related to such total amount.

(D) In conjunction with the disclosure of the "Amount Reaffirmed", the statements –

(i) "The amount of debt you have agreed to reaffirm"; and

(ii) "Your credit agreement may obligate you to pay additional amounts which may come due after the date of this disclosure. Consult your credit agreement."

(E) The "Annual Percentage Rate", using that term, which shall be disclosed as –

(i) if, at the time the petition is filed, the debt is an extension of credit under an open end credit plan, as the terms "credit" and "open end credit plan" are defined in section 103 of the Truth in Lending Act then –

(I) the annual percentage rate determined under paragraphs (5) and (6) of section 127(b) of the Truth in Lending Act, as applicable, as disclosed to the debtor in the most recent periodic statement prior to entering into an agreement of the kind specified in subsection (c) or, if no such periodic statement has been given to the debtor during the prior 6 months, the annual percentage rate as it would have been so disclosed at the time the disclosure statement is given to the debtor, or to the extent this annual percentage rate is not readily available or not applicable, then

(II) the simple interest rate applicable to the amount reaffirmed as of the date the disclosure statement is given to the debtor, or if different simple interest rates apply to different balances, the simple interest rate applicable to each such balance, identifying the amount of each such balance included in the amount reaffirmed, or

(III) if the entity making the disclosure elects, to disclose the annual percentage rate under subclause (I) and the simple interest rate under subclause (II); or

(ii) if, at the time the petition is filed, the debt is an extension of credit other than under an open end credit plan, as the terms "credit" and "open end credit plan" are defined in section 103 of the Truth in Lending Act, then –

(I) the annual percentage rate under section 128(a)(4) of the Truth in Lending Act, as disclosed to the debtor in the most recent disclosure statement given to the debtor prior to the entering into an agreement of the kind specified in subsection (c) with respect to the debt, or, if no such disclosure statement was given to the debtor, the annual percentage rate as it would have been so disclosed at the time the disclosure statement is given to the debtor, or to the extent this annual percentage rate is not readily available or not applicable, then

(II) the simple interest rate applicable to the amount reaffirmed as of the date the disclosure statement is given to the debtor, or if different simple interest rates apply to different balances, the simple interest rate applicable to each such balance, identifying the amount of such balance included in the amount reaffirmed, or

(III) if the entity making the disclosure elects, to disclose the annual percentage rate under (I) and the simple interest rate under (II).

(F) If the underlying debt transaction was disclosed as a variable rate transaction on the most recent disclosure given under the Truth in Lending Act, by stating "The interest rate on your loan may be a variable interest rate which changes from time to time, so that the annual percentage rate disclosed here may be higher or lower."

(G) If the debt is secured by a security interest which has not been waived in whole or in part or determined to be void by a final order of the court at the time of the disclosure, by disclosing that a security interest or lien in goods or property is asserted over some or all of the debts the debtor is reaffirming and listing the items and their original purchase price that are subject to the asserted security interest, or if not a purchase-money security interest then listing by items or types and the original amount of the loan.

(H) At the election of the creditor, a statement of the repayment schedule using 1 or a combination of the following –

(i) by making the statement: "Your first payment in the amount of \$ ---- is due on ---- but the future payment amount may be different. Consult your reaffirmation agreement or credit agreement, as applicable.", and stating the amount of the first payment and the due date of that payment in the places provided;

(ii) by making the statement: "Your payment schedule will be:", and describing the repayment schedule with the number, amount, and due dates or period of payments scheduled to repay the debts reaffirmed to the extent then known by the disclosing party; or

(iii) by describing the debtor's repayment obligations with reasonable specificity to the extent then known by the disclosing party.

(I) The following statement: "Note: When this disclosure refers to what a creditor 'may' do, it does not use the word 'may' to give the creditor specific permission. The word 'may' is used to tell you what might occur if the law permits the creditor to take the action. If you have questions about your reaffirming a debt or what the law requires, consult with the attorney who helped you negotiate this agreement reaffirming a debt. If you don't have an attorney helping you, the judge will explain the effect of your reaffirming a debt when the hearing on the reaffirmation agreement is held."

