The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005—
Business Bankruptcy Amendments

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INTRODUCTION

On March 10, 2005, the Senate passed S. 256 by a vote of 74-25, and on April 14, 2005, the House of Representatives followed suit by a vote of 302-126. Finally, after nearly a decade of tumultuous and often contentious legislative history, on April 20, 2005, the President signed S. 256 enacting it into law as Pub. L. No. 109-8. The short title of S. 256 is now the “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,” which for purposes of this paper we will call the “Act.”

Section 1501 of the Act provides that the general effective date of the Act shall be 180 days after the date of enactment. Thus the Act is generally effective on October 17, 2005. Please note, however, that certain provisions of the Act have different dates on which they become effective and as to which cases they apply. Section XV below discusses the more important of those particular dates.

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The Act constitutes the most comprehensive set of amendments to the Bankruptcy Code (11 U.S.C.A. sections 101, et seq.) since the 1984 amendments. Although the Act's amendments to the Bankruptcy Code affecting consumer bankruptcies have received the vast majority of publicity and media attention, the Act also made sweeping changes to the business bankruptcy provisions of the Bankruptcy Code. The Act made far-reaching changes to provisions concerning a debtor's exclusivity, non-residential real property leases, utilities, preferences, the ordinary course defense, reclamation claims, and labor issues, among many other things. This article focuses exclusively on the business amendments to the Bankruptcy Code and does not discuss any of the consumer changes to the Bankruptcy Code.

I. ADMINISTRATIVE ISSUES

A. AMENDMENTS THAT AFFECT NON-RESIDENTIAL REAL PROPERTY LEASES

1. Extension of Assumption/Rejection Period—§ 365(d)(4)

The Act amends Bankruptcy Code section 365(d)(4), providing that the time within which a debtor in possession may assume, assume and assign, or reject an unexpired lease of nonresidential real property is the earlier of: "(i) the date that is 120 days after the date of the order for relief; or (ii) the date of the entry of an order confirming the plan." However, on a motion of the trustee or lessor filed prior to the expiration of this period, the court may extend this period for 90 days for cause. After the court grants that first 90-day extension, it cannot further extend the assumption/rejection period without the prior written consent of the lessor in each instance. As a practical matter, the debtor now has 210 days to assume its unexpired leases of non-residential real property.

These amendments will change the course of many Chapter 11 cases where a debtor often seeks to postpone the decision on what to do with its leases until the very end of the case or at least until it determines the size of the reorganized entity. Those debtors will be forced to assume prematurely, or reject, their leases of nonresiden-

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3 All section references in this article, unless otherwise stated, are to the Bankruptcy Code.
tial real property, which could result in large administrative liabilities or premature rejection of potentially valuable leases, even taking into account some amendments to Bankruptcy Code section 503(b). Alternatively, it is quite possible that some financially troubled retailers with seasonal businesses will refuse to file voluntary petitions during the first half of the year and wait for vendors to file an involuntary petition, which can create a gap period outside the statutory limits imposed by these amendments.

2. Administrative Claim Upon Rejection of Lease Previously Assumed by the Debtor—§ 503(b)(7)

In *Nostas Assoc. v. Costich (In re Klein Sleep Products, Inc.)*, the debtor in possession assumed a lease of nonresidential real property. A Chapter 11 trustee was appointed when the debtor’s reorganization efforts failed. The Chapter 11 trustee promptly rejected the lease, and the lessor sought recovery of future rent under the lease. The trustee argued that the rejection of a previously-assumed lease should be treated as a breach entitling the lessor to a general unsecured claim. The Second Circuit disagreed and held that the lessor’s claim for future rent gave rise to an administrative expense claim entitled to priority under Bankruptcy Code section 503(b). The Second Circuit further held that the section 502(b)(6) cap did not apply to the lessor’s claim.

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5 Revised section 365(d)(4) provides:

(4)(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B)(i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days upon motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.


7 Klein, 78 F.3d 18, 30.

8 Klein, 78 F.3d 18, 33.
Amended section 503(b) overrules that portion of *Klein* that held that the lessor was entitled to assert its administrative expense claim without being subject to the cap imposed by section 502(b)(6). Under the Act, a lessor with respect to a lease that was previously assumed and then rejected will have an administrative expense claim for future rent “for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises.”

Damages for “going dark” and penalties are expressly excluded from the administrative claim under revised Bankruptcy Code section 503(b)(7). Mitigation principles will apply only to the extent that the lessor actually receives rent from a nondebtor. This new cap was added in recognition of the severe reduction in the period to assume or reject leases under amended section 365(d)(4).

New section 503(b)(7) overrules that portion of *Klein* that held that the 502(b)(6) cap does not apply to these claims, although the cap will apply on a more limited basis. The cap will apply to the lessor’s claim for future rent after the first two years: “the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6).”

The amendments will most seriously affect Chapter 11 debtors that operate retail chains. In those cases, a debtor often has many leases that it may want to assume or reject, depending on how the retail stores operate during heavy shopping seasons. Under the Act, many of those debtors will not have the benefit of waiting to decide. Either the debtor assumes its leases and takes the chance that it ultimately will have to reject the leases and be subject to the lessor’s administrative claim under revised section 503(b)(7) or the debtor immediately rejects the leases possibly to the detriment of its future business operations.

It is also unclear how these provisions will operate if the landlord has a security deposit. If the lease is assumed and then later rejected, does the security deposit secure the administrative claim under new section 503(b)(7), the claim for remaining sums due for the balance of the term of the lease under section 502(b)(6), or both? If the deposit is insufficient to cover both the section 506(b)(7) claim and the section 502(b)(6) claim, how is it allocat-

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ed? Current law requires that the security deposit reduce the 502(b)(6) capped claim with any excess retained by the estate.11

B. AMENDMENTS THAT AFFECT EXECUTORY CONTRACTS AND UNEXPIRED LEASES


The Bankruptcy Code provides that the debtor cannot assume an executory contract or unexpired lease under which there had been a default unless, at the time of assumption, the debtor cured, or provided adequate assurance that the debtor would promptly cure, such default.12 There existed an exception, however, under former section 365(b)(2)(D). The cure requirement was not applicable to a default that was a breach of a provision relating to, among other things, "the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease."13

Disagreement over the proper interpretation of section 365(b)(2)(D) arose. Debtors argued that pursuant to the express language of section 365(b)(2)(D), it was unnecessary to cure nonmonetary defaults, such as a breach relating to a use provision in a lease. The nondebtor party to the contract or lease used the same statutory language to assert that the only exceptions to the cure requirement were penalty rates or penalty provisions relating to nonmonetary obligations. But the default associated with the breach of the nonmonetary provision itself still needed to be cured. In addition, if that breach was a "historical" breach, it was not possible to cure.

Two courts of appeals split on their interpretation of section 365(b)(2)(D). The court of appeals for the Ninth Circuit, in Worthington v. General Motors Corp. (In re Claremont Acquisition Corp., Inc.),14 prohibited a Chapter 11 debtor from assuming and

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assigning its franchise agreements due to its inability to cure certain nonmonetary defaults arising from its failure to operate the franchise in accordance with the agreement's "going dark" clause. The Ninth Circuit began with the proposition that Bankruptcy Code section 365(b)(1) requires the debtor to cure all monetary and nonmonetary defaults before it can assume or assign an executory contract or unexpired lease. The Ninth Circuit noted that although section 365(b)(2) contains a list of items that need not be cured before assumption and assignment, a nonmonetary default was not one of those items. The dispute was over the construction of the language of former section 365(b)(2)(D):

(2) Paragraph (1) of this section [365(b)] does not apply to a default that is a breach of a provision relating to—

* * *

(D) the satisfaction of any penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.

The debtors and proposed assignees took the position that the phrase "penalty rate or provision" meant "penalty rate or other provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease." The franchisor took the position that the phrase meant "penalty rate or provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease." The Ninth Circuit agreed with the franchisor. Taking the position that the nonmonetary default was a "historical fact" that could not be cured, the Ninth Circuit would not allow the debtor to assign the franchise agreement.

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15 Claremont Acquisition, 113 F. 3d 1029, 1035.
16 Claremont Acquisition, 113 F. 3d 1029, 1033.
18 Claremont Acquisition, 113 F. 3d 1029, 1033.
19 Claremont Acquisition, 113 F. 3d 1029, 1033.
20 Claremont Acquisition, 113 F. 3d 1029, 1034.
21 Claremont Acquisition, 113 F. 3d 1029, 1033-34.
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The court of appeals for the First Circuit, interpreting the same language of section 365(b)(2)(D) in light of the rehabilitative purpose of the Bankruptcy Code, held that it was not necessary for the debtor to cure nonmonetary defaults prior to assumption.22

The Act amends sections 365(b)(1)(A) and 365(b)(2)(D) to address this conflict. Amended section 365(b)(1)(A) provides that:

(b)(1) If there has been a default in an executory contract or unexpired lease of the debtor, the trustee may not assume such contract or lease unless, at the time of assumption of such contract or lease, the trustee—

(A) cures, or provides adequate assurance that the trustee will promptly cure, such default other than a default that is a breach of a provision relating to the satisfaction of any provision (other than a penalty rate or penalty provision) relating to a default arising from any failure to perform nonmonetary obligations under an unexpired lease of real property, if it is impossible for the trustee to cure such default by performing nonmonetary acts at and after the time of assumption, except that if such default arises from a failure to operate in accordance with a nonresidential real property lease, then such default shall be cured by performance at and after the time of assumption in accordance with such lease, and pecuniary losses resulting from such default shall be compensated in accordance with the provisions of this paragraph[.]23

Amended Section 365(b)(2)(D) provides that:

(2) Paragraph (1) of this section [365(b)] does not apply to a default that is a breach of a provision relating to—

* * *

(D) the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.24

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Thus, with respect to personal property leases and other executory contracts, the Act codifies the holding in *Claremont Acquisition*. Amended section 365(b)(2)(D) now provides that the only exceptions to the cure requirement are the satisfaction of penalty rates or penalty provisions. So, in order to assume the executory contract or personal property lease, the debtor must cure breaches of nonmonetary provisions. As discussed in *Claremont Acquisition*, cures of historical defaults are impossible. Therefore, debtors in possession will be unable to assume in those circumstances.

However, *Claremont Acquisition* is no longer good law with respect to unexpired real property leases. Under amended section 365(b)(1)(A), the trustee need not cure defaults that relate to a breach of a nonmonetary obligation under an expired real property lease if it is impossible to do so. However, if the default arises from a failure to operate in accordance with the unexpired real property lease, then that default must be cured by performing at and after the time of assumption in accordance with such lease and by compensating the landlord for its pecuniary losses resulting from such default.

The differing treatment accorded real property leases and executory contracts may create problems for debtors that have defaulted on provisions concerning real property under personal property contracts such as franchise agreements. Under amended section 365(b)(2)(D), those debtors may not be permitted to assume and assign their agreements if it is impossible to cure non-penalty nonmonetary defaults.

2. Impairment of Claims or Interests Related to Nonmonetary Defaults—§ 1124(2).

The Act amends section 1124(2) to correspond with the amendments to section 365(b)(1) & (2). Amended sections 1124(2)(A) & (D) provide that:

Except as provided in section 1123(a)(4) of this title, a class of claims or interests is impaired under a plan unless, with respect to each claim or interest of such class, the plan—

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(2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default—

(A) cures any such default that occurred before or after the commencement of the case under this title, other than a default of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;

* * *

(D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a non-residential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure[.]²⁵

This section appears to prevent “going dark” clauses in loan agreements from preventing reinstatement of the loan as unimpaired. A technical error in the cross reference to section 365(b), however, could lead to the conclusion, contrary to existing law in the Ninth Circuit, that penalty clauses associated with monetary defaults may be subject to cure as a condition of treating a claim as unimpaired.²⁶


Former Bankruptcy Code section 365(c)(4) & (d)(5)-(9) included expired provisions that specifically protect and relate to air carriers and lessors of aircraft terminals. Section 328 of the Act deletes all of those provisions.

²⁵ 11 U.S.C.A. § 1124(2)(A) & (D) (as amended) (emphasis added).
C. UTILITIES—§ 366.

The Act significantly amends Bankruptcy Code section 366. These amendments give a tremendous amount of power to the utilities, making it possible for a utility to alter, refuse, or discontinue utility service without relief from the automatic stay and without court approval.

To begin with, section 366 now includes a definition of the term “assurance of payment”:

(c)(1)(A)For purposes of this subsection, the term “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 that is mutually agreed on between the utility and the debtor or the trustee.27

Note that the above list does not include administrative expense priority as an acceptable form of adequate assurance. In fact, amended section 366(c)(1)(B) provides that administrative expense priority does not constitute adequate assurance. This resolves an ambiguity in the legislative history and conflicting case law favorably for nondebtor utilities.

Turning to a utility’s ability to terminate service without court approval and without relief from the automatic stay, it appears that a utility can do so if the form and amount of adequate assurance payment is not “satisfactory” to the utility. Specifically, amended section 366(c)(2) allows a utility to “alter, refuse, or discontinue utility service, if during the 30-day period beginning on the date of filing of the petition, the utility does not receive from the debtor or the trustee adequate assurance of payment for utility service that is satisfactory to the utility.”28

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Although amended section 366 authorizes the court to modify the amount of the proposed adequate assurance payment, there simply is no requirement that the utility seek court approval before terminating service in accordance with the new provision. Moreover, although it might be suggested that a utility would need to seek relief from the automatic stay before terminating service, the provisions of this section that specifically authorize the utility to terminate service probably will control.

