

CLIENT ALERT

OVERVIEW OF THE BANKRUPTCY ABUSE AND CONSUMER PROTECTION ACT OF 2005

On April 20, 2005, President George W. Bush signed into law the Bankruptcy Abuse and Consumer Protection Act of 2005, Public Law No. 109-8 (the "2005 Bankruptcy Act"), which amends title 11 of the United States Code, 11 U.S.C. §§ 101-1330 (the "Bankruptcy Code"). While certain provisions have different effective dates, the 2005 Bankruptcy Act generally becomes effective on October 17, 2005 (*i.e.*, 180 days after enactment) and it will apply only to cases filed on or after that date. While the 2005 Bankruptcy Act has largely been discussed for its effects on consumer bankruptcies, it also contains many provisions that address commercial bankruptcies. In this bulletin, we briefly summarize those provisions of the 2005 Bankruptcy Act that are of general application in commercial cases and include, for your reference, a detailed chart describing many of the various provisions of the 2005 Bankruptcy Act as well as the sections of the Bankruptcy Code that those provisions amend. This bulletin does not address the provisions dealing solely with small businesses and only generally describes Title IX of the 2005 Bankruptcy Act, which addresses financial contract provisions. We have organized the description of the amendments by topics rather than by sections of the Bankruptcy Code. If you have any questions regarding the 2005 Bankruptcy Act, kindly contact one of the partners in the Financial Restructuring Group.

LANDLORDS AND TRADE CREDITORS

Nonresidential Real Property Leases (Sections 365, 503)

The 2005 Bankruptcy Act extends the initial 60-day period to assume or reject nonresidential real property leases to 120 days, but permits only a single 90-day extension for cause. Further extensions require the written consent of each landlord. The 2005 Bankruptcy Act also limits administrative-priority claim damages arising from rejection of a previously assumed nonresidential real property lease to two years' worth of monetary obligations following the later of the rejection date and turnover of the premises.

In addition, the 2005 Bankruptcy Act clarifies that, to assume an unexpired real property lease, the debtor need not cure a default arising from any failure to perform nonmonetary obligations under the lease "if it is impossible 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 (i) such default shall be cured by performance at the time of assumption in accordance with such lease and (ii) pecuniary losses resulting from such default shall be compensated in accordance with Bankruptcy Code section 365.

Prior to the 2005 Bankruptcy Act, section 365(d)(4) of the Bankruptcy Code required a debtor to make a decision to assume or reject its unexpired leases of nonresidential real property no later than 60 days after the entry of the order for relief. Section 365(d)(4) also authorized the court to extend this initial 60-day period if the debtor demonstrated cause for such extension but did not set a limit on the number of extensions the court could grant, and such extensions were routinely granted up to the confirmation hearing in a case.

Under the 2005 Bankruptcy Act, the initial 60-day period in Bankruptcy Code section 365(d)(4) is extended to 120 days. In addition, the court has authority to extend the period by 90 days if the debtor demonstrates cause for such extension, thereby providing the debtor with a total of 210 days to assume or reject its nonresidential real property leases. In order for the court to grant any extensions beyond this 210-day period, however, the debtor must provide evidence of the lessor's prior written consent to such additional extensions.

The limitation on the length of the extension under Bankruptcy Code section 365(d)(4) will certainly have an impact on a debtor whose business comprises a significant amount of real estate assets (*e.g.*, retail store chain). A debtor often chooses to postpone its decision to assume or reject nonresidential real property leases until it confirms a plan of reorganization. There may be several reasons for this delay. First, it provides the debtor and its financial advisors with maximum flexibility to implement a new business plan. Second, it minimizes the potential administrative expense obligation of the estate. In order to assume the real property lease, the debtor must "cure" any damages that occur prior to the bankruptcy case and provide "adequate assurance" of its ability to perform its obligations under the lease. Moreover, the rent due under the lease, once it is assumed, becomes an administrative expense obligation even if the case is later converted to chapter 7 of the Bankruptcy Code. Third, debtors often use the delay in assumption of the lease to negotiate more favorable terms from the landlord.

Congress has, however, somewhat mitigated the administrative expense burden created by assumption of the leases. The 2005 Bankruptcy Act also amends Bankruptcy Code section 503(b), which generally governs the allowance of administrative expenses, to provide for a cap on the amount of an administrative expense a lessor of nonresidential real property can claim if its lease is assumed and then subsequently rejected by the debtor. Under new Bankruptcy Code section 503(b)(7), the lessor under a lease that is previously assumed but subsequently rejected shall be entitled to an administrative expense claim in an amount equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date and the date of turnover of the property. This amount will not be subject to any setoff except it will be mitigated by any sums received from an entity other than the debtor,¹ such as rent from a new tenant if the lessor is able to re-let the premises. To the extent the lessor has claims for remaining sums due for the balance of the term of the lease, those claims shall be afforded general unsecured status and will be subject to the cap set forth in Bankruptcy Code section 502(b)(6), which generally governs a lessor's claims for damages resulting from the debtor's rejection of its lease.

Despite the imposition of this statutory cap on the amount of administrative expenses a lessor could claim, with the limitation on the length of the extension under revised Bankruptcy Code section 365(d)(4), the debtor no longer has the ability to continually delay the assumption of its real estate leases. Given this amendment, and other amendments regarding the debtor's exclusive period to file a plan of reorganization (discussed below), we expect that companies in distress will do as much as possible of their financial planning for a restructuring prior to the filing of a chapter 11 case.

Reclamation (Section 546)

The 2005 Bankruptcy Act expands the current 10-day reclamation period to 45 days and permits a nonreclaiming seller to assert an administrative expense claim for the value of goods received by the debtor not later than 20 days prepetition.

Prior to the 2005 Bankruptcy Act, under Bankruptcy Code section 546(c), a supplier of goods could assert its rights under applicable non-bankruptcy law to reclaim goods it had sold to the debtor if the supplier made its reclamation demand within 10 days of the debtor's receipt of the goods and the debtor was insolvent at the time of receipt. Thus, Bankruptcy Code section 546(c) generally required a two-step analysis: (1) does the seller have a right to reclamation under non-bankruptcy law; and (2) has the seller satisfied the additional requirements of Bankruptcy Code section 546(c)? If so, a supplier was entitled either to the return of the goods delivered to the debtor or, if the return of the goods was not possible, to a lien or an administrative expense claim for the value of the goods.

The 2005 Bankruptcy Act's amendments to Bankruptcy Code section 546(c) will significantly improve the reclamation rights of

suppliers of goods. The 2005 Bankruptcy Act revises the reclamation procedures to permit suppliers to make their reclamation demands "not later than 45 days after the date of the receipt of such goods," or, if the 45-day period expires after the debtor files for bankruptcy, "not later than 20 days after the date of the commencement of the case." In addition, the 2005 Bankruptcy Act may have eliminated the requirement that suppliers' reclamation claims be valid under applicable non-bankruptcy (state) law, although the revised statutory language on this point is unclear. However, the amendment expressly provides that reclamation demands are subject to the "prior rights" of a secured creditor with a security interest in supplied goods. The 2005 Bankruptcy Act also deletes the provisions in Bankruptcy Code section 503(b) that allow a court to grant a lien or administrative expense claim for the value of the goods subject to reclamation in lieu of the return of the goods.

Potential Unresolved Issues. It is unclear if this deletion means suppliers with reclamation claims will be entitled only to recovery of the goods or if they could still receive a lien or an administrative claim for the value of the goods. As set forth above, it is clear that suppliers whose goods the debtor received during the 20 days preceding the bankruptcy filing will still be entitled to administrative expense status under the amendments to Bankruptcy Code section 503(b). But it is unclear what remedies are available for those reclamation suppliers whose goods the debtor received during the 20-45 day period preceding the bankruptcy filing.

Despite this ambiguity, however, the amendments significantly improve the position of suppliers of goods with respect to other unsecured creditors. For example, many holders of other unsecured debt (such as notes) may find that their claims are now junior in priority to a significant amount of supplier claims. The amendments likely will also impact secured creditors. Even though a secured creditor will have a superior right to its collateral, if the debtor seeks to reorganize it will still have to pay in cash, in full, suppliers who delivered their goods to the debtor during the 20 days prior to the bankruptcy filing. Accordingly, asset-based lenders may begin requiring reserves against borrowing bases designed to cover 20 days' supply of goods.