"(J) (i) The following additional statements:

"Reaffirming a debt is a serious financial decision. The law requires you to take certain steps to make sure the decision is in your best interest. If these steps are not completed, the reaffirmation agreement is not effective, even though you have signed it.

"1. Read the disclosures in this Part A carefully. Consider the decision to reaffirm carefully. Then, if you want to reaffirm, sign the reaffirmation agreement in Part B (or you may use a separate agreement you and your creditor agree on).

"2. Complete and sign Part D and be sure you can afford to make the payments you are agreeing to make and have received a copy of the disclosure statement and a completed and signed reaffirmation agreement.

"3. If you were represented by an attorney during the negotiation of your reaffirmation agreement, the attorney must have signed the certification in Part C.

"4. If you were not represented by an attorney during the negotiation of your reaffirmation agreement, you must have completed and signed Part E.

"5. The original of this disclosure must be filed with the court by you or your creditor. If a separate reaffirmation agreement (other than the one in Part B) has been signed, it must be attached.

"6. If you were represented by an attorney during the negotiation of your reaffirmation agreement, your reaffirmation agreement becomes effective upon filing with the court unless the reaffirmation is presumed to be an undue hardship as explained in Part D.

"7. If you were not represented by an attorney during the negotiation of your reaffirmation agreement, it will not be effective unless the court approves it. The court will notify you of the hearing on your reaffirmation agreement. You must attend this hearing in bankruptcy court where the judge will review your reaffirmation agreement. The bankruptcy court must approve your reaffirmation agreement as consistent with your best interests, except that no court approval is required if your reaffirmation agreement is for a consumer debt secured by a mortgage, deed of trust, security deed, or other lien on your real property, like your home.

"Your right to rescind (cancel) your reaffirmation agreement. You may rescind (cancel) your reaffirmation agreement at any time before the bankruptcy court enters a discharge order, or before the expiration of the 60-day period that begins on the date your reaffirmation agreement is filed with the court, whichever occurs later. To rescind (cancel) your reaffirmation agreement, you must notify the creditor that your reaffirmation agreement is rescinded (or canceled).

"What are your obligations if you reaffirm the debt? A reaffirmed debt remains your personal legal obligation. It is not discharged in your bankruptcy case. That means that if you default on your reaffirmed debt after your bankruptcy case is over, your creditor may be able to take your property or your wages. Otherwise, your obligations will be determined by the reaffirmation agreement which may have changed the terms of the original agreement. For example, if you are reaffirming an open end credit agreement, the creditor may be permitted by that agreement or applicable law to change the terms of that agreement in the future under certain conditions.

"Are you required to enter into a reaffirmation agreement by any law? No, you are not required to reaffirm a debt by any law. Only agree to reaffirm a debt if it is in your best interest. Be sure you can afford the payments you agree to make.

"What if your creditor has a security interest or lien? Your bankruptcy discharge does not eliminate any lien on your property. A 'lien' is often referred to as a security interest, deed of trust, mortgage or security deed. Even if you do not reaffirm and your personal liability on the debt is discharged, because of the lien your creditor may still have the right to take the security property if you do not pay the debt or default on it. If the lien is on an item of personal property that is exempt under your State's law or that the trustee has abandoned, you may be able to redeem the item rather than reaffirm the debt. To redeem, you make a single payment to the creditor equal to the current value of the security property, as agreed by the parties or determined by the court."

(ii) In the case of a reaffirmation under subsection (m)(2), numbered paragraph 6 in the disclosures required by clause (i) of this subparagraph shall read as follows:

"6. If you were represented by an attorney during the negotiation of your reaffirmation agreement, your reaffirmation agreement becomes effective upon filing with the court."

(4) The form of such agreement required under this paragraph shall consist of the following:

"Part B: Reaffirmation Agreement. I (we) agree to reaffirm the debts arising under the credit agreement described below.

"Brief description of credit agreement:

"Description of any changes to the credit agreement made as part of this reaffirmation agreement:

"Signature: Date:

"Borrower:

"Co-borrower, if also reaffirming these debts:

"Accepted by creditor:

"Date of creditor acceptance:"

(5) The declaration shall consist of the following:

(A) The following certification:

"Part C: Certification by Debtor's Attorney (If Any).