Given a utility’s ability to terminate service, debtors that cannot reach agreements with utilities will have to attempt to preempt termination by seeking relief from the bankruptcy court within the first 30 days of the case. It may not be easy for debtors that successfully preempt termination to have the court modify proposed adequate assurance payments, however. The section sets forth certain facts that the court cannot consider when determining whether to modify an adequate assurance payment. Section 366(c)(3)(B) provides that:

In making a determination… whether an assurance of payment is adequate, the court may not consider… (i) the absence of security before the date of filing of the petition; (ii) the payment by the debtor of charges for utility service in a timely manner before the date of filing of the petition; or (iii) the availability of an administrative expense priority.

In addition to the amendment discussed above, according to section 366(c)(4), the utility will be permitted to “recover or set off against a security deposit provided to the utility by the debtor before the date of filing the petition without notice or order of the court.”

D. PREFERENCES

1. The DePrizio Fix—§ 547(i)

The Bankruptcy Reform Act of 1994 (the 1994 Reform Act) amended Bankruptcy Code section 550 to overrule Levit v. Ingersoll Rand Fin. Corp. (In re DePrizio). DePrizio addressed the is-

issue of the appropriate preference period for payments to third-party lenders on account of debts guaranteed by insiders.

*DePrizio* extended the preference avoidance period from 90 days to one year for non-insider creditors that received payments that benefited an insider. Specifically, *DePrizio* allowed a trustee to recover loan payments that the debtor made to its non-insider lender within one year preceding the bankruptcy filing because those payments benefited the debtor's controlling shareholders who guaranteed the loan. The court in *DePrizio* reasoned that the payments were made for the benefit of a insider creditors because: (1) the insider guarantors benefited from the payments because their obligations under the guarantees were reduced; and (2) the insider guarantors were creditors of the debtor because they had contingent claims against the debtor's estate.

The 1994 Reform Act added subsection (c) to section 550. Subsection (c) provides that:

(c) If a transfer made between 90 days and one year before the filing of the petition—

(1) is avoided under section 547(b) of this title; and

(2) was made for the benefit of a creditor that at the time of such transfer was an insider; the trustee may not recover under subsection (a) from a transferee that is not an insider.\(^{30}\)

After the amendment under the 1994 Reform Act, several decisions held that section 550(c) did not overrule *DePrizio* in some circumstances. One of the decisions that highlighted the loophole was *Roost v. Associates Home Equity Servs., Inc. (In re Williams)*.\(^{31}\) In *In re Williams*, a Chapter 7 debtor and his wife signed a note to finance the purchase of their mobile home. The note was secured by the mobile home and the real property upon which the mobile home was situated. The lender perfected its security interest more than 90 days but less than one year before the commencement of the debtor's Chapter 7 case. Under the *DePrizio* rationale, the trustee sought to avoid the security interest, based upon the fact that the transfer benefited the debtor's wife, who was an insider.


The debtor did not dispute that the transfer benefited his wife. Rather, the debtor argued that Bankruptcy Code section 550(c) prohibited any recovery by the trustee. In response, the trustee argued that it was not attempting to "recover" any property because the debtor’s interest in the mobile home became property of the debtor’s estate upon the commencement of the bankruptcy case. The trustee was not seeking to "recover" any property under Bankruptcy Code section 550(a). Rather, the trustee merely sought to avoid the lender's security interest under Bankruptcy Code section 547(b).

Relying upon canons of statutory construction and those decisions that have recognized that the Bankruptcy Code separates the concepts of avoidance and recovery, the Williams court held that the security interest was avoidable under the DePrizio doctrine even though recovery of a payment would be precluded by section 550(c). The court suggested that had Congress intended to add an exception or defense to section 547, it would have done so.

Congress has now done so by adding subsection (i) to Bankruptcy Code section 547:

If the trustee avoids under subsection (b) a transfer made between 90 days and 1 year before the date of filing of the petition, by the debtor to an entity that is not an insider for the benefit of a creditor that is an insider, such transfer shall be considered to be avoided under this section only with respect to the creditor that is an insider.

Note that this "DePrizio Amendment" fix applies to any case that is pending or commenced on or after the date of enactment of the Act. It is unclear whether the fix will apply to adversary proceedings pending on the date of enactment.

2. Modification of Ordinary Course Defense—§ 547(c)(2)

Amended section 547(c)(2) modifies the ordinary course defense, creating a less rigorous standard for establishing the defense. The former law required that subparagraphs (A), (B), and (C) be satisfied in order to establish an ordinary course defense. The amendments change that standard by making (2)(B) and (2)(C) disjunctive "or" as opposed to conjunctive "and" requirements. The new law provides that a transfer may not be avoided:

32 Congress Credit Corp. v. AJC Intern., 186 B.R. 555, 558 (D.P.R. 1995).
(2) to the extent that such transfer was in payment of a debt in-
curred by the debtor in the ordinary course of business or fi-
ancial affairs of the debtor and the transferee, and such transfer was—

(A) made in the ordinary course of business or financial af-
fairs of the debtor and the transferee; or

(B) made according to ordinary business terms.}\end{quote}

Thus a preference defendant need only establish (2)(A) or (2)(B),
whereas under the prior law the defendant was required to establish
both of these elements to the ordinary course defense. In general,
this will allow defendants to protect payments that, though were not
made in accordance with ordinary business terms, were nevertheless
ordinary as between the parties. This largely follows the construc-
tion placed on the existing statute by Judge Posner in In re Tolona
Pizza Products Corp.\end{quote}

Litigants should note that this defense only protects debts incurred in the ordinary course of business or financial affairs of the debtor and the transferee.

3. Monetary Limitation for Corporate Debtors—§ 547(c)(9)

Before the law was amended, there was no monetary limit on a
business debtor’s ability to pursue a preference. Now, a business
debtor cannot avoid transfers of less than $5,000. Oddly, this “ju-
risdictional minimum” is made an affirmative defense rather than
an element of the trustee’s case in chief. The Act adds Paragraph
(9) to subsection 547(c):

(c) The trustee may not avoid under this section a transfer—

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(9) if, in a case filed by a debtor whose debts are not pri-
marily consumer debts, the aggregate value of all prop-
erty that constitutes or is affected by such transfer is
less than $5,000.


The Act amends 28 U.S.C.A. section 1409(b) to provide that a
trustee may commence a preference action “to recover a money

\[33\ 11 U.S.C.A. § 547(c)(2) (as amended) (emphasis added).

963, 29 Collier Bankr. Cas. 2d (MB) 716, Bankr. L. Rep. (CCH) P 75395 (7th Cir. 1993).]
judgment of or property worth less than $1,000 or a consumer debt of less than $15,000, or a debt (excluding a consumer debt) against a noninsider of less than $10,000, only in the district court for the district in which the defendant resides."

5. Expansion of Time to Perfect a Transfer—§ 547(e)(2)

Bankruptcy Code section 547(e)(2) governs when a transfer is made for purposes of Bankruptcy Code section 547(b). The former law provided that a transfer was made at the time the transfer takes effect between the parties, if the transferee properly perfects its interest within 10 days. If the transferee did not perfect within the 10-day "grace period," the transfer was deemed to have occurred on the date of perfection. Late perfection would have made a transfer otherwise outside the preference period within the period and deny the defendant protection under the contemporaneous exchange for value defense.

The Act amends section 547(e)(2), changing the 10-day grace period to a 30-day grace period. This makes it unlikely that administrative delays in recording financing statements or in obtaining certificates of title will cause preference problems.

6. Expansion of Time to Perfect a Purchase Money Security Interest—§ 547(c)(3)(B)

The Act amends section 547(c)(3)(B) to expand the time period within which a creditor can perfect a purchase money security interest. Before the law was amended, section 547(c)(3)(B) provided that a trustee could not avoid a transfer that created a security interest in property acquired by the debtor "that is perfected on or before 20 days after the debtor receives possession of such property[.]" That 20-day period is now a 30-day period. A trustee will not be permitted to avoid a transfer that is an enabling loan that creates a security interest in property acquired by the debtor that is perfected on or before 30 days after the debtor receives possession of such property.

E. FRAUDULENT TRANSFERS AND OBLIGATIONS—§ 548.

The Act amends Bankruptcy Code section 548 to provide for an increase in the amount of time before the petition date in which a trustee may avoid a transfer or obligation incurred by the debtor from one year to two years. }35 Section 1406 of the Act provides that
this provision shall apply only to cases commenced under Title 11 more than one year after the date of enactment of the Act.

The Act further amends section 548 to make transfers to insiders under employment contracts, not in the ordinary course of business, expressly subject to avoidance. \textsuperscript{36} Section 1406 of the Act provides that this provision is effective on the date of enactment of the Act but applicable only to cases filed on or after the date of enactment.

In most situations, this employment contract amendment appears to add nothing that is not already available under the current statute except for the extension of the lookback period to two years. Transfers and obligations, regardless of how they are created, are voidable as constructively fraudulent if the required elements are satisfied. But this addition marks a significant change in constructive fraudulent transfer law for "solvent" debtors. Under Bankruptcy Code section 548, as amended, transfers made within two years before the petition date to insiders under employment contracts, if not in the ordinary course of business, are subject to avoidance if the debtor received less than reasonably equivalent value in exchange for such transfer, regardless of the solvency, capitalization, or debts of the debtor. \textsuperscript{37}

Moreover, it should be noted that this provision is located within the constructive fraud portion of section 548, which applies a "reasonably equivalent value" standard for determining whether a given transfer or obligation is avoidable. The benefits given would be measured against the value expected to be received from the employee as of that time—and not by hindsight. Arguably, then, most such transfers probably would not be vulnerable.

Finally, the "not in the ordinary course of business" portion of the proposal actually detracts from the effectiveness of the statute because most employment contracts arguably can be treated in the ordinary course of a company’s business, meaning that few such contracts would actually fall within the ambit of the statute. The one kind of contract that might actually be vulnerable is one made with turnaround professionals, which as a policy matter is the one set of contracts that probably should be insulated (or at least somewhat sheltered) from the operation of section 548. Turnaround pro-

\textsuperscript{35} 11 U.S.C.A. § 548(a)(1) (as amended).
\textsuperscript{36} 11 U.S.C.A. § 548(a)(1) (as amended).
professionals employed before the petition date or management that take bonuses within two years before the petition date might very well be subject to this new provision in section 548.

F. POSTPETITION TRANSFERS—§§ 549(C), 101(54), 362(B)

Bankruptcy Code section 549 empowers the trustee, with certain limitations, to avoid unauthorized postpetition transfers of estate property. Section 549(c) provides one of those limitations. Section 549(c) limits the trustee's ability to avoid postpetition transfers of real property to good faith purchasers for present fair equivalent value and without knowledge of the bankruptcy filing, unless a copy or notice of the petition was properly recorded before the transferee perfects its interest in the property.38

Section 1214 of the Act amends Bankruptcy Code section 549(c) to overrule Thompson v. Margen (In re McConville).39 In McConville, lenders that did not have any knowledge of the commencement of the debtor's bankruptcy case made a postpetition mortgage loan to the debtor without obtaining a court order. In addition to holding that the lenders violated Bankruptcy Code section 364(c)(2) by making a secured loan without prior bankruptcy court approval, the Ninth Circuit held that Bankruptcy Code section 549(c) was inapplicable because the postpetition creation of the lien on the debtor's real property was not a "transfer of property" within the meaning of section 549(c).

The problem created by McConville is now corrected. Section 1214 of the Act replaces the phrase "transfer of real property" with "transfer of an interest in real property." Under the revised law, the creation of a lien will fall under the 549(c) exception.

To accompany the amendments to section 549(c), section 1201 of the Act expands the definition of the word "transfer" to include the "creation of a lien." Section 101(54) now provides:

(54) The term "transfer" means—

(A) the creation of a lien;

(B) the retention of title as a security interest;

(C) the foreclosure of a debtor's equity of redemption; or

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38 11 U.S.C.A. § 549(c).
(D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with—

(i) property; or

(ii) an interest in property[.]

Section 311(a) of the Act amends section 362(b) to preclude the stay "of any transfer that is not avoidable under section 544 and that is not avoidable under section 549."

G. RECLAMATION—§ 546(C)

Bankruptcy Code section 546(c) protects a seller of goods' right to reclamation under state law. Before the law was amended, a seller of goods could seek to reclaim goods that the debtor received while it was insolvent, provided that the seller made a written reclamation demand "(A) before 10 days after receipt of such goods by the debtor; or (B) if such 10-day period expires after the commencement of the case, before 20 days after receipt of such goods by the debtor."

The Act amends section 546(c) to provide as follows:

(c)(1) Except as provided in subsection (d) of this section and in section 507(c), and subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof, the rights and powers of the trustee under section 544(a), 545, 547, and 549 are subject to the right of a seller of goods that has sold goods to the debtor, in the ordinary course of such seller's business, to reclaim such goods if the debtor has received such goods while insolvent, within 45 days before the date of the commencement of a case under this title, but such a seller may not reclaim such goods unless such seller demands in writing reclamation of such goods—

(A) not later than 45 days after the date of receipt of such goods by the debtor; or

(B) not later than 20 days after the date of commencement of the case, if the 45-day period expires after the commencement of the case.