Moreover, the interplay between (i) the amendment arguably deleting the requirement that the reclamation creditor have a valid claim under state law and (ii) the amendment providing that reclamation claims are subject to the "prior rights" of a secured creditor may cause tension. In many instances, courts disallowed reclamation claims in their entirety under the rationale that, under state law, (i) the reclamation claim was invalid because the secured creditor is determined to be a bona fide purchaser for value pursuant to the Uniform Commercial Code and (ii) a reclamation claim is invalid as to a bona fide purchaser for value. This may no longer be the case if the reclamation creditor's claim is not subject to state law, which could result in the allowance of many more reclamation claims.

¹ It is not clear whether this language is intended to refer to sums received from a new tenant only or whether sums received from an entity that has guaranteed the debtor's liability on the lease should reduce the amount of the landlord's claim, which would be contrary to existing law.

The practical effect of these amendments should not be underestimated. Indeed, for some debtors, the 45-day pre-petition window of protection afforded to certain of their trade creditors could represent millions of dollars of claims that will rank above unsecured pre-petition claims, thereby materially diluting recoveries to pre-petition unsecured creditors, such as bondholders. Moreover, these amendments could also have an impact on the composition of official creditors' committees. Because a portion of their claims will have been converted into administrative expense claims, in certain cases trade creditors are likely to represent, as a group, less of the total unsecured creditor pool than they traditionally used to represent, and therefore fewer trade creditor representatives are likely to be appointed to such committees. This may mean that other unsecured creditors, such as bondholders, may control official committees in cases where they would previously have had to share such control with trade creditors.

Preferences (Section 547)²

The amendments to Bankruptcy Code section 547 address preference issues, including:

- Ordinary Course of Business Defense. The 2005 Bankruptcy Act amends the "ordinary course of business" defense such that creditor defendants need only show that payment was consistent with (i) payment history between the debtor and creditor or (ii) industry standards. Creditor defendants no longer need to prove both facts to rely on the defense.
- Amount Transferred. The 2005 Bankruptcy Act will prohibit the commencement of preference actions for transfers less than \$5,000 by debtors whose debts are not primarily consumer debts.
- Transfer For Benefit Of Insider Creditor. The 2005 Bankruptcy Act protects noninsider creditors from avoidance under Bankruptcy Code section 547 of a transfer made to it "for the benefit of" an insider creditor; corrects and completes the Bankruptcy Reform Act of 1994's apparently imperfect attempt to repeal the so-called "DePrizio rule"; applies "to any case that is pending or commenced on or after the date of enactment (i.e., April 20, 2005)."
- Security Interests. The 2005 Bankruptcy Act increases from 10 to 30 days the "relation-back" period in which a security interest may be perfected without being avoidable as a preferential transfer.
- Purchase Money Security Interests. The 2005 Bankruptcy Act increases from 20 to 30 days the "relation-back" period in which a purchase-money security interest may be perfected without being avoidable as a preferential transfer.

Bankruptcy Code section 547 provides that a debtor has the ability to avoid any transfer of an interest or property of the debtor to or for the benefit of the debtor if certain requirements are established, including that the transfer was made (i) to or for the benefit of a creditor; (ii) for or on account of an antecedent debt owed by the debtor; (iii) while the debtor was insolvent; and (iv) that, with respect to non-insiders, the debtor made the transfer on or within 90 days prior to filing for bankruptcy. Bankruptcy Code section 547(c), however, sets forth a number of limitations on the debtor's ability to avoid these "preferences," including that the debtor made the transfer in the ordinary course of business. Prior to the 2005 Bankruptcy Act, the ordinary-course defense provided that a debtor could not avoid a transfer as a preference if the transfer was in payment of a debt incurred by the debtor in the ordinary course of the business or financial affairs of the debtor and the transferee and was made: (i) in the ordinary course of the business of the debtor and the creditor and (ii) according to ordinary business terms. Accordingly, both of the enumerated requirements had to be present in order for the ordinary-course defense to apply.

The 2005 Bankruptcy Act revises Bankruptcy Code section 547(c) to state that only one of the two enumerated requirements must be present in order for the ordinary-course defense to apply. Because these two requirements are now independent of each other, there will be an increase in the number of creditors that could assert the ordinary-course defense, although it is unclear how significant that increase will be. In addition, the 2005 Bankruptcy Act creates a carve-out for smaller transfers by amending Bankruptcy Code subsection 547(c) to provide that a debtor may not avoid an otherwise preferential transfer if the total amount of the transfer is less than \$5,000, and seems to complete the repeal of the so-called "DePrizio rule."

Prior to the 2005 Bankruptcy Act, a debtor could avoid a lien or security interest as a preference unless the secured creditor took all steps necessary for the perfection of the lien or security interest prior to, at the time of, or within ten days following the extension of secured credit. The 2005 Bankruptcy Act amends Bankruptcy Code section 547(e)(2) to extend the "grace period" for a secured creditor to complete any filings or other necessary steps to perfect a security interest or lien from ten days to thirty days following the extension of the secured credit. This extension provides the secured creditor with a more reasonable opportunity to perfect its lien without subjecting it to possible avoidance.

PRE-PACKAGED PLANS

Pre-Packaged Plans (Sections 341, 1125)

The 2005 Bankruptcy Act authorizes postpetition solicitation of plan acceptances without prior approval of a disclosure statement from a holder of a claim or interest if (i) such solicitation complies with applicable non-bankruptcy law and (ii) such holder was solicited prepetition in a manner complying with

² Although the amendments to section 547 of the Bankruptcy Code are discussed in the Landlords and Trade Creditors section, section 547 also applies to entities other than landlords and trade creditors although trade creditors are likely to be more affected by certain aspects of the 2005 amendments to section 547.

applicable non-bankruptcy law. The 2005 Bankruptcy Act will also allow a court to dispense with the first meeting of creditors if plan acceptances were solicited prepetition.

Prior to the 2005 Bankruptcy Act, prepetition solicitations of a plan were sometimes approved by courts in the context of prenegotiated or pre-packaged bankruptcy cases. The 2005 Bankruptcy Act amends Bankruptcy Code section 1125 to specifically allow a debtor to solicit creditors or equity holders postpetition for an acceptance or rejection of an amended version of a plan voted on prepetition without having to file and obtain approval of a disclosure statement as long as the solicitation complies with applicable non-bankruptcy law.

Potential Unresolved Issues. The amendment does not require an approved disclosure statement on file in connection with the postpetition solicitation of holders of claims that were solicited prepetition in accordance with applicable non-bankruptcy law. Therefore, it appears that plans solicited pre-bankruptcy can be amended and solicited post-bankruptcy in accordance with applicable nonbankruptcy law without an approved disclosure statement. One issue courts may be confronted with is whether the parties whose acceptance or rejection may be solicited postpetition must be identical to those solicited prepetition. The amendment says "holder of a claim" arguably requiring the same institution or individual. It is also unclear whether the amendment overrules -- which many had hoped it would -- certain decisions rejecting postpetition "lockup" agreements as violative of the prohibition against postpetition solicitation. Indeed, absent a prepetition solicitation (which was not present in these cases), it would appear that the better argument is that the amendment does not allow "lockup" agreements to be executed postpetition.

OFFICIAL COMMITTEE ISSUES

Creditors' And Equity Security Holders' Committees (Section 1102)

The 2005 Bankruptcy Act will require creditors' committees to share information with the creditors they represent and to solicit comments from those creditors. The court may also order the United States Trustee (the "UST") to change the membership of the creditors' committee and to include, in particular circumstances, a "small business concern."

Section 1102 of the Bankruptcy Code governs the appointment of creditors' and equity security holders' committees in chapter 11 cases. Although the Bankruptcy Code provides that a committee shall ordinarily consist of the persons or entities holding the seven largest claims against the debtor of the kinds of claims represented by such particular committee, the make-up of each committee ultimately rests in the hands of the UST. Prior to the 2005 Bankruptcy Act, the Bankruptcy Code did not address whether the court had any authority to direct the UST to alter the membership of a committee. Case law on this topic is also unsettled.

The 2005 Bankruptcy Act attempts to resolve this issue by creating a new Bankruptcy Code subsection 1102(a)(4) that states

that a court, upon the request of a party in interest, "may order the United States trustee to change the membership of a committee appointed under this subsection, if the court determines that the change is necessary to ensure adequate representation of creditors or equity security holders."