"I hereby certify that (1) this agreement represents a fully informed and voluntary agreement by the debtor; (2) this agreement does not impose an undue hardship on the debtor or any dependent of the debtor; and (3) I have fully advised the debtor of the legal effect and consequences of this agreement and any default under this agreement.

"Signature of Debtor's Attorney: Date:"

(B) If a presumption of undue hardship has been established with respect to such agreement, such certification shall state that in the opinion of the attorney, the debtor is able to make the payment.

(C) In the case of a reaffirmation agreement under subsection (m)(2), subparagraph (B) is not applicable.

(6) (A) The statement in support of such agreement, which the debtor shall sign and date prior to filing with the court, shall consist of the following:

"Part D: Debtor's Statement in Support of Reaffirmation Agreement.

"1. I believe this reaffirmation agreement will not impose an undue hardship on my dependents or me. I can afford to make the payments on the reaffirmed debt because my monthly income (take home pay plus any other income received) is \$ ----, and my actual current monthly expenses including monthly payments on post-bankruptcy debt and other reaffirmation agreements total \$ ----, leaving \$ ---- to make the required payments on this reaffirmed debt. I understand that if my income less my monthly expenses does not leave enough to make the payments, this reaffirmation agreement is presumed to be an undue hardship on me and must be reviewed by the court. However, this presumption may be overcome if I explain to the satisfaction of the court how I can afford to make the payments here: ----.

"2. I received a copy of the Reaffirmation Disclosure Statement in Part A and a completed and signed reaffirmation agreement."

(B) Where the debtor is represented by an attorney and is reaffirming a debt owed to a creditor defined in section 19(b)(1)(A)(iv) of the Federal Reserve Act, the statement of support of the reaffirmation agreement, which the debtor shall sign and date prior to filing with the court, shall consist of the following:

"I believe this reaffirmation agreement is in my financial interest. I can afford to make the payments on the reaffirmed debt. I received a copy of the Reaffirmation Disclosure Statement in Part A and a completed and signed reaffirmation agreement."

(7) The motion that may be used if approval of such agreement by the court is required in order for it to be effective, shall be signed and dated by the movant and shall consist of the following:

"Part E: Motion for Court Approval (To be completed only if the debtor is not represented by an attorney.). I (we), the debtor(s), affirm the following to be true and correct:

"I am not represented by an attorney in connection with this reaffirmation agreement.

"I believe this reaffirmation agreement is in my best interest based on the income and expenses I have disclosed in my Statement in Support of this reaffirmation agreement, and because (provide any additional relevant reasons the court should consider):

"Therefore, I ask the court for an order approving this reaffirmation agreement."

(8) The court order, which may be used to approve such agreement, shall consist of the following:

"Court Order: The court grants the debtor's motion and approves the reaffirmation agreement described above."

Joseph S.U. Bodoff is a partner at the Boston law firm of Bodoff & Slavitt LLP, where his practice concentrates in business bankruptcy, Chapter 11 reorganizations and related litigation, as well as out-of-court workouts and liquidations. He has participated in the financial restructuring of businesses in numerous industries, including manufacturing, retail, wholesale, high technology, service, finance, utilities, health care, agriculture and real estate. He is active in the American Bankruptcy Institute, where he served on its Board of Directors and its Executive Committee. He previously served as co-chair of the ABI Unsecured Trade Creditor Committee and as co-chair of the ABI Northeast Bankruptcy Conference. He currently serves as executive editor of *ABI World* and on the attorney advisory board for the ABI's professional compensation study. He is board certified in Business Bankruptcy Law by the American Board of Certification.

Mr. Bodoff is a frequent lecturer before trade and professional groups and is the author of a number of articles on bankruptcy issues. He is a contributing author of a treatise on asset sales in bankruptcy, having written the chapter on the role of Creditors' Committees in asset sales. As co-chair of the ABI Unsecured Trade Creditor Committee, he spearheaded a project to produce the *ABI Creditors' Committee Manual*, of which over 30,000 copies have been distributed. Under his leadership, the ABI completed a two-year project studying the Bankruptcy Code's preference provisions. Three of the recommendations resulting from the study were included in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, which was enacted in April.