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(2) If a seller of goods fails to provide notice in the manner described in paragraph (1), the seller still may assert the rights contained in section 503(b)(9). \(^{41}\)

Thus a seller has a right to reclaim its actual goods under the Act if: (1) the debtor received the goods while it was insolvent and within 45 days before the bankruptcy filing; and (2) the seller makes a written reclamation demand on the debtor (a) not later than 45 days after the date the debtor received the goods, or (b) not later than 20 days after the commencement of the case, if the 45 day period expires after the commencement of the case. \(^{42}\)

Importantly, the prior law permitting the court to deny reclamation of the goods to a seller with such a right that has made a demand in return for granting the seller either a priority claim under section 503(b) or a claim secured by a lien has been stricken from the statute. \(^{43}\) Under the Act, if the seller satisfies the notice and written demand provisions of either section 546(c)(1) or 546(c)(2), then the seller appears to have an absolute right to reclaim its goods.

The automatic stay under Bankruptcy Code section 362, however, has not been amended to take into account the significant changes in a seller’s right to reclamation under the Act. Accordingly, even though a seller might have a right to reclamation under amended section 546(c), such reclamation might still be denied as a violation of the automatic stay as an “act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate.” \(^{44}\) Moreover, the estate’s possession of the property might permit a debtor in possession to sell the property under section 363 of the Bankruptcy Code, at which point the seller might lose the right of reclamation. This issue might well turn on whether the goods at issue are considered property of the estate under section 541.

Moreover, with respect to a seller’s reclamation rights, note the amendment to Bankruptcy Code section 503(b). Section 503(b)(9) allows an administrative expense for “the value of any goods received by the debtor within 20 days before the date of commencement of a case under this title in which the goods have been sold to

\(^{41}\) 11 U.S.C.A. § 546(c) (as amended) (emphasis added).

\(^{42}\) 11 U.S.C.A. § 546(c) (as amended) (emphasis added).

\(^{43}\) 11 U.S.C.A. § 546(c)(2) (former).

the debtor in the ordinary course of such debtor's business.\footnote{11 U.S.C.A. § 503(b)(9) (as amended).} This section may be unworkable because on its face, it does not eliminate the expense if the goods are reclaimed. Moreover, how the goods will be valued remains to be seen. The paragraph appears to be intended to allow certain sellers that do not properly seek reclamation in accordance with section 546(c) to have an administrative expense claim for the value of such goods. This is good for vendors if the estate is not administratively insolvent and especially bad for other administrative claimants if it is.

Amended section 546(c) provides that a seller's reclamation rights are limited by section 507(c)\footnote{Section 546(c) should refer to section 507(b) instead of 507(c). Section 507(b) provides that: "If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection." 11 U.S.C.A. § 507(b). (Bankruptcy Code section 507(c) provides that "[a] claim of a governmental unit arising from an erroneous refund or credit of a tax has the same priority as a claim for the tax to which such refund or credit relates." 11 U.S.C.A. § 507(c)).} and the prior rights of holders of security interests in the goods or the proceeds thereof. This appears to be a cross reference mistake and probably should have referred to section 507(b) rights.

H. STATUTORY LIENS

1. Purchasers for Adequate and Full Value—§ 545(2)

The Act adds a somewhat obscure "except" clause to section 545(2)—the section authorizing the trustee to strong-arm certain statutory liens. Under existing law unrecorded tax liens could be avoided, of course, but under some court decisions, even recorded federal tax liens may lose to a trustee because section 6323 of the Internal Revenue Code of 1986 allows (with respect to certain kinds of property listed in 26 U.S.C.A. section 6323(b)) “[a] person who for adequate and full consideration in money or money's worth, acquires an interest (other than a lien or security interest) in property which is valid under local law against subsequent purchasers without actual notice,”\footnote{Section 546(c) should refer to section 507(b) instead of 507(c). Section 507(b) provides that: "If the trustee, under section 362, 363, or 364 of this title, provides adequate protection of the interest of a holder of a claim secured by a lien on property of the debtor and if, notwithstanding such protection, such creditor has a claim allowable under subsection (a)(1) of this section arising from the stay of action against such property under section 362 of this title, from the use, sale, or lease of such property under section 363 of this title, or from the granting of a lien under section 364(d) of this title, then such creditor's claim under such subsection shall have priority over every other claim allowable under such subsection." 11 U.S.C.A. § 507(b). (Bankruptcy Code section 507(c) provides that "[a] claim of a governmental unit arising from an erroneous refund or credit of a tax has the same priority as a claim for the tax to which such refund or credit relates." 11 U.S.C.A. § 507(c)).} to defeat a recorded tax lien if he
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is without actual notice of the lien. The intent of the amendment
appears to be to prevent the bankruptcy trustee from “stepping into
the shoes” of this kind of purchaser under the statutory lien strong-
arm power.

It is unclear whether the amendment will accomplish this as-
sumed objective. Amended section 545(2) provides that:

The trustee may avoid the fixing of a statutory lien on property
of the debtor to the extent that such lien—

* * *

(2) is not perfected or enforceable at the time of the com-
 mencement of the case against a bona fide purchaser
that purchases such property at the time of the com-
 mencement of the case, whether or not such a pur-
 chaser exists, except in any case in which a purchaser
is a purchaser described in section 6323 of the Internal
Revenue Code of 1986, or in any other similar provi-
sion of State or local law.]48

It is very difficult to parse amended section 545(2). The new
“except” clause appears to be referring to an actual purchaser, and
may be interpreted as creating a kind of safe harbor for such per-
sons. Of course, actual purchasers of property subject to properly
recorded federal tax liens and of the type described are few and far
between, and would in any event unquestionably defeat both the
government and the bankruptcy trustee under the former law. On
the other hand, certainly there are much clearer ways for Congress
to state that a properly recorded tax lien cannot be defeated by a
bankruptcy trustee, if indeed that is what is intended.

The amendment does not appear to change the former law with
respect to a tax lien properly recorded against accounts receiv-
able, inventory and other types of property protected by 26
U.S.C.A. § 6323(c) (dealing with certain types of commercial fi-
nancing agreements).

Note that most courts draw a strong distinction between “bona
fide purchaser” as the term is understood in the context of former
section 545(2) and “purchaser” as it is defined and understood un-

48 11 U.S.C.A. § 545(2) (as amended) (emphasis added).
der Internal Revenue Code section 6323. Those courts generally point out that the distinction lies between the meaning of "value" and "adequate and full consideration."49

2. Warehouseman's Liens—§ 546(i)(1)

Before the Act, a trustee's power to avoid statutory liens included the power to avoid certain warehouseman's liens.50 Amended section 546(i)(1) now limits a trustee's ability to avoid a warehouseman's lien for storage, transportation, or other costs incidental to the storage and handling of goods, notwithstanding the provisions of section 545: "Notwithstanding paragraphs (2) and (3) of section 545, the trustee may not avoid a warehouseman's lien for storage, transportation or other costs incidental to the storage and handling of goods."51

The Act provides that this new provision is to be "applied in a manner consistent with any State statute applicable to such lien that is similar to section 7-209 of the Uniform Commercial Code, as in effect on the date of enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, or any successor to such section 2-709."

I. LABOR ISSUES


Under the former law courts sometimes related the priority of a back pay award to the date of the debtor’s wrongful conduct. Now, without regard to the time of the debtor’s conduct, if the court determines that payment will not substantially increase the probability of layoff or termination of current employees, the Act makes back pay wages and benefits attributable to any period occurring after the commencement of the case an administrative expense.52

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50 11 U.S.C.A. § 545(2) and (3) (former law).
2. Exclusion from Property of the Estate—§ 541(b)(7)

The Act excludes from property of the estate amounts withheld or collected for payments to certain employee benefit plans.\(^{53}\)

3. Mandatory Service as Plan Administrator—§§ 521(a)(7), 704(a)(11)

The Act requires a debtor in possession or trustee to continue to perform the obligations of any employee benefit plan for which the debtor served as administrator on the date of the filing of the petition.\(^{54}\)

In most ERISA plans, the employer either is the plan administrator or appoints the plan administrator. This amendment codifies the position taken by the Department of Labor that the trustee, standing in the shoes of the debtor, has the obligation to continue to perform these functions (or appoint someone to perform these functions) and wind up the plan(s).

4. Employee Wage and Benefit Priorities—§ 507(a)

The Act increases, from 90 days to 180 days before the earlier of the petition date or the date that the debtor ceased business, the period within which unsecured claims for earned wages, salaries, and commissions, including vacation, severance, and sick leave, are entitled to administrative priority under Bankruptcy Code section 507(a).\(^{55}\) The Act also increases the amount of such claim from $4,925 to a maximum of $10,000 for each individual or corporation.\(^{56}\) The effective date of this provision is the date of enactment but it only applies to cases filed after that date.

Similarly, the Act increases the maximum amount of a claim for employee benefit plan contributions entitled to administrative priority to the number of employees covered by each plan multiplied by $10,000 less the sum of (i) the aggregate amount paid to such employees under section 507(a)(4) (as amended), and (ii) the aggregate amount paid on behalf of such employees to any other employee benefit plan.\(^{57}\)

\(^{54}\) 11 U.S.C.A. §§ 521(a)(7) and 704(a)(11) (as amended).
Additionally, although likely not intended, this section may lead the PBGC to file substantial priority claims and may cause enhanced competition between the universes of section 507(a)(4) claimants.

5. Committee of Retired Employees—§ 1114(b)

The Act amends section 1114(b) of the Bankruptcy Code. Section 1114(b) requires that the court, upon motion by a party in interest and after notice and hearing, order the appointment of a committee of retired employees if the debtor seeks to modify or not pay the retiree benefits. Upon entry of an order to appoint a committee of retired employees, section 447 would then confer the responsibility of appointing members to the committee to the UST, rather than the court. As such, it becomes consistent with other provisions regarding appointment of committees.

6. Key Employee Retention Programs—§ 503(c)

Key Employee Retention Programs (KERPs) have become quite prevalent (and lucrative) in Chapter 11 cases. The justification for these programs is to compensate integral employees during the Chapter 11 case on the grounds that such retention is necessary for successful reorganization and, thus, in the best interests of creditors. Under the prior law, no provision specifically concerns approval of KERPs by the bankruptcy court. The Act amends Bankruptcy Code section 503 by adding new subsection (c) specifically providing under what facts and circumstances approval of KERPs and similar severance programs is permissible. Section (c) provides:

(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid—

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that—

(A) 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;

(B) the services provided by the person are essential to the survival of the business; and
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(C) either—

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 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 such transfer is made or obligation is incurred:

(2) a severance payment to an insider of the debtor, unless—

(A) the payment is part of a program that is generally applicable to all full-time employees; and

(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition. 58

The Act severely limits KERP s and severance plans. In fact, this provision will for all intents and purposes eliminate a company's ability to receive court approval for a KERP. A company will now

58 11 U.S.C.A. § 503(c) (as amended).
be required to show not only that each key management employee has another offer, but they will take it absent a KERP. This is nearly an impossible standard to satisfy and requires that each such employee come to court and testify under oath that they have another offer and will leave absent the KERP. A company working through Chapter 11 reorganization would lose productivity while its key employees are out interviewing for jobs, and many of these employees might simply leave. In addition, the Act requires that the debtor prove that the services of the key employee are "essential to the survival of the business." However, for many Chapter 11 companies with good prospects of reorganization, the crucial issue is not merely survival but value creation for their constituents. Even if the company cannot show it will "fail" due to the loss of the employee, successful reorganization usually depends on maximizing the value of the enterprise, which depends on retention of key managers.

Interestingly, the Act says nothing about "incentive" bonus plans, other than a generalized provision that any additional compensation must be justified by the facts and circumstances. It will be interesting to see whether more management compensation programs are categorized as "incentive" bonus plans to get them approved under the provisions of section 503(c)(3) instead of the more cumbersome and scrutinizing provisions of section 503(c)(1) and (2).

7. Reinstatement of Retiree Benefits—§ 1114

The Act amends section 1114 of the Bankruptcy Code to permit the court to reinstate retiree medical, disability or death benefits modified by the debtor within 180 days before the filing of the Chapter 11 petition while the debtor was insolvent unless the balance of the equities clearly favors such modification. This Amendment takes effect on the date of enactment of the Act, but only in cases filed on or after the effective date of the Act.

J. Debtor's Duties Regarding Federal Tax Returns—§ 521(e) & (j)

Section 521 is amended to provide that not later than seven days before the date first set for the meeting of creditors, the debtor shall provide the trustee a copy of the Federal income tax return required under applicable law (or at the election of the debtor, a transcript of such return) for the most recent tax year ending immediately before the commencement of the case and for which a federal
income tax return was filed.\textsuperscript{59} In addition, at the same time that the debtor complies with the above duty, the debtor is required to provide such tax return (or transcript) to any creditor that timely requests a copy.\textsuperscript{60} If the debtor fails to comply with these duties to the trustee or to requesting creditors, the court is required to dismiss the case "unless the debtor demonstrates that the failure to so comply is due to circumstances beyond the control of the debtor."\textsuperscript{61}

The Act amends Bankruptcy Code section 521 to provide that if the debtor fails to file a tax return that becomes due after the commencement of the case or to properly obtain an extension of the due date for filing such return, the taxing authority may request that the court convert or dismiss the case.\textsuperscript{62} Moreover, if the debtor does not file the required return or obtain the extension referred to above within 90 days after a request to convert or dismiss is filed by the taxing authority, the court is required to convert or dismiss the case, whichever is in the best interests of creditors and the estate.\textsuperscript{63}

**K. Transfers Made by Nonprofit Charitable Corporations—**

**§ 363(d)**

Bankruptcy Code section 363(d) is amended to provide that the trustee may use, sell, or lease property under subsection (b) or (c) of this section only:

1. in accordance with applicable nonbankruptcy law that governs the transfer of property by a corporation or trust that is not a moneymed, business, or commercial corporation or trust; and

2. to the extent not inconsistent with any relief granted under subsection (e), (d), (e), or (f) of section 362.\textsuperscript{64}

Although clearly not the intent of the drafters, this amendment could be read to apply to all section 363 sales in bankruptcy.