Potential Unresolved Issues. It is unclear from this proposed language if the court has authority to direct the UST to appoint specific creditors to a committee (e.g., UST must appoint creditor XYZ to the creditors' committee) or if the court only may require the UST to alter membership to include a general type of creditor (e.g., UST must appoint a utility creditor to the creditors' committee). Nevertheless, this amendment will clearly give a creditor an additional means of voicing its opinion if it believes that the committee appointed to represent its interest is not acting in the creditor's best interest. In addition, Bankruptcy Code subsection 1102(a)(4) does not appear to be limited only to the appointment of additional members to a committee. Instead, it is possible that a creditor could use this provision to force the removal of an existing member from a committee. The 2005 Bankruptcy Act leaves to the courts the mechanics of how official committees are to solicit comments from their constituencies.

EXCLUSIVITY, DISMISSAL, CONVERSION AND APPOINTMENT OF TRUSTEES

Exclusivity (Section 1121)

The 2005 Bankruptcy Act precludes the court from extending the 120-day and 180-day exclusive periods to file, and solicit acceptances of, a plan beyond dates that are 18 months (approximately 540 days) and 20 months (approximately 600 days), respectively, after the date of the order for relief.

Prior to the 2005 Bankruptcy Act, section 1121 of the Bankruptcy Code provided that no party other than the debtor could (i) file a plan of reorganization during the first 120 days of the bankruptcy case or (ii) solicit a plan during the first 180 days of the bankruptcy case if the debtor had filed a plan within the applicable period (together, the "Exclusivity Periods"). Section 1121 further provided that, upon the request of a party in interest, the court could reduce or extend the Exclusivity Periods for cause. Section 1121 did not impose any limit on the number or amount of extensions of the Exclusivity Periods that the debtor could seek.

The 2005 Bankruptcy Act amends section 1121(d) to provide a strict cap on the extension of the Exclusivity Periods. Pursuant to revised section 1121(d), the court may not extend the 120-day and 180-day Exclusivity Periods beyond dates that are 18 months and 20 months, respectively, after the date of entry of the order for relief, even if the debtor can demonstrate cause.

Potential Unresolved Issues. This revision creates significant issues in large and complex chapter 11 cases, which may take years to resolve due to the substantial negotiations (and litigation) between the debtor and various creditor and equity holder constituencies. Although it will likely be the exception rather than the norm, in many of these larger cases, the debtor may not be able

to file a plan within the first 18 months of the case that would have the support of all the major constituencies. Nevertheless, the debtor may feel compelled to file a plan by the 18-month deadline, even if it is unsupported, in order to preserve its exclusive right to attempt to secure confirmation of its plan. This revision also creates an incentive for a disgruntled creditor or party in interest to litigate and delay the plan process with the hope that the process is delayed beyond the 18- or 20-month deadlines. An expiration of the exclusivity periods would then allow the creditor or other parties in interest to file, if it chooses to do so, its own competing plan of reorganization. Thus, the proposed revisions to section 1121(d) may make large and complex chapter 11 cases even more complex. Bankruptcy Courts have been left with some discretion on how the competing plan process should work (e.g., the timing on which competing plans will be heard) because the 2005 Bankruptcy Act did not direct Bankruptcy Courts to hear competing plans concurrently.

Dismissal/Conversion (Sections 1104, 1112)

The 2005 Bankruptcy Act enumerates additional grounds for "cause" to convert or dismiss a chapter 11 case and provides that, if cause is established, the case shall be converted or dismissed "absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate." The 2005 Bankruptcy Act also prescribes time limits for hearing and deciding motions, and creates additional grounds for appointment of a trustee by providing that, if cause exists to convert or dismiss a case, the court may instead order the appointment of a trustee.

Section 1112(b) of the current Bankruptcy Code provides that a court, on the request of a party in interest, may either convert a chapter 11 case to a case under chapter 7 or dismiss the case entirely, whichever is in the best interests of creditors and the estate, for cause. Although not exhaustive, Bankruptcy Code section 1112(b) does provide a list of ten examples that constitute cause for conversion to chapter 7 or outright dismissal. The 2005 Bankruptcy Act expands the grounds for conversion or dismissal by adding to this list of examples. Under the 2005 Bankruptcy Act, the examples of cause are expanded to include, among other things: (i) gross mismanagement of the estate; (ii) failure to maintain appropriate insurance that poses a risk to the estate or to the public; (iii) unauthorized use of cash collateral substantially harmful to one or more creditors; (iv) failure to attend the meeting of creditors or examinations under Bankruptcy Rule 2004; (v) failure to pay postpetition taxes or file tax returns timely; and (vi) failure to comply with an order of the court. Similar to the amendments regarding the appointment of a trustee, this amendment appears to be designed to further police the activities of a debtor's management and ensure the protection of the estate's interests.

Appointment of Trustee (Section 1104)

The 2005 Bankruptcy Act refines existing law by clarifying the procedure for the election of a private trustee in a chapter 11 case. It also requires the UST to move for the appointment of a chapter 11 trustee if there are reasonable grounds to suspect that (i) current

members of the debtor's governing body, (ii) the debtor's chief executive or chief financial officer or (iii) 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.

Prior to the 2005 Bankruptcy Act, section 1104 of the Bankruptcy Code provided that at any time after the commencement of a bankruptcy case, the court, on the request of a party in interest, shall order the appointment of a trustee: (i) for cause, including fraud, dishonesty, incompetence or gross mismanagement of the affairs of the debtor by current management; or (ii) if the appointment of a trustee is in the interests of creditors, equity security holders and other interests of the estate.

Pursuant to the 2005 Bankruptcy Act, in addition to the two foregoing situations, the bankruptcy court shall appoint a trustee "if grounds exist to convert or dismiss the case under [Bankruptcy Code] section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of the creditors and the estate."

The amendments to Bankruptcy Code section 1104 appear to be the Bankruptcy Code's response to the Sarbanes-Oxley Act, which imposes stricter duties on and heightens the review of actions taken by corporate officers and directors. Indeed, the "if there are reasonable grounds to suspect" language in new Bankruptcy Code subsection 1104(e) seems to set a much lower threshold for the appointment of a trustee than that which existed prior to the 2005 Bankruptcy Act.

Potential Unresolved Issues. It remains unclear, however, how strictly the court will enforce this provision if a motion is brought by the UST and what impact this subsection will have on the ability of a party other than the UST to move for the appointment of a trustee.

INVESTMENT BANKS AND THEIR COUNSEL NO LONGER AUTOMATICALLY DISQUALIFIED AS ESTATE PROFESSIONALS

Disinterestedness (Section 101)

The definition of "disinterested person" is expanded and will no longer exclude prepetition investment bankers for a security of the debtor and attorneys for such investment bankers. The amendment allows such professionals and attorneys to be retained in a debtor's case.

Bankruptcy Code section 327 provides that a debtor may employ one or more attorneys, accountants or other professional persons that do not hold or represent an interest adverse to the estate, and that are "disinterested persons," to assist the debtor in carrying out its duties under the Bankruptcy Code. Prior to the 2005 Bankruptcy Act, the general requirement for a person (defined to include individuals, partnerships and corporations) to be considered

a "disinterested person," as that term was used in Bankruptcy Code section 327, was that such person could not be a creditor, equity security holder or insider of the debtor.

Current Regime. Investment banks, along with their attorneys and their directors, officers and employees, however, faced additional restrictions before they could qualify as a "disinterested person." An investment bank was not considered "disinterested" if it was or had been the investment banker for any currently outstanding security of the debtor, or, within the three years prior to the debtor's bankruptcy filing, it had been the investment banker for any security of the debtor. In addition, an attorney that represented an investment bank in connection with the offer, sale or issuance of a security of the debtor did not qualify as a "disinterested person." Directors, officers and employees of an investment bank would also not qualify as "disinterested persons" if, within the two years prior to the debtor's bankruptcy, they had been employed by an investment bank not eligible to be employed under the Bankruptcy Code. Finally, any person deemed to have held 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 or connection with an investment bank identified in Bankruptcy Code subsection 101(14)(B) or (C) would also not qualify as a "disinterested person."