Because the principal beneficiaries of any nonprofit charitable corporation are supposed to be the members of the general public, each state has detailed legislation governing the management of non-profit charitable corporations.

\textsuperscript{60} 11 U.S.C.A. § 521(e)(2)(A)(ii) (as added).
\textsuperscript{61} 11 U.S.C.A. § 521(e)(2)(B) & (C) (as added).
\textsuperscript{62} 11 U.S.C.A. § 521(g)(1) (as added).
\textsuperscript{63} 11 U.S.C.A. § 521(g)(2).
\textsuperscript{64} 11 U.S.C.A. § 363(d) (as amended).
the nonprofit which provides the attorney general’s office of each particular state with broad supervisory and regulatory authority to assure that this “charitable trust” is carried out. This includes restrictions on the sale of the nonprofit charitable corporation. This amendment to Bankruptcy Code section 363(d) will give the attorneys general of the states significant power to restrict how a nonprofit operates in Chapter 11 in terms of its business plan, Chapter 11 plan, and exit strategy.

I. NOTICE PROVISIONS

The notice provisions of section 342 are amended to provide for specific notice to be served in order to be effective. New section 342(e)(2)(A) and (B) provide as follows:

(2)(A) If, within the 90 days before the commencement of a voluntary 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 correspondence, then any notice required by this title to be sent by the debtor to such creditor shall be sent to such address and shall include such account number.

(B) If a creditor would be in violation of applicable non-bankruptcy law by sending any such communication within such 90-day period and if such creditor supplies the debtor in the last 2 communications with the current account number of the debtor and the address at which such creditor requests to receive correspondence, then any notice required by this title to be sent by the debtor to such creditor shall be sent to such address and shall include such account number. If the notice concerns an amendment that adds a creditor to the schedules of assets and liabilities, the debtor shall include the full taxpayer identification number in the notice sent to that creditor, but the debtor shall include only the last 4 digits of the taxpayer identification number in the copy of the notice filed with the court.

66 See, e.g., Haw. Rev. Stat. § 414D-222 (sale of assets other than in the regular course of activities).
Subsection (c)(2)(A) requires that, within 90 days of the petition date, a creditor sends a communication (which includes an account number) to the debtor requesting to receive correspondence at a certain address, then any bankruptcy notice must be sent to that address and must include the account number. If the debtor does not comply with this provision, then such notice may not be effective under subsection (g) (discussed below). Subsection (c)(2)(B) appears to provide that the foregoing applies even if such communications to the debtor violate applicable nonbankruptcy law.

New subsection (f) of section 342 appears to allow a creditor to file a notice in any bankruptcy court as to how such creditor desires to be served by all bankruptcy courts, and if notice is not served in that manner it may be ineffective under subsection (g). It is unclear how this subsection will work in practice, if at all, in a Chapter 11 case where the debtor in possession or its noticing agent is deputized as a clerk of the court under 28 U.S.C.A. § 156(b).

Finally, new subsection 342(g) provides for notice by the debtor or the court to be effective even if it is not served as required by the other provisions of section 342, if it is received by a person designated by the creditor, and procedures are established to get notice to such person. Subsection (g) provides as follows:

(g)(1) Notice provided to a creditor by the debtor or the court other than in accordance with this section (excluding this subsection) shall not be effective notice until such notice is brought to the attention of such creditor. If such creditor designates a person or an organizational subdivision of such creditor to be responsible for receiving notices under this title and establishes reasonable procedures so that such notices receivable by such creditor are to be delivered to such person or such subdivision, then a notice provided to such creditor other than in accordance with this section (excluding this subsection) shall not be considered to have been brought to the attention of such creditor until such notice is received by such person or such subdivision.

(2) A monetary penalty may not be imposed on a creditor for a violation of a stay in effect under section 362(a) (including a monetary penalty imposed under section 362(k)) or for fail-
ure to comply with section 542 or 543 unless the conduct that is the basis of such violation or of such failure occurs after such creditor receives notice effective under this section of the order for relief.\(^{58}\)

Pursuant to the second sentence of (g)(1), is a creditor now obligated to publish or otherwise make known its internal designations and procedures regarding receipt of notice?

It is unclear whether the above-described notice provisions apply only to notices given by the court or the debtor, or also to the debtor in possession, or even the trustee, which should not be the case. They also possibly apply to the debtor in possession where it has been deputized by the court to act.

Section 1514 is added to provide for notice to foreign creditors. New section 1514 provides as follows:

(a) Whenever in a case under this title notice is to be given to creditors generally or to any class or category of creditors, such notice shall also be given to the known creditors generally, or to creditors in the notified class or category, that do not have addresses in the United States. The court may order that appropriate steps be taken with a view to notifying any creditor whose address is not yet known.

(b) Such notification to creditors with foreign addresses described in subsection (a) shall be given individually, unless the court considers that, under the circumstances, some other form of notification would be more appropriate. No letter or other formality is required.

(c) When a notification of commencement of a case is to be given to foreign creditors, such notification shall—

(1) indicate the time period for filing proofs of claim and specify the place for filing such proofs of claim;

(2) indicate whether secured creditors need to file proofs of claim; and

(3) contain any other information required to be included in such a notification to creditors under this title and the orders of the court.

\(^{58}\) 11 U.S.C.A. § 342(g) (as added).
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(d) Any rule of procedure or order of the court as to notice or the filing of a proof of claim shall provide such additional time to creditors with foreign addresses as is reasonable under the circumstances.⁶⁹

New section 103(k) provides that section 1514 applies to all cases under Title 11.

There is much ambiguity with respect to new section 1514 because of the inarticulate drafting. Subsection (a) refers to creditors "that do not have addresses in the United States." Subsection (b) refers to "creditors with foreign addresses described in subsection (a)," but it is unclear which creditors in subsection (a) this is referencing. This could be referring simply to creditors "that do not have addresses in the United States," but it could also just as easily be referring to "creditors generally" or to "any class or category of creditors" with foreign addresses, which would include all U.S. companies that have foreign addresses or subsidiaries with foreign addresses. Subsection (c) confuses matters further by referring to "foreign creditors." Finally, subsection (d) reverts back to the language of "creditors with foreign addresses," but makes no reference to subsection (a), as subsection (b) does. In short, there is likely to be much confusion and uncertainty with respect to the application of these foreign notice provisions, particularly if a United States creditor chooses to list a foreign address as its preference for notice.

II. SMALL BUSINESS PROVISIONS

A. DEFINITIONS RELATING TO SMALL BUSINESS DEBTORS—§ 101(51C) & (51D)

Before the Act, "small business" was defined in Bankruptcy Code section 101(51)(C). The Act deletes the definition for small business and replaces it with definitions of "small business case" and "small business debtor:"

(51C) "small business case" means a case filed under chapter 11 of this title in which the debtor is a small business debtor;

(51D) "small business debtor"—

(A) subject to subparagraph (B), means a person engaged in commercial or business activities (including any affiliate of such person that is also a debtor under this title and excluding a person whose primary activity is the business of owning and operating real property or activities incidental thereto) that has aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition or the date of the order for relief in an amount not more than $2,000,000 (excluding debts owed to 1 or more affiliates or insiders) for a case in which the United States trustee has not appointed under section 1102(a)(1) a committee of unsecured creditors or where the court has determined that the committee of unsecured creditors is not sufficiently active and representative to provide effective oversight of the debtor; and

(B) does not include any member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than $2,000,000 (excluding debt owed to 1 or more affiliates or insiders).\textsuperscript{70}

To escape the provisions set forth below, a small business debtor is incentivized to form an active creditor's committee.

B. ISSUES AFFECTING PLAN CONFIRMATION

I. New Exclusivity Period in Small Business Cases—\textsection\textsection 1121

Before the Act, a small business debtor (of which there were virtually none, since the current small businesses provisions were both unattractive and elective) had the exclusive right to file a plan until 100 days after the date of the order for relief.\textsuperscript{71} In small business cases, a plan must have been filed in any event, be it by the debtor or another party in interest, within 160 days after the date of the order for relief.\textsuperscript{72} The exclusivity deadline could be extended for cause under former Bankruptcy Code section 1121(e)(3)(B) only if the debtor demonstrated that "the need for an increase is caused by circumstances for which the debtor should not be held accountable."\textsuperscript{73}

\textsuperscript{70} 11 U.S.C.A. \textsection 101(51C) \& (51D) (as amended).
\textsuperscript{71} 11 U.S.C.A. \textsection 1121(e)(1) (former).
\textsuperscript{72} 11 U.S.C.A. \textsection 1121(e)(2) (former).
The small business provisions are no longer optional, according to amended section 1121, if no committee has been appointed or the court determines that the committee is inactive. Thus all business debtors with $2 million or less in debt (other than single asset real estate debtors, which are treated separately) must comply with the special small business provisions if there is no committee or no active committee.

The Act extends the small business debtor's exclusivity period to 180 days and the absolute deadline for plan filing to 300 days after the date of the order for relief. The court will not be permitted to extend those periods unless: (1) 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; (2) a new deadline is imposed at the time the extension is granted; and (3) an extension order is signed before the existing deadline has expired.

The new law changes the standard and may make it more difficult for a small business debtor to extend the exclusivity period successfully. The preponderance of the evidence standard places the burden on the movant (usually the debtor in these instances) to show that it will propose a confirmable plan within a reasonable time period. The former standard only required the debtor to establish that it should not be held accountable for its failure to file a plan. Moreover, small business debtors will need to ensure that they move quickly to seek to extensions before the expiration of the statutory periods.

2. Deadline for Confirmation of a Plan—§ 1129(e)

The Act adds a new subsection (e) to Bankruptcy Code section 1129, which specifies a time period within which a small business debtor's plan must be confirmed.

According to amended section 1129(e), a small business debtor must confirm a plan no later than 45 days after it is filed with the court. That period can be extended if the debtor can demonstrate that it is more likely than not that the court will confirm a plan within a reasonable period of time. If the period is to be extended, a new deadline must be imposed at the time the period is extended and the extension order must be signed before the statutory period expires.

3. Standard Form of Disclosure Statement and Plan

The amendments direct the Judicial Conference of the United States to prescribe standard form disclosure statements and plans of reorganization for small business debtors, in accordance with Rule 9009 of the Federal Rules of Bankruptcy Procedure. These forms are supposed to achieve a practical balance between the reasonable needs of the courts, United States trustees, creditors, and other parties in interest for reasonably complete information, and economy and simplicity for debtors.

4. More Flexible Rules for Plan and Disclosure Statement—§ 1125(f)

Before the Act, a court could conditionally approve a disclosure statement in a small business case.74 Thereafter, the debtor could solicit acceptances or rejections to the plan, provided that holders of claims and interests were mailed a copy of the conditionally approved disclosure statement within 10 days before the confirmation hearing.75 Moreover, the court could hold a combined hearing on the disclosure statement and plan.76

The Act amends section 1125(f) to authorize a court to determine that the plan itself provides adequate information, making it unnecessary to file a separate disclosure statement. Moreover, the section authorizes the court to approve a form disclosure statement. The amendments preserve the court’s ability to (1) conditionally approve a disclosure statement, and (2) combine the plan and disclosure statement hearing. The small business debtor still can solicit acceptances to a conditionally approved disclosure statement, provided that the disclosure statement is mailed to holders of claims and interests at least 25 days before the confirmation hearing.

C. DUTIES OF TRUSTEE OR DEBTOR IN POSSESSION IN SMALL BUSINESS CASES

1. Duties of Debtor in Small Business Cases—§ 1116

The Act added a new section 1116 to Chapter 11 setting forth the duties of trustees or debtors in possession in small business cases. Section 1116 requires a small business debtor to attach addi-

tional information to its voluntary petition, and requires management to attend meetings and hearings. Section 1116 provides that:

In a small business case, a trustee or the debtor in possession, in addition to the duties provided in this title and as otherwise required by law, shall—

(1) append to the voluntary petition or, in an involuntary case, file not later than 7 days after the date of the order for relief—

(A) its most recent balance sheet, statement of operations, cash-flow statement, Federal income tax return; or

(B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;

(2) attend, through its senior management personnel and counsel, meetings scheduled by the court or the United States trustee, including initial debtor interviews, scheduling conferences, and meetings of creditors convened under section 341 unless the court, after notice and a hearing, waives that requirement upon a finding of extraordinary and compelling circumstances;

(3) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances;

(4) file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;

(5) subject to section 363(c)(2), maintain insurance customary and appropriate to the industry;

(6)(A) timely file tax returns and other required government filings; and

(B) subject to section 363(c)(2), timely pay all taxes entitled to administrative expense priority except those
being contested by appropriate proceedings being
diligently prosecuted; and

(7) allow the United States trustee, or a designated representa-
tive of the United States trustee, to inspect the debtor’s
business premises, books, and records at reasonable
times, after reasonable prior written notice, unless notice
is waived by the debtor.\footnote{11 U.S.C.A. § 1116 (as added).}

It appears that the debtor’s tax return must be filed with the
court as a public document.

2. Increased Debtor Reporting Requirements—§ 308

The Act added a new section 308 to Chapter 3 that requires a
small business debtor to file periodic financial and other reports
containing information with respect to the debtor’s profitability
and the debtor’s projected cash receipts and disbursements. In
addition to that information, the small business debtor must report
whether it is in compliance with the requirements of the Bankrupt-
cy Code and the Federal Rules of Bankruptcy Procedure and
whether it has paid its taxes and filed its tax returns. It is unclear
whether these periodic reports will take the place of the monthly
operating reports that are required to be filed and served upon the
Office of the U.S. Trustee.

The effective date of the amendments with respect to the in-
creased debtor reporting requirements is 60 days after the date on
which “rules are prescribed under section 2075 of title 28, United
States Code, to establish forms to be used to comply with section
308 of title 11, United States Code.”

Section 435 of the Act directs the Judicial Conference of the
United States to propose a corresponding Federal Rule of Bank-
ruptcy Procedure to implement new section 308.

3. Increased Supervision by Office of the United States
Trustee—28 U.S.C.A. § 586(a)(7)

The United States Trustee (UST) will have increased monitoring
responsibilities in small business cases. 28 U.S.C.A. § 586(a)(7)
sets forth the UST’s increased monitoring functions in small busi-
ness cases. In small business cases, the UST is now required to
conduct an initial debtor interview “as soon as practicable” after
the date of the order for relief, but before the first meeting of creditors under Bankruptcy Code section 341(a). During the initial debtor interview, the UST will: (i) begin to investigate the debtor's viability; (ii) inquire about the debtor's business plan; (iii) explain the debtor's obligations to file monthly operating reports and other required reports; (iv) attempt to develop an agreed scheduling order; and (v) inform the debtor of other obligations.

In addition to investigating the debtor's viability during the initial debtor interview and making other inquiries, the UST may visit the debtor's business to "ascertain the state of the debtor's books and records, and verify that the debtor has filed its tax returns [...]." Moreover, the UST will review and monitor diligently the debtor's activities, to identify as promptly as possible "whether the debtor will be unable to confirm a plan [...]." This represents a potentially important shift toward involving the UST in business operations as well as case administration.

It is difficult to determine how the UST's increased monitoring function in small business cases will affect a small business debtor's ability to conduct its normal business operations. However, many contend that requiring the UST to have that much involvement in a small business debtor's business affairs will only hinder the small business debtor's reorganization efforts.

D. AUTOMATIC STAY DOES NOT APPLY TO SERIAL FILERS—§ 362(N)(1)

Unless a small business debtor can prove by a preponderance of the evidence that (1) its bankruptcy resulted from circumstances beyond the debtor's control that were not foreseeable at the time the case was filed, and that (2) it is more likely than not that the court will confirm a plan of reorganization (as opposed to a liquidating plan), the automatic stay will not apply in a case in which the debtor:

(A) is a debtor in a small business case pending at the time the petition is filed;

(B) was a debtor in a small business case that was dismissed for any reason by an order that became final in the 2-year period

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ending on the date of the order for relief entered with respect

to the petition;

(C) was a debtor in a small business case in which a plan was
confirmed in the 2-year period ending on the date of the or-
der for relief entered with respect to the petition; or

(D) is an entity that has succeeded to substantially all of the as-
ets or business of a small business debtor described in sub-
paragraph (A), (B), or (C), unless such entity establishe55es by
a preponderance of the evidence that such entity acquired
substantially all of the assets or business of such small busi-
ness debtor in good faith and not for the purpose of evading
this paragraph.80

At first glance, it would appear that the automatic stay does not
apply in a small business case, but that is incorrect. These provi-
sions were added to prevent serial filing. Note that the serial filer provision
will not apply to an involuntary case, provided that there was no col-
lusion by the debtor with creditors. Given the new limitation on the
automatic stay, the preferred course of action for a small business
debtor that has confirmed a plan of reorganization within the past
two years, and subsequently wishes to liquidate in Chapter 11, is to
reopen the prior case. It is unclear why Congress appears to prefer a
failed reorganization to be followed by another attempt at reorgan-
ization than by orderly liquidation under Chapter 11.

III. SINGLE ASSET REAL ESTATE

A. DEFINITION—§ 101(51B)

Single asset real estate (SARE) cases have been of little signifi-
cance so far because the $4 million cap excluded most projects
owned and operated by special purpose entities. The Act eliminat-
ed the $4 million cap:

(51B) 'single asset real estate' means real property constitut-
ing 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 who 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 activities incidental.\textsuperscript{81}

The elimination of the cap means that for the first time the SARE rules will apply in large real estate cases. Note however that the definition will still exclude real estate projects upon which the debtor operates a “real” business — hotels, farms, health care and so forth. Also, there will be significant pressure on defining exactly what is a single “project” for purposes of application of the SARE rules as multi-project entities remain excluded.

B. MONTHLY PAYMENTS—§ 362(D)(3)

Amended section 362(d)(3) provides:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annul-ling, modifying, or conditioning such stay—

* * *

(3) with respect to a stay of an asset against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later—

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments that—

(i) may, in the debtor’s sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured

\textsuperscript{81} 11 U.S.C.A. § 101(51B) (as amended).
by a judgment lien or by an unmatured statutory lien); and

To date there is little case law or experience with section 362(d)(3) because of the cap. It remains to be seen how significant the SARE rules will be in practice in light of this limited experience. But at least in theory, the debtor will have to pay to play; that is, stay current on monthly payments to secured creditors. Application of those monthly payments will depend on whether the creditor is over or undersecured. If the creditor is undersecured, under United Sav. Ass'n of Texas v. Timbers of Inwood Forest Associates, Ltd., the payments should be applied to reduce principal. Alternatively, the debtor can avoid foreclosure by getting a confirmable plan on file within 90 days.

The amendments to subsection (d)(3) allow the debtor (or presumably any party resisting relief from stay) to move to extend the time period for commencement of payments within the 90 days for "cause." The amendments further loosen up the time frame for the commencement of monthly payments by allowing the debtor to contest the applicability of the SARE rules and only requiring payments to commence within 30 days after a determination that SARE is applicable. Especially in the larger cases, debtors may well take advantage of these provisions to defer payment.

C. MONTHLY PAYMENTS FROM PLEDGED RENTS—
§ 362(D)(3)(B)

Before the Act a creditor whose claim was secured by single asset real estate could obtain relief from the automatic stay unless (1) the debtor filed a confirmable plan of reorganization, or (2) the debtor was making monthly payments "to each creditor whose claim is secured by such real estate... which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate."84

There was a split of authority under the former law on whether rents could be a source of required adequate protection payments. The Act amends section 362(d)(3)(B) to make it possible for debtors to commence making payments to secured creditors from pledged rents. Since rents are the only likely source of cash payments in a SARE case, this is a major concession to debtors.

D. RATE OF INTEREST—§ 363(D)(3)(B)(II)

Before the law was amended, a single asset real estate debtor could commence making monthly payments “equal to interest at a current fair market value rate on the value of the creditor’s interest in real estate.” The Act changes the applicable rate of interest to “an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor’s interest in the real estate.” This should simplify administration of the statute and under market conditions of falling rates probably works to the advantage of lenders.

Note that the payments are measured in the amount of interest; they are not interest payments. Whether the payments will be attributable to interest or principal probably will depend on whether the secured creditor’s lien on the property is over or undersecured.

E. CREATION OR PERFECTION OF LIENS FOR SPECIAL TAXES OR ASSESSMENTS ON REAL PROPERTY—§ 362(B)(18)

The Second Circuit, in Lincoln Sav. Bank, et al v. Suffolk County Treasurer (In re Parr Meadows Racing Ass’n, Inc.), held that the automatic stay prohibited “[t]he creation of a local tax lien upon real property unless the county has a prepetition interest in the real property[.]” The 1994 amendments to the Bankruptcy Code overruled Parr Meadows by creating an additional exception to the automatic stay for “[t]he creation or perfection of a statutory lien for an ad valorem property tax imposed by the District of Columbia or a political subdivision of the State, if such tax comes due after the filing of the petition.”

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Amended section 362(b)(18) expands the overruling of *Parr Meadows* by clarifying that the exception to the stay applies to all special taxes and assessments on real estate, whether or not ad valorem:

(18) under subsection (a) of the creation or perfection of a statutory lien for an ad valorem property tax, or a special tax or special assessment on real property whether or not ad valorem, imposed by a governmental unit, imposed by the District of Columbia, or a political subdivision of a State, if such tax or assessment comes due after the date of the filing of the petition.\(^8\)

**IV. CHAPTER 11 PLAN ISSUES**

**A. EXCLUSIVITY—§ 1121(D)**

Amended section 1121(d) will affect the debtor's ability to seek unlimited extensions of the plan exclusivity and solicitation periods. Before the Act, Bankruptcy Code section 1121(d) permitted a party in interest to seek to reduce or increase (1) the 120-day period within which the debtor has the exclusive right to submit a plan of reorganization and (2) the 180-day period within which the debtor must obtain acceptances to its proposed plan of reorganization. Former section 1121(d) did not limit the debtor's ability to continue to seek extension after extension, provided that the requisite cause is established each time.

The Act adds a new paragraph to section 1121(d), which limits the debtor to a 14-month extension in the case of both the exclusivity and plan solicitation periods:

(2)(A) The 120-day period specified in paragraph (1) may not be extended beyond a date that is 18 months after the date of the order for relief under this chapter.

(B) The 180-day period specified in paragraph (1) may not be extended beyond a date that is 20 months after the date of the order for relief under this chapter.\(^9\)

These revisions will have the most serious impact on the larger, more complex and more contentious Chapter 11 cases, and may

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\(^8\) 11 U.S.C.A. § 362(b)(18) (former).

encourage creditors to stall negotiations toward a consensual plan in order to obtain the right to file competing plans in such cases.

B. REVISED DEFINITION OF “ADEQUATE INFORMATION”—§ 1125(A)(1)

The Act expanded the definition of “adequate information” to include the following language “[I]n determining whether a disclosure statement provides adequate information, the court shall consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing additional information.”

Moreover, section 717 of the Act specifies that “adequate information” also should include “a discussion of the potential material Federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case.”

C. MODIFICATION OF PLAN—§ 1127(F)

New section 1127(f)(1) makes clear that the pre-confirmation modification of a plan must comply with the requirements of sections 1121 through 1128 and all of the requirements of section 1129. Moreover, new section 1127(f)(2) provides that the plan as modified becomes the plan only after there has been disclosure under section 1125 as the court may direct and such modification is approved by the court.

D. DISCHARGE

1. Individual Chapter 11 Debtors—Plan Payments Must be Made Before Discharge is Effective—§§ 1129(a)(14) & (15), 1141(d)(5)

The Act added a new paragraphs (14) and (15) to section 1129(a) applicable to debtors who are individuals. New paragraph (14) provides as follows:

(14) If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such

statute for such obligation that first became payable after the
date of the filing of the petition. 93

New paragraph (15) provides as follows:

(15) In a case in which the debtor is an individual and in which
the holder of an allowed unsecured claim objects to the con-
firmation of the plan—

(A) the value, as of the effective date of the plan, of the prop-
erty to be distributed under the plan on account of such
claim is not less than the amount of such claim; or

(B) the value of the property to be distributed under the plan is
not less than the projected disposable income of the debtor
(as defined in section 1325(b)(2)) to be received during the
5-year period beginning on the date that the first pay-
ment is due under the plan, or during the period for which
the plan provides payments, whichever is longer. 94

Although some might characterize these provisions as peonage,
it is unlikely that they will be challenged as such unless the debtor
is put into Chapter 11 involuntarily (through an involuntary peti-
tion or conversion) and the court confirms a creditor’s plan over
the debtor’s dissent.

The Act also added a new paragraph to subsection 1141(d) that
requires a Chapter 11 individual debtor to complete all payments
under a plan before a discharge will become effective. 95 The
amendments to section 1141(d)(5)(A) simply clarify that an indi-
vidual must confirm a plan and complete all of the payments under
the plan before a discharge will become effective. Section
1141(d)(5)(B) gives the court discretion to grant a discharge to an
individual Chapter 11 debtor that has not completed all of the pay-
mants under a plan if:

(i) the value, as of the effective date of the plan, of property ac-
      tually distributed under the plan on account of each allowed
      unsecured claim is not less than the amount that would have

been paid on such claim if the estate of the debtor had been liquidated under chapter 7 on such date; and

(ii) modification of the plan under section 1127 is not practicable.96

2. Corporate Chapter 11 Debtors—Limitation on Discharge of Certain Fraud and Tax Claims in Chapter 11—
§ 1141(d)(6)

The Act added paragraph (6) to section 1141(d) to circumscribe the scope of the Chapter 11 discharge. A brief review of the legislative history is useful in understanding the scope of this provision. In the 107th Congress, H.R. 333 (House Bill) subjected corporate debtors to an exception from discharge for certain false and fraudulent taxes, and also probably intended to make applicable to corporate debtors the section 523(a)(2) exception to discharge for certain debts incurred by fraud.

Amended 1141(d)(6), according to section 708 of the House Bill, provided that:

(6) Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor that is a corporation from any debt described in section 523(a)(2) or for a tax or customs duty with respect to which the debtor—

(A) made a fraudulent return; or

(B) willfully attempted in any manner to evade or defeat that tax or duty.

As drafted, the House Bill clearly excluded fraudulent tax or customs duty claims from a corporate Chapter 11 debtor’s discharge if the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat the claim. Less clear, however, was whether the amendment would subject corporate debtors to the section 523(a)(2) exception to discharge for non-tax debts. The ambiguity concerned the absence of a comma after “523(a)(2).” As drafted, the plain language of the amendment limited the 523(a)(2) debts excepted from discharge to those “with respect to which the debtor made a fraudulent return or willfully attempted in any manner to evade or defeat that tax or duty.”