Amendment. The 2005 Bankruptcy Act removes these restrictions on investment banks in their entirety. In order to be considered a "disinterested person," an investment bank, therefore, is subject only to the same general restrictions applicable to all other persons, namely, the person (i) must not be a creditor, equity security holder or insider of the debtor; (ii) must not have been a director, officer or employee of the debtor within the two years prior to the debtor's bankruptcy filing; and (iii) must not have any interest materially adverse to the interest of the estate or any class of creditors or equity security holders by virtue of any direct or indirect relationship to or connection with the debtor. These same general restrictions apply to the investment bank's attorneys and its officers, directors and employees. The practical effect of this amendment is that many investment banks previously prohibited from serving in such capacity on a postpetition basis no longer face any such restrictions.

EXECUTIVE COMPENSATION ISSUES

Employee Retention/Severance (Section 503)

The amendments to Bankruptcy Code section 503 address employee retention and severance issues, including:

- **Key Employee Retention Programs.** Under the 2005 Bankruptcy Act, retention bonuses are not permitted unless: (i) the payment is "essential to retention" because the insider has a "bona fide job offer from another business at the same or greater rate of compensation"; (ii) the insider's services are "essential to the survival of the business"; and (iii) either (a) the amount of the payment does not exceed 10 times the amount of the mean of similar

payments made to non-management employees for any purpose during the same calendar year or (b) if there have been no payments to non-management employees, the payment does not exceed 25% of the amount of any similar payment to the insider in the preceding calendar year.

- **Severance.** Under the 2005 Bankruptcy Act, severance payments are not permitted unless: (i) the severance program is available to all full-time employees or (ii) the insider severance payment is not greater than ten times the mean amount paid to non-management employees during the same year.

Section 503 of the Bankruptcy Code governs the allowance of postpetition administrative expenses. Prior to the 2005 Bankruptcy Act, Bankruptcy Code section 503 did not provide any specific guidelines regarding the allowance of administrative expense claims for retention bonuses, severance pay and other transfers or obligations incurred for the benefit of a debtor's officers, managers or consultants hired postpetition. The 2005 Bankruptcy Act adds a new Bankruptcy Code subsection 503(c) to specifically address these issues.

With respect to retention bonuses, new Bankruptcy Code subsection 503(c) requires the court to deny an administrative expense claim by an insider (defined to include directors, officers and persons in control of the debtor) for a retention bonus unless the court first makes the findings described above. These restrictions on incentive compensation limit a debtor's ability to develop a retention program for its key employees, some of whom may be the most intimately familiar with and critical to the debtor's business operations. Further, given the comparatively stricter restrictions placed on the amount of retention bonuses, there appears to be a preference for severance payments over retention bonuses. It is possible this preference relies on the rationale that it is more important or equitable to compensate an officer that promised to maintain its employment with the debtor during its bankruptcy but is nevertheless terminated, than to reward an officer who happens to retain his position with the debtor upon its emergence from bankruptcy. Nevertheless, the preference for severance payments may not be that substantial because an insider is not entitled to the severance payment unless the payment is part of a severance program that is "generally applicable to all full-time employees" (emphasis supplied), which rarely is the case. Thus, to the extent a debtor seeks to compensate those officers and managers terminated as a result of the debtors' bankruptcy, the debtor must also provide appropriate compensation to the remainder of the debtor's full-time employees.

Finally, new Bankruptcy Code subsection 503(c) requires the court to deny the administrative expense claim of any officer, manager or consultant hired postpetition for transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case. This amendment appears to potentially limit the compensation a debtor can offer a chief restructuring or chief turnaround officer that typically serves in such capacity only for the duration of the bankruptcy case and in effect may impair the debtor's ability to attract such professionals.

Potential Unresolved Issues. The ramifications of this amendment on cases will depend, at least in part, on how courts define the facts and circumstances that would justify these amounts and the definition of "insider" (*i.e.*, whether this amendment applies only to top management or all officers).

Fraudulent Transfers (Section 548)

The amendments to Bankruptcy Code section 548 address issues regarding fraudulent transfers, including:

- **Reach-back Period.** The 2005 Bankruptcy Act extends the current 1 year "reach-back" period to 2 years prior to the bankruptcy filing. Please note that this is not limited to alleged fraudulent transfers to insiders but applies to all potential fraudulent transfers.
- **Insider Transfers.** The 2005 Bankruptcy Act also enables a debtor to avoid an insider transfer pursuant to an employment contract if it was made outside the ordinary course of business and the debtor received less than reasonably equivalent value.

The amendment to Bankruptcy Code section 548 extends the "reach-back" period for any kind of fraudulent transfer to two years prior to the debtor's bankruptcy filing. Prior to the 2005 Bankruptcy Act, only transfers made within the one year prior to the bankruptcy filing could be avoided as fraudulent transfers. This amendment may not have a significant impact because Bankruptcy Code section 544 already allows a debtor to avoid transfers pursuant to state law fraudulent conveyance statutes, which often have statutes of limitation longer than two years.

Congress appears to have been focused on insider compensation in bankruptcy cases. Prior to the 2005 Bankruptcy Act, the Bankruptcy Code did not contain a specific provision restricting the debtor's ability to make such transfers. The 2005 Bankruptcy Act, however, amends Bankruptcy Code section 548 (in addition to employee retention and severance (discussed above)), which generally governs the debtor's ability to avoid fraudulent transfers and obligations, by specifically allowing a debtor to avoid any transfer or obligation to or for the benefit of an insider if the debtor made such a transfer or incurred such an obligation under an employment contract and not in the ordinary course of business and received less than reasonably equivalent value.

AUTOMATIC STAY

Automatic Stay (Sections 101, 362)

The 2005 Bankruptcy Act excepts from the automatic stay (i) investigation, enforcement (other than for monetary sanctions) and delisting actions of securities self-regulatory organizations (*e.g.*, registered securities exchanges); (ii) a governmental unit's setoff of a prepetition tax refund against a prepetition tax obligation, unless applicable non-bankruptcy law would not permit such a setoff because of a pending action to determine the amount or legality of a tax liability; and (iii) the creation or perfection of a statutory lien for a postpetition

special tax or special assessment on real property, whether or not ad valorem. The 2005 Bankruptcy Act also adds to the existing exception regarding postpetition ad valorem property taxes.

UTILITIES

Adequate Assurance to Utility Service Providers (Section 366)

The 2005 Bankruptcy Act clarifies what constitutes "assurance of payment" and provides that "an administrative expense priority shall not constitute an assurance of payment." The 2005 Bankruptcy Act also provides a special 30-day period and procedures for chapter 11 cases and permits a utility, "[n]otwithstanding any other provision of law," to recover or set off against a prepetition security deposit "without notice or order of the court."

Prior to the 2005 Bankruptcy Act, section 366 of the Bankruptcy Code provided that a utility service provider could not alter, refuse or discontinue utility service to the debtor, if, within 20 days of its bankruptcy filing, the debtor "furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date." In numerous chapter 11 cases, courts relied on the utility service provider's ability to assert an administrative expense claim for any unpaid postpetition services and the debtor's ability to fund such expenses through its debtor-in-possession facility as a form of "adequate assurance of payment."

The 2005 Bankruptcy Act, however, prohibits the court's reliance on administrative expense status for postpetition utility service claims as a means of adequate assurance by revising Bankruptcy Code section 366 to include a new subsection (c) that specifically defines "assurance of payment" as: (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. In addition, new Bankruptcy Code subsection 366(c) specifically states that "an administrative expense priority shall not constitute an 'assurance of payment.'"

While the amendment to Bankruptcy Code section 366 may not have a huge impact on commercial bankruptcies, it will require certain chapter 11 debtors, such as those with significant retail operations, to increase the amount of borrowing they seek under their debtor-in-possession financing in order to be able to fund the new, stricter security deposit requirements for each of their various utility service providers.

REVISIONS TO CERTAIN TAX PROVISIONS

The 2005 Bankruptcy Act revises various sections of the Bankruptcy Code regarding tax issues. A summary of some the more important proposed changes follows:

Interest Rate on Tax Claims

Pursuant to section 1129 of the current Bankruptcy Code, if a chapter 11 debtor seeks to defer payment of its tax claims upon confirmation of its plan of reorganization, the present value

of the payments must equal the allowed amount of the claim. Prior to the 2005 Bankruptcy Act, the Bankruptcy Code did not state the appropriate interest rate that should be used in calculating the present value of the tax claim. Bankruptcy courts have reached several different conclusions as to what is the appropriate interest rate, including the federal judgment rate, the national prime rate and the rate applicable under non-bankruptcy law.