On the other hand, it could be argued that the drafters intended to place a comma after "section 523(a)(2)," which would have made section 523(a)(2) applicable to corporate debtors to allow creditors to pursue postconfirmation fraud actions against corporate debtors. The problem with that outcome is that section 523(c) requires the bankruptcy court to exercise exclusive jurisdiction over nondischargeability complaints under section 523(a)(2). Although the bankruptcy judge is not required to determine the amount of the nondischargeable debt, most exercise their power to do so. It is unclear whether bankruptcy courts will exercise exclusive jurisdiction over section 1141 nondischargeability complaints to the extent they involve debts "described" in section 523(a)(2).

Not surprisingly, the House version of new paragraph (6) raised a lot of concern among bankruptcy practitioners by opening the door for any creditor to seek exception to the Chapter 11 discharge on grounds of fraud perhaps even after confirmation of the plan. In the 107th Congress, the Senate fixed one potential problem created by the House by making it clear that the provision applies only to the claims of governmental units against corporate debtors under certain limited circumstances. A modified version of the Senate's proposed provision was agreed upon by the House and Senate, and this version was adopted in the 109th Congress and contained in the Act. Accordingly, amended section 1141(d)(6) provides that:

(6) Notwithstanding paragraph (1), the confirmation of a plan does not discharge a debtor that is a corporation from any debt—

(A) of a kind specified in paragraph 2(A) or 2(B) of section 523(a) that is owed to a domestic governmental unit, or owed to a person as a result of an action filed under subchapter III of chapter 37 of title 31 or any similar State statute; or

(B) for a tax or customs duty with respect to which the debtor—

(i) made a fraudulent return; or

(ii) willfully attempted in any manner to evade or defeat such tax or such customs duty.97

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In this section the semicolon after "similar State statute" removes the ambiguity about whether the scope extends to non-tax fraud debts.

As drafted, the new provision includes claims of a person under subchapter III of Title 37. Subchapter III of Chapter 37 of Title 31 is entitled "Claims Against the United States Government." The various sections of subchapter III of Chapter 37 authorize the Attorney General or the heads of various federal governmental agencies to settle claims that are asserted against the United States. Such claims include, but are not limited to, claims of or relating to government employees, property damage, and damages caused by the Federal Bureau of Investigation.

Claims arising under subchapter III of chapter 37, however, are not only limited to claims against the United States government. Section 3729 permits the United States government to bring a civil action against private parties who bring "false claims" claims against the United States government. Section 3730 permits private persons to bring a Qui Tam action against any person for violation of section 3729. Thus a debt owed by a debtor to a private person and/or the United States government as a result of a "false claims" Qui Tam action filed under 31 U.S.C.A. §§ 3729, et seq., is not dischargeable under a plan.

E. TAX PROVISIONS

1. Rate of Interest on Tax Claims—§ 511

The Act adds a new section to chapter 5 of the Bankruptcy Code. Section 511 relates to the rate of interest on tax claims. Section 511 provides that the rate of interest on a tax claim is determined under applicable nonbankruptcy law:

(a) If any provision of this title requires the payment of interest on a tax claim or on an administrative expense tax, or the payment of interest to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be the rate determined under applicable nonbankruptcy law.99

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It is unclear whether "the rate determined under applicable non-bankruptcy law" is the default rate. This issue is particularly interesting where the tax claim is secured and reinstated in a Chapter 11 case under section 1124(2). New section 511(b) provides that if taxes are to be paid under a confirmed plan, "the rate of interest shall be determined as of the calendar month in which the plan is confirmed." This revision does not take into account that in some cases, the effective date of the plan is long after confirmation.

2. Time and Manner of Payment of Tax Claims Under a Plan—§ 1129(a)(9)(C) & (D)

Before the Act, one of the requirements for confirmation of a plan was that the plan provide that the allowed unsecured claims of governmental units "receive on account of such claim deferred cash payments, over a period not exceeding six years after the date of assessment of such claim, of a value, as of the effective date of the plan, equal to the allowed amount of such claim." The Act significantly amends section 1129(a)(9)(C).

First, governmental units holding allowed unsecured claims must receive on account of such claim, regular installment payments in cash "of a total value, as of the effective date of the plan, equal to the allowed amount of such claim." Second, payments to taxing authorities can no longer be stretched out for a period of six years from the date of assessment. Under amended section 1129(a)(9)(C)(ii), those claims must be paid in full within five years after the date of the entry of the order for relief.

Third, and perhaps most significant, a taxing authority must be paid in a manner not less favorable than other non-priority unsecured claims provided for by the plan (other than cash payments made to a convenience class). Thus, if a class (other than a convenience class) is paid on the effective date of the plan, then it is arguable that the taxing agency must be paid on the effective date as well. On the other hand, if trade claims are paid at a discount on the effective date, perhaps the payment in full of the tax claim a few years later is not a manner less favorable. Courts will interpret

the statute to determine whether the "manner" of payment refers to the kind, timing, amount, or percentage of consideration paid or some other factors.

Finally, taxing authorities holding secured claims that would otherwise meet the description of unsecured priority claims will be entitled to cash payments in the same manner and over the same period as described above.103 This provision implies that "manner" does not refer to whether a payment obligation is secured or unsecured.

3. Taxes Incurred Before the Commencement of the Case—§ 507(a)(8)(B)

Before the law was amended, the unsecured property tax claims of governmental units qualified for priority under Bankruptcy Code section 507(a)(8) if property taxes were assessed before the commencement of the case.104 The Act amended section 507(a)(8)(B) to provide that property taxes that have been incurred before the commencement of the case receive priority treatment.105 Accordingly, taxes that are incurred prepetition but assessed postpetition will qualify for priority treatment under Bankruptcy Code section 507(a)(8).

4. Determination of Tax Liability—§ 505(a)(2)(C)

Before the law was amended, a bankruptcy court could determine the debtor's tax liability, unless the matter was already contested and adjudicated before a court of competent jurisdiction.106 The Act added a new subparagraph (C) to section 505(a)(2), preventing the bankruptcy court from determining "the amount or legality of any amount arising in connection with an ad valorem tax on real or personal property of the estate, if the applicable period for contesting or redetermining that amount under any law (other than a bankruptcy law) has expired."107

Most states have statutes that provide a limited time period within which a party may contest the assessment of an ad valorem tax. Under amended section 505(a), a bankruptcy court is not au-
authorized to adjudicate a dispute over the assessment of an ad valorem tax after the expiration of the applicable non-bankruptcy period for contesting or determining the assessment.

5. Provisions Affecting Subordination of Tax Liens—§ 724(b) & (e)

Bankruptcy Code section 724(b) provides for the subordination of tax liens to pay among other things, secured claims and administrative expenses. Former section 724(b)(1) granted first priority to holders of allowed claims that were secured by a lien on the property that also was subject to a tax lien. The Act amends section 724(b)(1) to provide that tax liens arising in connection with ad valorem taxes will not be subordinated to the payment of secured claims. Amended section 724(b)(1) provides that:

(b) Property in which the estate has an interest and that is subject to a lien that is not avoidable under this title (other than to the extent that there is a properly perfected unavoidable tax lien arising in connection with an ad valorem tax on real or personal property of the estate) and that secures an allowed claim for a tax, or proceeds of such property, shall be distributed—

(1) first, to any holder of an allowed claim secured by a lien on such property that is not avoidable under this title and that is senior to such tax lien[.]

Perhaps more problematic is the section that essentially re-orders the priority for the payment of Chapter 11 administrative expenses in cases that have been converted to Chapter 7. Former section 724(b)(2) granted second priority over tax liens to holders of allowed administrative expense claims under section 507(a)(1). Such claims included Chapter 11 administrative expenses incurred during Chapter 11 cases that are later converted to Chapter 7. Amended section 724(b)(2)(2) makes it clear that Chapter 11 administrative expenses, except for certain employee claims, will no longer receive second priority under section 724(b)(2). Amended section 724(b)(2) provides:

(2) second, to any holder of a claim of a kind specified in section 507(a)(1) (except that such expenses, other than claims

of wages, salaries, or commissions that arise after the filing of a petition, shall be limited to expenses incurred under chapter 7 of this title and shall not include expenses incurred under chapter 11 of this title, 507(a)(2), 507(a)(3), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title, to the extent of the amount of such allowed tax claim that is secured by such tax lien."  

Finally, the Act adds a new paragraph (e) to section 724:

(e) Before subordinating a tax lien on real or personal property of the estate, the trustee shall—

(1) exhaust the unencumbered assets of the estate; and

(2) in a manner consistent with section 506(c), recover from property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving or disposing of such property.

6. Setoff of Tax Refunds—§ 326(b)(26)

Before the Act, the automatic stay would preclude a taxing authority from setting off an income tax refund under certain circumstances. According to amended section 362(b)(26), a governmental unit can set off a tax refund with respect to a taxable period that ended before the commencement of the case against an income tax liability for a taxable period that ended before the commencement of the case.

However, if applicable nonbankruptcy law would not permit the setoff due to a pending action to determine the amount or legality of a tax liability, the government cannot set off the refund, but may hold it pending resolution of the action. The taxing authority can be compelled to release the tax refund, but only if it is granted adequate protection (within the meaning of section 361) for its secured claim under Bankruptcy Code section 506(a).

7. Stay of Tax Proceedings Limited to Prepetition Taxes—§ 362(a)(8)

Before the Act, the automatic stay applied to "[t]he commencement or continuation of a proceeding before the United States Tax
Court concerning the debtor."\textsuperscript{113} The Act amends section 362(a)(8) to make the stay applicable to "[t]he commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title."\textsuperscript{114}

F. Appointment of Trustee in Cases Suspected of Fraud—
§ 1104(e)

The Act amends section 1104 of the Bankruptcy Code by adding a new subsection (e) providing for the UST to move for the appointment of a trustee if reasonable grounds exist of suspected fraud in the management of the debtor or the debtor's public financial reporting by the executives or management of the Chapter 11 debtor. New subsection (e) provides as follows:

(e) The United States trustee shall move for the appointment of a trustee under subsection (a) if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor's chief executive or chief financial officer, or members of the governing body who selected the debtor's chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor's public financial reporting.\textsuperscript{115}

The Amendment is effective on the date of enactment of the Act, but only in cases filed on or after that date.

V. PREPACKAGED BANKRUPTCIES

A. PREPETITION SOLICITATION AND ACCEPTANCE—
§ 1125(G)

Before the Act, a debtor could not solicit acceptances or rejections to a plan postpetition until the holders of each claim or interest received a bankruptcy court-approved disclosure statement.\textsuperscript{116}

\textsuperscript{113} 11 U.S.C.A. § 362(a)(8).
\textsuperscript{114} 11 U.S.C.A. § 362(a)(8) (as amended).
\textsuperscript{115} 11 U.S.C.A. § 1104(e) (as amended).
\textsuperscript{116} 11 U.S.C.A. § 1125(b)(former).
With respect to a prepackaged plan, the debtor could solicit acceptances under section 1126(b) but apparently that solicitation process could not continue postpetition without the approval of a disclosure statement. The Act adds a new subsection (g) to section 1125, making it clear that “an acceptance or rejection of the plan may be solicited from a holder of a claim or interest if such solicitation complies with applicable nonbankruptcy law and if such holder was solicited before the commencement of the case in a manner complying with applicable nonbankruptcy law."\textsuperscript{117}

B. NO MEETING OF CREDITORS REQUIRED IN PREPACKAGED BANKRUPTCY—§ 341(E)

A party in interest can now request that the UST refrain from convening a meeting of creditors under Bankruptcy Code section 341(a) if the debtor has solicited acceptances to a prepackaged plan.\textsuperscript{118} After notice and a hearing, and if there is cause, the court may direct the UST to refrain from convening a 341(a) meeting.

VI. CREDITOR’S COMMITTEES

A. REIMBURSEMENT OF ATTORNEY’S FEES—§ 503(B)(4)

The Third Circuit held that the 1994 amendment to Bankruptcy Code section 503(b)(3)(F), which authorized reimbursement of expenses incurred by creditor’s committee members, authorized reimbursement of attorney’s fees incurred by members of a creditors’ committee.\textsuperscript{119}

Overruling \textit{In re First Merchants Acceptance Corp.}, the Act amends section 503(b)(4) to clarify that committee members cannot be reimbursed for the attorney’s fees that they incur in connection with committee activities.\textsuperscript{120} Amended 503(b)(4) specifically

\textsuperscript{117} 11 U.S.C.A. § 1125(g) (added).

\textsuperscript{118} 11 U.S.C.A. § 341(c)(added).


\textsuperscript{120} 11 U.S.C.A. § 503(b)(3)(F) (providing for reimbursement to committee members).
excludes 503(b)(3)(F) when it refers to which parties can seek reasonable compensation for accountants and attorneys.

B. EXPANSION OF COMMITTEES—§ 1102(A)(4) & (B)(3)

The Act amends Bankruptcy Code section 1102(a), making it clear that the bankruptcy judge may change the composition of creditors’ and equity security holders’ committees that are appointed by the UST on request of a party in interest and after notice and a hearing. In addition, the court can order the UST to add to the committee a small business concern creditor if that creditor “holds claims (of the kind represented by the committee) the aggregate amount of which, in comparison to the annual gross revenue of that creditor, is disproportionately large.”

Amended section 1102(b) increases the committee members’ duties to non-member creditors. The committee will be required to provide non-member creditors access to committee information and solicit and receive comments from non-members. It is unclear how the committee members that have signed confidentiality agreements with the debtor or other parties in interest will be able to carry out these newly-created disclosure duties. It is also unclear whether giving non-member creditors access to committee communications with counsel will waive the committee’s attorney/client privilege.