The 2005 Bankruptcy Act provides, through new section 511, that, with respect to tax claims, the appropriate interest rate for calculating the present value of deferred payments on allowed tax claims is the applicable rate under non-bankruptcy law. According to revised Bankruptcy Code subsection 1129(a)(9)(C) and new Bankruptcy Code subsection 1129(a)(9)(D), this interest rate will apply to both secured and unsecured tax claims. As a consequence of these amendments, debtors in certain jurisdictions that had adopted the federal judgment rate or prime rate could face an increase in the amount of interest they will have to pay on their tax claims because the rates applicable under non-bankruptcy law typically are higher than the federal judgment rate and prime rate.

No Bifurcation of Tax Liability for Year of Bankruptcy Filing

Prior to the 2005 Bankruptcy Act, it was unclear whether a corporate debtor's tax liability for the year in which it files a bankruptcy petition (the "Filing Year") should be bifurcated into a prepetition portion and a postpetition administrative expense portion. Several circuit level courts that have considered this issue have held that the bankruptcy filing does bifurcate the tax liability. Pursuant to the 2005 Bankruptcy Act's revisions to Bankruptcy Code section 507(a)(8), however, this bifurcation is eliminated and all income and gross receipts taxes for the Filing Year constitute postpetition administrative expenses that the debtor must pay in full in the ordinary-course. Because most plans of reorganization typically provide for the payment of tax claims in full (due to their priority nature), the most significant effect of this revision will be to foreclose the debtor's ability to defer the payment of taxes relating to income and gross receipts incurred during the prepetition portion of the Filing Year.

Deferring Payments on Priority Taxes

Prior to the 2005 Bankruptcy Act, a chapter 11 debtor had the ability to spread the payment of unsecured priority taxes over a period of six years following the date of the assessment of the tax claim. In many cases this six-year period did not begin running until the debtor's emergence from bankruptcy because the assessment of the tax claim was typically delayed throughout the course of the bankruptcy case. The 2005 Bankruptcy Act shortens this time period by requiring the debtor to complete payment of the taxes within five years following the date of the debtor's filing for bankruptcy, regardless of the date the tax is deemed assessed. The new payment period, therefore, conceivably could be much shorter than the one debtors enjoy under the current Bankruptcy Code. As a consequence of this provision, in more complex chapter 11 cases that take several

years to reach confirmation, the debtor may see the payment period shrink or disappear entirely.

The 2005 Bankruptcy Act allows the five-year payment period to apply to secured tax claims as well. This expansion to include secured tax claims might not, however, provide much consolation to a debtor. Because secured tax claims will continue to accrue interest during the pendency of the bankruptcy case, it may be cheaper for some debtors to seek authority from the court to pay their secured tax obligations during the bankruptcy and stop the accrual of interest, even if that means the debtor must abandon its right to pay the secured tax claims over a several-year period post-emergence.

Discharge of Tax Claims

The Bankruptcy Code provides that the confirmation of a plan discharges a corporate debtor from all debts, unless the plan is a liquidating plan. Prior to the 2005 Bankruptcy Act, Bankruptcy Code section 1141 could be interpreted as allowing for the discharge of taxes that a taxing agency had not assessed because of the debtor's filing of a fraudulent return or intentional attempts to evade or defeat such taxes. Under the 2005 Bankruptcy Act, this ambiguity is eliminated because Bankruptcy Code section 1141 is revised to clearly state that the confirmation of the debtor's plan, regardless of whether the plan is a plan of reorganization or a plan of liquidation, does not discharge these "fraudulent" taxes.

Disclosure of Federal Tax Consequences

Bankruptcy Code section 1125(b) provides that the disclosure statement that accompanies a plan at the time of the plan's solicitation must contain "adequate information" regarding the plan. "Adequate information" is defined as "information of a kind, and in sufficient detail, as is reasonably practicable,.... that would enable a hypothetical investor of the relevant class to make an informed judgment about the plan." Pursuant to the 2005 Bankruptcy Act, the definition of "adequate information" is amended to include "a discussion of the potential material Federal tax consequences of the plan to the debtor, any potential successor to the debtor, and a hypothetical investor typical of the holders of claims or interest in the case." This amendment should not have a material impact because most bankruptcy attorneys already advise a debtor to include a discussion of the Federal tax consequences of the debtor's plan in the accompanying disclosure statement.

CROSS-BORDER BANKRUPTCY CASES

Ancillary and Other Cross-Border Cases (Proposed New Chapter 15 of the Bankruptcy Code)³

The 2005 Bankruptcy Act creates a new chapter in the Bankruptcy Code designed to regulate the relationship between bankruptcy cases in the United States and foreign jurisdictions. As stated in the new language, the purpose of chapter 15 is to

³ Unless otherwise stated, all references to "sections" in this part refer to the new section numbers that will be created once chapter 15 becomes effective.

incorporate the Model Law on Cross-Border Insolvency – which the United Nations developed – in order to promote: (i) cooperation between the United States, the various entities involved in bankruptcy cases (including the UST, trustees, examiners and debtors) and the courts and authorities of foreign countries; (ii) "greater legal certainty for trade and investment"; (iii) "fair and efficient administration of cross-border insolvencies"; (iv) "protection and maximization of the value of a debtor's assets"; and (v) "facilitation of rescue of financially troubled businesses, thereby protecting investment and preserving employment."

Prior to the 2005 Bankruptcy Act, there were only 3 subsections in Bankruptcy Code section 304 dedicated to this area of bankruptcy law. New chapter 15, however, represents a significant expansion of the statutes regulating this area. Specifically, chapter 15 provides more detailed requirements for the initiation of an ancillary proceeding, an expanded description of the rights conferred on foreign representatives once an ancillary proceeding is commenced and additional guidance regarding the coordination of cases under the Bankruptcy Code with foreign proceedings.

For example, prior to the 2005 Bankruptcy Act, a case ancillary to a foreign proceeding was commenced by the filing of a petition with the bankruptcy court by a foreign representative. Under new Bankruptcy Code sections 1504 and 1515, this petition is renamed a "petition of recognition." A court must enter an order granting recognition of the foreign proceeding if certain evidentiary requirements are met, including proof of the existence of a "foreign main proceeding" (defined as "a foreign proceeding pending in the country where the debtor has center of its main interests") or a "foreign nonmain proceeding" (defined as "a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment"). The entry of the order recognizing the foreign proceeding enables the foreign representative, if it chooses, to file (i) an involuntary case under Bankruptcy Code section 303 or (ii) if the foreign proceeding is a "foreign main proceeding," a voluntary case under Bankruptcy Code section 301 or 302.

In addition, the entry of an order of recognition confers on the foreign representative the right to operate the debtor's business, as well as many of the rights and powers of a trustee. Furthermore, pursuant to new Bankruptcy Code section 1520(a), certain sections of the Bankruptcy Code apply with respect to the debtor and its property located within the territories of the United States, such as (i) the automatic stay (Bankruptcy Code section 362); (ii) restrictions on the use, sale or lease of property (Bankruptcy Code section 363); and (iii) the requirement of adequate protection (Bankruptcy Code section 361). The recognition of a foreign proceeding, whether main or nonmain, also enables the court, at the request of the foreign representative, to grant certain types of relief to the extent they are not provided under Bankruptcy Code section 1520, including: (i) staying the commencement or continuation of an individual action or proceeding concerning the debtor's assets, rights, obligations or liabilities; (ii) staying execution against the

debtor's assets; and (iii) suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor. Recognition of a foreign proceeding also allows the court to entrust the distribution of all or a part of a debtor's assets in the United States to the foreign representative or another person, provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected.

These protections and benefits afforded upon commencement of the ancillary case are much more specific than those provided prior to the 2005 Bankruptcy Act. Under former Bankruptcy Code section 304(b), upon the commencement of the ancillary case, the court could enjoin the commencement or continuation of any action against the debtor with respect to property in the United States involved in a foreign proceeding or against the property itself. In addition, the court could enjoin the enforcement of any judgment against the debtor with respect to such property in or any act or judicial proceeding to create or enforce a lien against property of the estate. The court could also order turnover of property of the estate, or the proceeds of the property, to the foreign representative. Finally, the court may order other appropriate relief.

By comparison of former Bankruptcy Code section 304 to new chapter 15, it is clear that Congress intends to better define (and perhaps expand) the scope of the bankruptcy court's authority and the substantive rights of foreign representatives with respect to ancillary proceedings. In order to promote interaction with foreign proceedings, chapter 15 also requires the bankruptcy courts, trustees and examiners to cooperate to the maximum extent possible with a foreign court or foreign representative. It should be noted, however, that despite the attempts to promote comity between United States bankruptcy cases and foreign proceedings, Bankruptcy Code section 1507 provides that a bankruptcy court may refuse to take any action governed by chapter 15 that the court deems is "manifestly contrary to public policy of the United States."

PROCEDURAL MATTERS

Additional Judges

The 2005 Bankruptcy Act provides for temporary appointment of additional Bankruptcy Judges, including four for the District of Delaware, one for the Southern District of New York, three for the Central District of California and one for the Eastern District of California. Appointments will increase the number of Bankruptcy Judges in the affected districts for at least five years.

Effective Date

While certain provisions have different effective dates (as noted on the chart below), the 2005 Bankruptcy Act generally becomes effective on October 17, 2005 (*i.e.*, 180 days after enactment) and it will apply only to cases filed after that date.

SECTION-BY-SECTION SUMMARY OF SIGNIFICANT COMMERCIAL PROVISIONS OF PUBLIC LAW NO. 109-8, "BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005" (ENACTED APRIL 20, 2005)

SECTION	TITLE	EFFECT	COMMENTS
311 (a)	Automatic Stay	Amends § 362 ¹	Among other things, provides that the automatic stay provided under § 362(a) does not apply to any transfer that is not avoidable under either § 544 or § 549; one of three provisions of the Act (see also Act §§ 1201(6) and 1214) that respond the Ninth Circuit's decision in <u>In re McConville</u> , 110 F.3d 47 (9th Cir.), <u>cert. denied</u> , 522 U.S. 966 (1997)
324 ²	Exclusive jurisdiction in matters involving bankruptcy professionals	Amends § 1334(b), (e)	Grants District Court (and Bankruptcy Court) exclusive jurisdiction over all claims or causes of action that involve construction of § 327 or related disclosure rules
328	Defaults based on nonmonetary obligations	Amends §§ 365, 1124	Clarifies that, to assume an unexpired real property lease, the debtor need not cure a default arising from any failure to perform nonmonetary obligations under the lease "if it is impossible 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 (1) such default shall be cured by performance at the time of assumption in accordance with such lease and (2) pecuniary losses resulting from such default shall be compensated in accordance with § 365; clarifies that the debtor is otherwise excused only from curing any penalty rate or penalty provision relating to a nonmonetary default; makes corresponding changes in § 1124(2) (impairment of claims or interests)

¹ In this summary, (1) sections of the Bankruptcy Code are cited as "§ ___" and (2) sections of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 are cited as "Act § ___".

² Section 324 applies to cases filed after April 20, 2005. Act § 324(b).

SECTION	TITLE	EFFECT	COMMENTS
329	Clarification of postpetition wages and benefits	Amends § 503(b)(1)(A)	Grants administrative claim status to wages and benefits awarded under particular "back pay" actions as back pay attributable to the postpetition period as a result of the debtor's violation of federal or state law without regard to the time of the occurrence of unlawful conduct on which award is based or to whether any services were rendered; payment of such wages and benefits is conditioned on court's determination such payment "will not substantially increase the probability of layoff or termination of current employees" during the case
331	Limitation on retention bonuses, severance pay and certain other payments	Amends § 503(b)	Prohibits allowance or payment of (1) retention transfers or obligations to or for the benefit of an insider of the debtor, unless the court finds 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 (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 there were no such similar transfers or obligations with respect to 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 (i) the payment is part of a program that is generally available to all full-time employees and (ii) 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 petition date

SECTION	TITLE	EFFECT	COMMENTS
401	Adequate protection for investors	Amends §§ 101, 362(b)	Excepts from the automatic stay investigation, enforcement (other than for monetary sanctions), and delisting actions of securities self-regulatory organizations (e.g., registered securities exchanges)
402	Meetings of creditors and equity security holders	Adds § 341(e)	Authorizes court to order that a meeting of creditors under § 341 not be held if plan acceptances were solicited prepetition
403	Protection of refinancing of security interest	Amends § 547(e)(2)	Increases from 10 to 30 days the "relation-back" period in which a security interest may be perfected without being avoidable as a preferential transfer (see also Act § 1222 below)
404	Executory contracts and unexpired leases	Amends § 365(d)(4), (f)(1)	Extends from 60 to 120 days (or the date of confirmation of a plan, if earlier than the 120 th day) the time by which the debtor must (1) assume or reject a lease of nonresidential real property under which the debtor is the lessee or (2) have the lease deemed rejected; permits the court (1) to extend this 120-day period for no more than 90 days and (2) to grant subsequent extensions only upon prior written consent of the lessor in each instance; ensures that assignment of an executory contract or unexpired lease under § 365(f)(1) is subject not only to § 365(c), but also to § 365(b), one effect of which is to ensure that assumption or assignment of a lease of real property in a shopping center must be subject to the provisions of the lease (such as use clauses)
405	Creditors and equity security holders committees	Amends § 1102(a)	Authorizes the court to order the UST to change the membership of a committee and to include, in particular circumstances, a "small business concern"; requires committee to provide information to, and solicit and receive comments from, creditors of the kind represented by the committee
406	Amendment to section 546 of title 11, United States Code	Adds § 546(j)	Precludes debtor, notwithstanding § 545(2) and (3), from avoiding a warehouseman's lien for storage, transportation, or other costs incidental to the storage and handling of goods arising under UCC § 7-209 or similar state statutes
407	Amendments to section 330(a) of title 11, United States Code	Amends § 330(a)	Clarifies that § 330(a) applies to examiners, chapter 11 trustees and professional persons; requires court, in determining the compensation to be awarded to a trustee, to treat such compensation as a commission based on § 326
408	Postpetition disclosure and solicitation	Adds § 1125(g)	Authorizes postpetition solicitation of plan acceptances without prior approval of a disclosure statement from a holder of a claim or interest if (i) such solicitation complies with applicable non-bankruptcy law and (ii) such holder was solicited prepetition in a manner complying with applicable non-bankruptcy law

SECTION	TITLE	EFFECT	COMMENTS
409	Preferences	Amends § 547(c)	Makes it easier for creditor to satisfy the "ordinary course of business" preference defense under § 547(c)(2) by providing that creditor must establish only two elements: (1) the transfer was in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee <u>and either</u> (2) the transfer was made in the ordinary course of business or financial affairs of the debtor and the transferee <u>or</u> (3) the transfer was made according to ordinary business terms; under current law, creditor must establish all three elements; provides that a transfer cannot be avoided as a preference if, in a case filed by a debtor whose debts are not primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than \$5,000
411	Period for filing plan under Chapter 11	Amends § 1121(d)	Precludes the court from extending the 120- and 180-day exclusive periods to file, and solicit acceptances of, a chapter 11 plan beyond dates that are 18 and 20 months, respectively, after the date of the order for relief
414	Definition of disinterested person	Amends § 101(14)	Expands the definition of "disinterested person" by repealing exclusions that have been part of the bankruptcy law since 1938; eliminates the "investment banker" and "attorney for such an investment banker" disqualifications from the definition of disinterested person by (1) by deleting current § 101(14)(B) and (C) and (2) deleting the references to "investment banker" in current § 101(14)(A), (D), and (E)
416	Appointment of elected trustee	Amends § 1104(b)	Refines existing law by clarifying the procedure for the (1) election of a trustee in a chapter 11 case and (2) resolution of any dispute arising out of such an election
417	Utility service	Amends § 366	Clarifies what constitutes "assurance of payment" under § 366: cash deposit, letter of credit, certificate of deposit, surety bond, prepayment of utility consumption or "another form of security that is mutually agreed on between the utility and the debtor or the trustee"; provides that "an administrative expense priority shall not constitute an assurance of payment"; provides special 30-day period and procedures for chapter 11 cases; permits a utility, "[n]otwithstanding any other provision of law," to recover or set off against a prepetition security deposit "without notice or order of the court"
431	Flexible rules for disclosure statement and plan	Amends § 1125	Provides that, in determining whether a disclosure statement contains "adequate information" under § 1125(a)(1), "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"; although found in Title IV, Subtitle B of the Act, titled "Small Business Bankruptcy Provisions," this amendment would apply to all chapter 11 cases