C. ELECTION OF TRUSTEE—§ 1104(B)

The Act amends Bankruptcy Code section 1104(b) to provide procedural clarification regarding resolution of disputes over the election of a trustee at a meeting of creditors. The elected trustee is deemed “appointed” so that exclusivity will clearly terminate under section 1121(c)(1) of the Bankruptcy Code.

VII. CONSUMER PRIVACY

In the Toysmart.com Chapter 11 case, the question arose whether Toysmart.com could sell its customer list (containing approximately 250,000 names, addresses, billing information, shopping preferences, and family profiles) free of its contractual obli-

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gation to maintain customer privacy. Toysmart.com, a retailer of
educational toys, was 60% owned by Buena Vista Internet Group,
a subsidiary of Walt Disney.

Shortly after the commencement of its Chapter 11 liquidating
case, Toysmart.com filed a motion pursuant to Bankruptcy Code
section 363(b), seeking approval to sell substantially all of its as-
sets, including its customer list. Several parties objected to the sale
motion, including the Federal Trade Commission (the FTC), attor-
ey general of 39 states, and TRUSTe, an organization that certi-
fies companies that adhere to online privacy guidelines.

Just before the hearing on the sale motion, Toysmart.com and
the FTC reached a settlement which would have allowed Toys-
smart.com to sell its customer list to a buyer that was willing to pur-
chase Toysmart.com’s entire Web site. The bankruptcy court did
not approve the FTC settlement. The matter was eventually settled
when Buena Vista Internet Group offered Toysmart.com $50,000
to destroy its customer list.

The Toysmart.com case began the debate over the protection of
consumer privacy in the context of Bankruptcy Code section 363
asset sales. The consumer privacy issue raised many questions
about how consumer privacy could be protected during the age of
internet bankruptcies, where customer lists often constitute a ma-
jor portion of the debtor’s assets.

The amendments ensure that debtors sell “personally identifi-
able information” in accordance with their prepetition privacy pol-
cies by revising Bankruptcy Code section 363(b). “Personally
identifiable information” is defined in revised Bankruptcy Code
section 101(41A) as follows:

(41A)‘personally identifiable information’ means—

(A) if provided by an individual to the debtor in connection
with obtaining a product or a service from the debtor pri-
marily for personal, family, or household purposes—

(i) the first name (or initial) and last name of such indi-
vidual, whether given at birth or time of adoption, or
resulting from a lawful change of name;

(ii) the geographical address of a physical place of resi-
dence of such individual;
(iii) an electronic address (including e-mail address) of such individual;

(iv) a telephone number dedicated to contacting such individual at such physical place of residence;

(v) a social security account number issued to such individual; or

(vi) the account number of a credit card issued to such individual; or

(B) if identified in connection with 1 or more of the items of information specified in subparagraph (A)—

(i) a birth date, the number of a certificate of birth or adoption, or a place of birth; or

(ii) any other information concerning an identified individual that, if disclosed, will result in contacting or identifying such individual physically or electronically.

Amended section 363(b) prohibits a debtor from selling personally identifiable information in a manner that is inconsistent with its prepetition privacy policy (unless the court orders otherwise). In determining whether a debtor can sell personally identifiable information in a manner that is inconsistent with its prepetition privacy policy, the court is required to give due consideration to the facts and circumstances of the sale or lease. Ironically, these nominally privacy-protective provisions appear to broaden the authority of the debtor to use, and the court to authorize the sale of, customer lists in derogation of the debtor's prepetition contractual privacy obligations.

To further protect consumers' privacy in the context of section 363(b) sales, the court may order the UST to appoint a consumer privacy ombudsman. The Act added a new section 332 to set forth the duties of the ombudsman. The UST will appoint a disinterested person to act as an ombudsman when a debtor attempts to sell customer information in violation of its prepetition nondisclosure policies. The ombudsman will act as a friend of the court to assist the court in its consideration of the facts, circumstances, and conditions of the sale or lease. The ombudsman may also present

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information to the court to assist the court in its decision. Such in-
formation could include presentation of the debtor's privacy poli-
cy, potential losses or gains of privacy to consumers that the sale or
lease is approved, potential costs or benefits to consumers if the
sale or lease is approved, and potential alternatives which mitigate
potential privacy losses or potential cost to consumers.127

The ombudsman will be compensated at the expense of the es-
tate under Bankruptcy Code section 330.128

VIII. APPELLATE JURISDICTION

The Act revises 28 U.S.C.A. §158(d), making it possible for
parties to bypass district court or Bankruptcy Appellate Panel
(BAP) review and appeal orders and decrees of the bankruptcy
court directly to the courts of appeals. The Act sets forth the stan-
dard for the direct appeal:

(d)(1) The courts of appeals shall have jurisdiction of appeals
from all final decisions, judgments, orders, and decrees en-
tered under subsections (a) and (b) of this section.

(2)(A) The appropriate court of appeals shall have juris-
diction of appeals described in the first sentence of
subsection (a) if the bankruptcy court, the district
court, or the bankruptcy appellate panel involved,
acting on its own motion or on the request of a party
to the judgment, order, or decree described in such
first sentence, or all the appellants and appellees (if
any) acting jointly, certify that—

(i) the judgment, order, or decree involves a ques-
tion of law as to which there is no controlling de-
cision of the court of appeals for the circuit or of
the Supreme Court of the United States, or in-
volves a matter of public importance;

(ii) the judgment, order, or decree involves a ques-
tion of law requiring resolution of conflicting de-
cisions; or

(iii) an immediate appeal from the judgment, order, or decree may materially advance the progress of the case or proceeding in which the appeal is taken;

and if the court of appeals authorizes the direct appeal of the judgment, order, or decree.

(B) If the bankruptcy court, the district court, or the bankruptcy appellate panel—

(i) on its own motion or on the request of a party, determines that a circumstance specified in clause (i), (ii), or (iii) of subparagraph (A) exists; or

(ii) receives a request made by a majority of the appellants and a majority of appellees (if any) to make the certification described in subparagraph (A);

then the bankruptcy court, the district court, or the bankruptcy appellate panel shall make the certification described in subparagraph (A).\(^{129}\)

That standard will apply to final and interlocutory orders entered by the bankruptcy court. Final orders of the district court and bankruptcy appellate panel will remain appealable as of right to the courts of appeals as under pre-Act law.

Before the Act, as a matter of right, a party could appeal, to the district court or the BAP, final judgments, orders, and decrees of the bankruptcy court and interlocutory orders increasing or reducing plan exclusivity periods in Bankruptcy Code section 1121. The Act prohibits a party from appealing those matters directly to the courts of appeals without meeting the above standard.

With respect to all other interlocutory orders, the pre-Act law required a party to seek "leave of court" before an appeal was allowed. That section did not set forth any standards for determining when leave of court is appropriate. However, several courts did adopt the analogous provision of 28 U.S.C.A. §1292(b) as the standard for determining when a party should be granted leave to appeal. An analogous section authorizing certification of interlocutory appeals under the general jurisdictional statutes of the courts of appeals is 28 U.S.C.A. § 1292(b). It provides that:

\(^{129}\) 28 U.S.C.A. §158(d) (as amended).
(b) When a district judge, in making in a civil action an order not otherwise appealable under this section, shall be of the opinion that such order involves a controlling question of law as to which there is substantial ground for difference of opinion and that an immediate appeal from the order may materially advance the ultimate termination of the litigation, he so shall state in writing in such order. The Court of Appeals... may thereupon, in its discretion, permit an appeal to by taken from such order.\textsuperscript{130}

In general, courts have imposed a very high standard for certification of appeals under section 1292(b), and certification is rarely granted. Some courts adopt the section 1292(b) standard for determining when leave of court is appropriate,\textsuperscript{131} but most courts appear to apply a less rigorous standard. The ability of the parties or the bankruptcy court (in lieu of the district court) to certify a direct appeal and the absence of section 1292(b)'s controlling question language in the Act may allow a looser standard than that of section 1292(b) and more analogous to the leave of court standard to develop.

The Act also includes a set of temporary procedural rules that will apply to direct appeals to the court of appeals until a Federal Rule of Bankruptcy Procedure is promulgated or amended. These procedural rules are summarized as follows:

- The district court, bankruptcy court or bankruptcy appellate panel may enter the required certification;
- Rule 5 of the Federal Rules of Appellate Procedure will govern the procedure for filing the appeal;
- The appeal must be filed not later than 10 days after the certification of the bankruptcy court, district court, or bankruptcy appellate panel is entered on the docket; and
- A copy of the certification must be attached to the petition.

\textbf{IX. TRANSNATIONAL (NEW CHAPTER 15)}

The Act creates a new Chapter 15 to incorporate the Model Law on Cross-Border Insolvency. Chapter 15 is designed to provide a

\textsuperscript{130} 28 U.S.C.A. § 1292(b).
\textsuperscript{131} See 5 Collier on Bankruptcy, 5.07[4] (15th ed. rev.)
means for bankruptcy courts to effectively deal with cross-border insolvency cases. Chapter 15 includes several subchapters that govern access of foreign representatives and creditors to the bankruptcy court, recognition of foreign proceedings and relief, cooperation with foreign courts and foreign representatives, and concurrent proceedings.

**X. CONVERSION AND DISMISSAL**

The Act amends Bankruptcy Code section 1112(b) with respect to how a party in interest can move for conversion or dismissal of a case. Under the amended section, a court must convert or dismiss a case if the movant establishes "cause." Amended section 1112(b)(4) sets forth several items that would constitute "cause":

(A) substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;

(B) gross mismanagement of the estate;

(C) failure to maintain appropriate insurance that poses a risk to the estate or to the public;

(D) unauthorized use of cash collateral harmful to 1 or more creditors;

(E) failure to comply with an order of the court;

(F) 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;

(G) 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;

(H) failure timely to provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);

(I) failure timely to pay taxes due after the date of the order for relief or to file tax returns due after the date of the order for relief;
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(J) failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;

(K) failure to pay any fees or charges required under chapter 123 of title 28;

(L) revocation of an order of confirmation under section 1144;

(M) inability to effectuate substantial consummation of a confirmed plan;

(N) material default by the debtor with respect to a confirmed plan;

(O) termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and

(P) failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.\(^{132}\)

A party opposing a conversion or dismissal must show that either there is a reasonable likelihood that a plan will be confirmed within the timeframes established in section 1121(e) and 1129(e), or if those sections do not apply, within a reasonable period of time. In addition, the party opposing conversion or dismissal must show that even if there are grounds to convert or dismiss the case, there is reasonable justification for the debtor's act or omission (other than under paragraph (4)(A)) that will be cured within a reasonable period of time fixed by the court.\(^{133}\)

The Act contains a requirement that the court hear any motion to convert or dismiss within 30 days after the motion is filed and decide the motion no later than 15 days thereafter. The movant can consent to a continuance of the hearing on the motion.\(^{134}\)

The Act also amends section 1104(a) to allow the court to order the UST to appoint a trustee or examiner if grounds for conversion or dismissal exist.\(^{135}\)

Dismissal or conversion appears to be mandatory under revised section 1112 unless cure is possible, even if the best interests of

\(^{132}\) 11 U.S.C.A. § 1112(b)(4) (as amended).


\(^{134}\) 11 U.S.C.A. § 1112(b)(3) (as amended).

creditors are not served by dismissal or conversion. This unfortunate result may be forestalled by the court’s discretionary appointment of a trustee or an examiner under revised section 1104(a)(3).

XI. FINANCIAL CONTRACTS

The Financial Contract Provisions in Title Nine amend the Federal Deposit Insurance Act (FDIA), the Federal Deposit Insurance Corporation Improvement Act of 1991 (FDICIA), the Securities Investor Protection Act of 1970 (SIPA), and the Bankruptcy Code. During the 107th Congress, then Senator Gramm stated during the Senate Debate on March 15, 2001, that the financial contract provisions have four principal purposes:

1. To strengthen the provisions of the Bankruptcy Code and the FDIA that protect the enforceability of acceleration, termination, liquidation, close-out netting, collateral foreclosure and related provisions of certain financial agreements and transactions.

2. To harmonize the treatment of these financial agreements and transactions under the Bankruptcy Code and the FDIA.

3. To amend the FDIA and FDICIA to clarify that certain rights of the FDIC acting as conservator or receiver for a failed insured depository institution (and in some situations, rights of SIPC and receivers of certain uninsured institutions) cannot be defeated by operation of the terms of FDICIA.

4. To make other substantive and technical amendments to clarify the enforceability of financial agreements and transactions in bankruptcy or insolvency.\(^{136}\)

The Financial Contract provisions concern various types of financial contracts, including forward contracts, repurchase agreements, swap agreements, commodities contracts, and securities contracts. The amendments create definitions for the various agreements that fall under the financial contract provisions, some portions of which are controversial. The definitions of financial contracts, including the definitions of “forward contract,” “repurchase agreement,” “swap agreement,” and “securities contract,” include guarantees and reimbursement obligations. Thus a creditor-

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guarantor that has provided collateral under a financial contract will be subject to the netting protections that are afforded to financial institutions under the revised law.

The Act amends various provisions of the Bankruptcy Code to reflect the intent of Congress “[t]hat normal business practice in the event of a default of a party based on bankruptcy or insolvency is to terminate, liquidate or accelerate securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master netting agreements with the bankrupt or insolvent party.”

The Act makes the following amendments to the Bankruptcy Code:

- The Act amends Bankruptcy Code section 362(b)(17) to protect netting provisions in swap agreements, security agreements and master netting agreements. A corresponding amendment is made to SIPA to provide that a SIPA stay does not operate as a stay against netting provisions.

- The Act amends Bankruptcy Code sections 546(g) and 548(d)(2)(E) to clarify that the trustee cannot avoid transfers that are made in connection with a master netting agreement, unless the transfer was made to hinder, delay, or defraud creditors.