SECTION	TITLE	EFFECT	COMMENTS
440	Scheduling conferences	Amends §105(d)	Requires the court to "hold such status conferences as are necessary to further the expeditious and economical resolution of the case"; although found in Title IV, Subtitle B of the Act, titled "Small Business Bankruptcy Provisions," this amendment would apply to all cases
442	Expanded grounds for dismissal or conversion and appointment of trustee	Amends §§ 1104, 1112	Enumerates additional grounds for "cause" to convert or dismiss chapter 11 case; provides that, if cause is established, case shall be converted or dismissed "absent unusual circumstances specifically identified by the court that establish that the requested conversion or dismissal is not in the best interests of creditors and the estate"; prescribes time limits for hearing and deciding motion; creates additional grounds for appointment of trustee or examiner by providing that, if cause exists to convert or dismiss case, court may instead order the appointment of a trustee or examiner; although found in Title IV, Subtitle B of the Act, titled "Small Business Bankruptcy Provisions," these amendments would apply to all cases
445	Priority for administrative expenses	Adds § 503(b)(7)	Limits administrative-priority-claim damages arising from rejection of a previously assumed nonresidential real property lease to a sum equal to all monetary obligations due (excluding those arising from or relating to a failure to operate or a penalty provision) for the period of 2 years following the later of the rejection date or turnover of the premises; such administrative claim is without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor; treats the claim for remaining sums due as a claim under § 502(b)(6); although found in Title IV, Subtitle B of the Act, titled "Small Business Bankruptcy Provisions," this amendment would apply to all cases
446	Duties with respect to a debtor who is a plan administrator of an employee benefit plan	Amends §§ 521(a), 704(a) and 1106(a)(1)	Requires chapter 7 trustee, chapter 11 trustee and chapter 11 debtor in possession to continue to perform debtor's obligations as administrator (as defined in ERISA § 3) of an employee benefit plan if, on the petition date, the debtor served as such administrator; although found in Title IV, Subtitle B of the Act, titled "Small Business Bankruptcy Provisions," these amendments would apply to all cases
447	Appointment of committee of retired employees	Amends § 1114(d)	Clarifies that, if the court orders the appointment of a committee of retired employees, it is the responsibility of the UST to appoint the members of such committee; statute currently provides that "[t]he court . . . shall appoint" such committee; although found in Title IV, Subtitle B of the Act, titled "Small Business Bankruptcy Provisions," these amendments would apply to all chapter 11 cases
501	Petition and proceedings related to petition	Amends §§ 301 and 921(d)	Clarifies that, although under § 301 the commencement of a voluntary petition generally constitutes an order for relief, in a chapter 9 case the court must enter the order for relief

SECTION	TITLE	EFFECT	COMMENTS
502	Applicability of other sections to Chapter 9	Amends § 901(a)	The "Orange County amendment"; expressly incorporates "closeout" protections (liquidation, termination, acceleration, setoff, netting and damage measurement under §§ 555, 556, 559, 560, 561 and 562) for securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master netting agreements in chapter 9 cases
701	Treatment of certain liens	Amends §§ 724, 505(a)(2)	Provides greater protection to holders of <u>ad valorem</u> tax liens on real or personal property of the estate; limits the claims to which such liens may be subordinated under § 724; requires the debtor to exhaust unencumbered assets and to pursue § 506(c) recoveries before subordinating such liens
704	Rate of interest on tax claims	Adds § 511	Provides that (1) if the Bankruptcy Code requires the payment of interest (a) on a tax claim or an administrative expense tax or (b) to enable a creditor to receive the present value of the allowed amount of a tax claim, the rate of interest shall be determined under applicable non-bankruptcy law and (2) in the case of taxes paid under a confirmed plan, the rate of interest shall be determined as of the calendar month in which the plan is confirmed; applies to all tax claims (federal, state and local); displaces the current law, under which there is no uniform rate of interest applicable to tax claims, and varying standards have been used to determine the applicable rate
706	Priority property taxes incurred	Amends § 507(a)(8)(B)	Expands § 507(a)(8)(B) priority by covering property taxes within the meaning of that provision that were "incurred" prepetition; statute currently grants priority only to such taxes that were "assessed" prepetition
708	No discharge of fraudulent taxes in Chapter 11	Adds § 1141(d)(6)	Excepts from discharge in a corporate debtor's chapter 11 case (1) any debt (a) of the kind described in § 523(a)(2)(A) or (B) (that is, debt for money, property, services or an extension, renewal or refinancing of credit, to the extent obtained by (i) false pretenses, false representation or actual fraud, other than a statement respecting the debtor's financial condition or (ii) use of materially false written statement respecting the debtor's or an insider's financial condition), that (b) is owed to (i) a domestic governmental unit or (ii) a person as a result of an action under the federal False Claims Act or any similar state statute; or (2) 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 to defeat such tax or such customs duty

SECTION	TITLE	EFFECT	COMMENTS
710	Periodic payment of taxes in Chapter 11 cases	Amends § 1129(a)(9)(C); adds § 1129(a)(9)(D)	Requires chapter 11 plan to provide that holders of allowed § 507(a)(8) priority tax claims receive (1) regular installment payments in cash, (2) of a total value (as of the effective date) equal to the allowed amount of such claims, (3) "over a period ending not later than 5 years after the date of the order for relief" and (4) in a manner not less favorable than the most favored nonpriority unsecured claim provided for in the plan (other than cash payments to "convenience class creditors"); imposes similar requirement for secured claims that, but for their secured status, would constitute § 507(a)(8) priority tax claims
711	Avoidance of statutory tax liens prohibited	Amends § 545(2)	Denies the debtor, with regard to statutory liens, the rights of a hypothetical bona fide purchaser under Internal Revenue Code § 6323 and similar state or local law; prevents the debtor avoiding particular tax liens by taking advantage of the protection accorded to particular purchasers of property under such laws
712	Payment of taxes in the conduct of business	Amends §§ 503(b) and 506(b)-(c), and 28 U.S.C. § 960	Clarifies that, with specified exceptions, postpetition taxes incurred in the conducting of a debtor's business must be paid on or before the due date of the tax under applicable non-bankruptcy law; permits, in particular circumstances, payment of taxes in a chapter 7 case to be deferred until final distribution is made under § 726; clarifies that § 503(b)(1)(B)(i) applies to secured as well as unsecured tax claims, including property taxes for which liability is in rem, in personam, or both; exempts governmental units from the requirement to file a request for payment of an administrative expense for § 503(b)(1)(B) or (C) taxes or for related fines, penalties or reductions in credit as a condition to having those amounts allowed as administrative expenses; grants an oversecured creditor the right under § 506(b) to payment of postpetition fees, costs and charges provided for under a state statute, as well as under an agreement; permits the debtor to recover from a secured creditor under § 506(c) the payment of all <u>ad valorem</u> property taxes with respect to collateral
717	Standards for tax disclosure	Amends § 1125(a)(1)	Requires that a chapter 11 disclosure statement discuss the plan's potential material federal tax consequences to the debtor, any successor to the debtor and to a hypothetical investor that is representative of the claimants and interest holders in the case; substitutes a "hypothetical investor" standard for the current "hypothetical reasonable investor" standard

SECTION	TITLE	EFFECT	COMMENTS
718	Setoff of tax refunds	Adds § 362(b)	Excepts from the automatic stay a governmental unit's setoff of a prepetition tax refund against a prepetition tax obligation, unless applicable non-bankruptcy law would not permit such a setoff because of a pending action to determine the amount or legality of a tax liability; in the latter instance, permits the governmental unit to hold the refund pending resolution of the action, unless the court grants the taxing authority adequate protection
720	Dismissal for failure to timely file tax returns	Amends § 521	Authorizes taxing authorities to request that the court dismiss or convert a case if the debtor fails (1) to file a tax return that becomes due postpetition or (2) to properly obtain an extension of the due date for filing such return; if the debtor does not file such return or obtain such extension within 90 days after the taxing authority files such a request, the court shall dismiss or convert the case
801	Title VIII – Ancillary and Other Cross-Border Cases	Adds Chapter 15	Incorporates the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law (" <u>UNCITRAL</u> ") at its Thirtieth Session on May 12-30, 1997; repeals § 304, but the jurisprudence that developed under § 304 is preserved in the context of new § 1507 (titled "Additional assistance")
901-914	Title X – Financial Contract Provisions	Adds and amends numerous provisions of the Federal Deposit Insurance Act, the Federal Deposit Insurance Corporation Improvement Act of 1991, the Bankruptcy Code and the Securities Investor Protection Act of 1970	Clarifies and expands the termination, stay, setoff, netting, avoidance, damage computation and other protections granted to parties to securities contracts, commodity contracts, forward contracts, repurchase agreements, swap agreements and master netting agreements in bankruptcy cases and other insolvency proceedings of counterparties
1101-1106	Title XI – Health Care and Employee Benefits	Amends §§ 101, 503(b), 704(a), 1106(a)(1); adds §§ 332, 351, 362(b)(28)	Adds provisions relating to "health care business" bankruptcies, including provisions regarding (1) disposal of patient records, (2) administrative claim priority for costs of closing a health care business and other administrative expenses, (3) appointment of a patient care ombudsman, (4) duty of chapter 7 or chapter 11 debtor to transfer patients and (5) exception from the automatic stay of the debtor's exclusion from participating in the Medicare program or any other federal health care program
1201(6)	Definitions	Amends § 101(54)	Amends the definition of "transfer" to include "creation of a lien" (see also Act §§ 311(a) and 1214)