- The Act amends Bankruptcy Code sections 555, 556, 559, and 560 to expand the contractual right to liquidate securities contracts, commodities contracts, forward contracts, repurchase agreements and swap agreements to the right to liquidate, terminate or accelerate those contracts. Courts will interpret whether termination of contracts by non-debtor parties will excuse them from any liability that would have been owed if the contracts were closed out or liquidated.

- The Act adds to Chapter 5 of the Bankruptcy Code a new section 561 to protect the “[c]ontractual right to terminate, liquidate, accelerate, or offset under a master netting agreement[.]”

- The Act adds to Chapter 5 a new section 562 to govern the measure of damages in connection with the rejection of a financial contract. Section 562 provides that if the trustee rejects a financial contract or a financial institution liquidates,

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terminates or accelerates a financial contract the damages are measured as of the date of the rejection, liquidation, termination, or acceleration and treated as though the claim arose prepetition.

The principal substantive change in this area is to allow broad "cross-product" netting pursuant to "master netting agreements" for the first time. Thus a net credit for the debtor on a series of swaps can in effect collateralize the debtor's obligation on otherwise unrelated repurchase obligations with the same financial counterparty under a master netting agreement.

XII. CONFLICTS AND COMPENSATION

A. DISINTERESTEDNESS—§ 101(14)

The Act amends the definition of "disinterested person." All references to investment bankers in section 101(14)(B), (C), and (E) were deleted:

(14)'disinterested person' means a person that—

(A) is not a creditor, an equity security holder, or an insider;

(B) is not and was not, within 2 years before the date of the filing of the petition, a director, officer, or employee of the debtor; and

(C) does not have an interest materially adverse to the interest of the estate or of any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with, or interest in, the debtor, or for any other reason.\(^ {138}\)

Although this section removes investment bankers and their employees and attorneys from per se disqualification, it might cause courts to scrutinize more closely investment banker retentions. The former law drew a three-year line on per se disqualification for investment bankers of securities that are not outstanding.\(^ {139}\) To the extent that some courts might have viewed the three-year line as a safe harbor for older transactions, the amendment could open the door to more serious scrutiny.


B. COMPENSATION OF PROFESSIONALS

1. Amendments to section 328

Bankruptcy Code section 328 provides that “[t]he trustee or a committee appointed under Bankruptcy Code section 1102… with the court’s approval, may employ… a professional person… on any reasonable terms and conditions of employment, including on a retainer, on an hourly basis, or on a contingent fee basis.”[^140]

The Act confirms that a trustee may employ a professional person on a fixed and percentage fee basis by adding “on a fixed or percentage fee basis” just before “or on a contingent fee basis.”[^141] Courts use the terms “percentage fee” and “contingent fee” interchangeably. That addition is relatively unremarkable. The fixed fee alternative was added to fix a problem often encountered by Chapter 7 trustees. Chapter 7 trustees routinely turn over estate funds to secured creditors on account of their secured claims. Some courts have precluded Chapter 7 trustees from receiving their statutorily authorized fee in those circumstances based upon the notion that a trustee should be compensated only out of the proceeds of a sale of an estate asset, and not a mere disbursement to a secured creditor. The fixed fee alternative was added to section 328(a) as an attempt to fix that problem. The trustee still has the burden of proving that the fee is reasonable.

2. Amendments to section 330

The amendments to Bankruptcy Code section 330 are not controversial. However, please note the following amendment to encourage board certification. Former section 330(a)(3) provided that: “In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account” a total of five relevant factors. Amended section 330(a)(3) adds to that list of five factors one additional factor: “(E) with respect to a professional person, whether the person is board certified or otherwise has demonstrated skill and experience in the bankruptcy field.”[^142] It is unclear whether “board” certification must be done by a government board or whether a non-governmental board will suffice.

[^141]: 11 U.S.C.A. § 328(a) (as amended).
Moreover, the Act added a new paragraph to section 330(a), which is supposed to ensure that the court will award compensation to a trustee on a commission basis using the upper limit in section 326 as a standard: "(7) In determining the amount of reasonable compensation to be awarded to a trustee, the court shall treat such compensation as a commission, based on section 326." Unfortunately, this section is ambiguous and it is unclear whether basing the commission on section 326 means that section 326 is to be used to fix the amount of the trustee's commission or whether it sets a cap against which that commission will be measured.

C. JURISDICTION—28 U.S.C.A. § 1334(E)(2)

Before the Act, the district court (or the bankruptcy court if the case has been referred) had exclusive jurisdiction of "all of the property, wherever located, of the debtor as of the date of commencement of such case, and of property of the estate." Amended section 1334(e) includes another provision that grants the district court exclusive jurisdiction "over all claims or causes of action that involve construction of section 327 of title 11, United States Code, or rules relating to the disclosure requirements under section 327." This amendment applies to cases filed after the date of enactment of the Act.

The amendment is a weak remnant of a lobbying effort to prevent malpractice suits against bankruptcy professionals from being tried before a jury in state courts. The amendment is ineffective to address the problem. It does not mention malpractice suits at all. Moreover, the amendment will likely not affect fee disgorgement suits because it fails to mention sections 101(14) and 328(c). The amendment only affects construction of section 327 or rules relating to disclosure requirements under section 327. Most suits do not involve construction of section 327 or the rules relating to disclosure requirements. They involve determining whether a professional is disinterested under section 101(14) for purposes of fee disgorgement under section 328.

Note that exclusive federal jurisdiction is conferred "over all claims or causes of action that involve construction of section

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144 28 U.S.C.A. § 1334(e).
THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 327.” It is unclear whether claims that “involve construction” must “arise under” section 327 or whether the defendant’s ability to raise a defense involving construction under section 327 will be a sufficient basis for removal.

XIII. MISCELLANEOUS

A. MORE COMPLETE INFORMATION REGARDING ASSETS OF THE ESTATE

Section 419 of the Act directs the Judicial Conference of the United States to propose an amendment to the Federal Rules of Bankruptcy Procedure and Official Bankruptcy Forms that would direct a Chapter 11 debtor to disclose information regarding the value, operations, and profitability of any closely held corporation, partnership, or any other entity in which the debtor holds a substantial or controlling interest. Pursuant to the new rule, debtors will be required to file and serve periodic financial and other reports. The purpose of the proposed amendment to the Federal Rules of Bankruptcy Procedure is to ensure that the debtor’s interest in any closely held corporations, partnerships, or any other entity can be adequately valued and used to pay allowed claims against the debtor’s estate.

B. INVOLUNTARY CASES—§ 303(B)(1) & (H)(1)

The Act amended section 303 of the Bankruptcy Code as follows:

(b) An involuntary case against a person is commenced by the filing with the bankruptcy court of a petition under chapter 7 or 11 of this title—

(1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute as to liability or amount, or an indenture trustee representing such a holder, if such claims are noncontingent, undisputed claims aggregate at least $12,300 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;

* * *

(h) If the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the
chapter under which the petition was filed. Otherwise, after trial, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, only if—

(1) the debtor is generally not paying such debtor's debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount. 146

This amendment will make filing an involuntary petition more difficult because many claims can be disputed as to amount. Interestingly, the amendment to section 303 of the Bankruptcy Code is one of the few provisions of the Act which becomes effective on the date of enactment of the Act and applies to cases commenced under title 11 before, on, and after such date.

XIV. HEALTH CARE PROVISIONS

A. DISPOSAL OF PATIENT RECORDS—§ 351

The Act amends various sections of the Bankruptcy Code to provide for increased duties in health care bankruptcies. The amendments set forth a procedure for disposing of patient records when the estate does not have enough funds to pay to store the records. The Act adds section 351, which requires the trustee to publish notice of its intent to destroy patient records that are not claimed by either patients or their insurance carriers within 365 days after the notice is published. 147 After the 365-day period has run, and if the records have not been claimed, the trustee is required to either shred or burn written documents or, if the records are stored electronically, to destroy the records such that they can never be retrieved.

B. ADMINISTRATIVE EXPENSE PRIORITY—§ 503(b)(8)

The amendments further provide for administrative expense priority under a new section 503(b)(8) for the costs associated with closing a health care business. Such costs can include the costs associated with disposing of patient records and moving patients to alternative facilities. Trustees, federal agencies, or a department or agency of a state are entitled to such administrative expense claims. 148

146 11 U.S.C.A. § 303(b)(1) and (b)(1) (as amended).
148
C. OMBUDSMAN—§ 333

A disinterested ombudsman shall be appointed to act as a patient advocate.\textsuperscript{149} The ombudsman will be appointed within 30 days after the commencement of the case. The role of the ombudsman is to monitor and report to the court on the quality of patient care. The ombudsman is required to keep confidential all information relating to patient records.

D. TRUSTEE’S DUTIES TO TRANSFER PATIENTS—

§ 704(A)(12)

The Act expands the trustee’s duties under Bankruptcy Code section 704(a) to include the duty to “use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed.”\textsuperscript{150} It is of course unclear what constitutes “reasonable and best efforts” for an administratively insolvent estate.

E. COMPLIANCE WITH OTHER APPLICABLE LAW—

§§ 363(D), 1129(A)

Many health care cases involve debtors that are not moneyed corporations, and these charitable entities are commonly regulated under state law (often by the state attorney general). The Act amended sections 363(d) and 1129(a) of the Bankruptcy Code to require that any sale of estate assets involving a nonprofit debtor comply with otherwise applicable law. This may significantly complicate disposition of assets in health care cases involving nonprofit debtors. This provision is one of the few provisions of the Act immediately effective on the date of enactment.

F. EXCLUSION FROM MEDICARE—§ 362(B)(28)

Finally, the Act creates an exception to the automatic stay allowing the Secretary of Health and Human Services to exclude the debtor from Medicare, notwithstanding commencement of a bankruptcy proceeding.\textsuperscript{151}

\textsuperscript{148} 11 U.S.C.A. § 503(b)(8) (as amended).
\textsuperscript{149} 11 U.S.C.A. § 333 (added).
\textsuperscript{150} 11 U.S.C.A. § 704(a)(12) (added).
\textsuperscript{151} 11 U.S.C.A. § 362(b)(28) (added).
XV. EFFECTIVE DATES AND APPLICABILITY.

A. EFFECTIVE DATE IN GENERAL
The Act (section 1501(a)) provides for an effective date that is 180 days after its enactment. Since the Act became law on April 20, 2005, the general effective date was Monday, October 17, 2005. Except as specifically provided in the Act, the amendments apply to only those cases that were commenced on or after the effective date of the Act.

B. EFFECTIVE DATE OF SPECIFIC SECTIONS

1. DePrizio Amendments
The DePrizio Amendments apply to cases that were pending or commenced on or after the date of enactment of the Act. As noted above, the section does not address the status of adversary proceeding pending in cases before April 20, 2005, or those filed on or after April 20, 2005, in cases pending on April 20, 2005.

The House Bill and Senate Bill provided that the financial contract provisions would take effect on the date of enactment of the Act. The amendments would have been applicable to cases commenced on or after the date of enactment of the Act. The Act deleted that provision. Thus the financial contract provisions are effective 180 days after the enactment of the Act.

3. Small Business Debtor Reporting Requirements
Section 434(b) of the Act provides that new Bankruptcy Code section 308 will take effect 60 days after the date upon which the Advisory Committee on Bankruptcy Rules of the Judicial Conference promulgates the rules to establish the forms that will be required under section 308.

4. Exclusive Jurisdiction Over Matters Involving Professionals
The section that provides for the District Court’s (and bankruptcy court’s) exclusive jurisdiction over matters relating to disclosure obligations under Bankruptcy Code section 327 applies to cases filed after the date of enactment of the Act. Note that this

152 Act, § 1213(b).
153 Act, § 324(b).
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does not apply to cases filed on April 20, 2005, but only to cases
filed after this date.

5. Transfers Made By Nonprofit Charitable Corporations
The amendments made with respect to transfers made by nonprofit
charitable corporations apply to cases pending on the date of enactment
of the Act or filed on or after the date of enactment of the Act.\textsuperscript{154}

6. Bankruptcy Judges
The authorization of 28 new bankruptcy judgeships and the exten-
tion of certain existing temporary judgeships became effective
upon enactment.\textsuperscript{155}

7. Wage Priority Increase
The increase in the cap on the wage priority to $10,000 per em-
ployee and the expansion of the lookback period from 90 to 180
days took effect on the date of enactment of the Act but only in
cases filed on or after that date.\textsuperscript{156}

8. Fraudulent Transfers
The lookback for fraudulent transfers expands to two years in
cases filed on or after April 20, 2006. The avoidability of insider
transfers under employment agreements is effective on the date of
enactment of the Act in cases filed on or after that date.\textsuperscript{157}

9. Reinstatement of Retiree Benefits
The amendment to Bankruptcy Code section 1114 requiring re-
instatement of retiree benefits in certain circumstances is effective
on the date of enactment of the Act but only in cases filed on or af-

er that date.\textsuperscript{158}

10. U.S. Trustee Motion to Appoint a Trustee
The provision requiring the U.S. trustee to move for the appoint-
ment of a Chapter 11 trustee where there are reasonable grounds to
suspect fraud, dishonesty, or criminal conduct is effective on the date
of enactment of the Act but only in cases filed on or after that date.\textsuperscript{159}

\textsuperscript{154} Act, § 1221.
\textsuperscript{155} Act, § 1228.
\textsuperscript{156} Act, § 1401.
\textsuperscript{157} Act, § 1402.
\textsuperscript{158} Act, § 1403.
\textsuperscript{159} Act, § 1405.