SECTION	TITLE	EFFECT	COMMENTS
1208	Allowance of administrative expenses	Amends § 503(b)(4)	Clarifies that an attorney or an accountant for a member of an official committee cannot be compensated from the estate under § 503(b)(4)
1213 ³	Preferences	Amends § 547	Protects noninsider creditor from avoidance under § 547 of a transfer made to it "for the benefit of" an insider creditor; corrects and completes the Bankruptcy Reform Act of 1994's apparently imperfect attempt to repeal the so-called " <u>DePrizio</u> rule"
1214	Postpetition transactions	Amends § 549(c)	Protects good faith purchaser from avoidance under § 549 of a postpetition transfer "of an interest in real property" (such as a lien), rather than a "transfer of real property," as now provided (see also Act §§ 311(a) and 1201(6))
1216	General provisions	Amends § 901(a)	Makes § 1123(d) (amount necessary to cure a default in a plan shall be determined in accordance with the underlying agreement and applicable non-bankruptcy law) applicable in chapter 9 cases
1221 ⁴	Transfers made by nonprofit charitable corporations	Amends § 363(d); adds §§ 541(f), 1129(a)(16)	Restricts the debtor's ability to use, sell or lease property of a corporation or trust that is not a moneyed, business or commercial corporation or trust
1222	Protection of valid purchase money security interests	Amends § 547(c)(3)(B)	Increases from 20 to 30 days the "relation-back" period in which a purchase-money security interest may be perfected without being avoidable as a preferential transfer (see also § 403 above)
1223 ⁵	Bankruptcy judgeships	N/A	Provides for temporary appointment of additional Bankruptcy Judges, including four for the District of Delaware, one for the Southern District of New York, three for the Central District of California and one for the Eastern District of California; appointments will be increase the number of Bankruptcy Judges in the affected districts for at least five years
1225	Amendment to section 362 of title 11, United States Code	Amends § 362(b)(18)	Excepts from the automatic stay the creation or perfection of a statutory lien for a postpetition special tax or special assessment on real property, whether or not <u>ad valorem</u> ; adds to the existing exception regarding postpetition <u>ad valorem</u> property taxes

³ Section 1213 "appl[ies] to any case that is pending or commenced on or after" April 20, 2005. Act § 1213(b).

⁴ Section 1221 applies to cases that were pending under the Bankruptcy Code on, or that are filed under the Bankruptcy Code on or after, April 20, 2005, "except that the court shall not confirm a plan under [chapter 11] without considering whether [Act § 1221] would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor" after the petition date. Act § 1221(d).

⁵ Section 1223 took effect on April 20, 2005. Act § 1223(e).

SECTION	TITLE	EFFECT	COMMENTS
1227	Reclamation	Amends §§ 503(b) and 546(c)	Expands the current prepetition reclamation period from 10 days to 45 days; changes the reference to "any statutory or common law right of a seller of goods . . . to reclaim such goods" to "any right of a seller of goods . . . to reclaim such goods"; provides that a seller's right to reclaim goods is subject to the prior right of a holder of a security interest in such goods or the proceeds thereof; permits a seller that fails to provide a timely written demand for reclamation to assert a § 503(b) administrative claim for the value of any goods received by the debtor not later than 20 days prepetition if the goods have been sold to the debtor in the ordinary course of the debtor's business
1233	Expedited appeals of bankruptcy cases to courts of appeals	Amends 28 U.S.C. § 158	Permits Court of Appeals to authorize an immediate appeal of an order or decree that is not otherwise appealable, upon certification by the (1) the bankruptcy court, the district court or the bankruptcy appellate panel involved or (2) all the appellants and appellees acting jointly
1234 ⁶	Involuntary cases	Amends § 303(b)(1), (h)(1)	Amends the criteria for commencing an involuntary case; provides that a creditor is ineligible to be a petitioning creditor if (1) its claim is contingent as to liability or (2) the subject of a bona fide dispute as to (a) liability <u>or</u> (b) amount; further provides that the claims needed to meet the \$12,300 threshold must be both noncontingent and undisputed
1401 ⁷	Employee wage and benefit priorities	Amends § 507(a)	Increases, from 90 to 180 days, the prepetition "reach-back" period as to which claims for wages, salaries, commissions and sales commissions earned have priority under former § 507(a)(3); increases from \$4,650 to \$10,000 the monetary cap on wage and benefit priority claims under former § 507(a)(3) and (4) ⁸
1402 ⁹	Fraudulent transfers and obligations	Amends § 548(a) and (b); adds § 548(e)	Increases from one year to two years the prepetition "reach-back" period for avoiding fraudulent transfers and obligations under § 548(a) (intentional and constructive fraudulent transfers and obligations) and § 548(b) (partnership debtor's transfer, or obligation incurred, to general partner); provides that a transfer or obligation to or for the benefit of an insider under an employment contract (1) is subject to § 548 and (2) is avoidable regardless of the debtor's financial condition, if (a) it was made or incurred outside the ordinary course of business and (b) the debtor did not receive reasonably equivalent value in exchange; provides for avoidance of intentionally fraudulent transfers made by a debtor-beneficiary of a self-settled trust on or within 10 years before the petition date, including transfers made by a debtor in anticipation of a money judgment or other relief based on violation of federal or state securities laws

⁶ Section 1234 took effect on April 20, 2005, and "appl[ies] with respect to cases commenced under [the Bankruptcy Code] before, on, and after such date." Act § 1234(b).

⁷ Section 1401 applies to cases commenced under the Bankruptcy Code on or after April 20, 2005. Act § 1406(b)(1).

⁸ Pursuant to Act § 212, former § 507(a)(3) and (4) have been redesignated as § 507(a)(4) and 507(a)(5), respectively.

⁹ Section 1402 applies to bankruptcy cases commenced under the Bankruptcy Code on or after April 20, 2005, Act § 1406(b)(1), except that the new two-year reachback period applies only to cases commenced on or after April 21, 2006, *id.* § 1406(b)(2).

SECTION	TITLE	EFFECT	COMMENTS
1403 ¹⁰	Payment of insurance benefits to retired employees	Amends § 1114	Prevents a debtor from evading the requirements of § 1114, which currently applies only in a bankruptcy case, by modifying terminating retiree benefits on the eve of bankruptcy; provides that, if during the 180-day period preceding the petition date, the debtor (1) modifies retiree benefits and (2) was insolvent on the date such benefits were modified, upon motion, notice and a hearing, the court shall issue an order reinstating such benefits, unless it finds that "the balance of the equities clearly favors such modification"
1404 ¹¹	Debts nondischargeable if incurred in violation of securities fraud laws	Amends § 523(a)(19)(B)	Provides that § 523(a)(19) – which makes certain debts that result from the violation of federal or state securities law, or any regulation or order issued under such federal or state securities law, nondischargeable in the bankruptcy case of an individual (<i>i.e.</i> , natural person) debtor – applies to such debts that result before, on or after the petition date in the debtor's bankruptcy
1405 ¹²	Appointment of trustee in cases of suspected fraud	Adds § 1104(e)	Requires the UST to move for the appointment of a chapter 11 trustee if there are reasonable grounds to suspect that (1) current members of the debtor's governing body, (2) the debtor's chief executive or chief financial officer or (3) 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
1501	General effective date; application of amendments		Except as otherwise provided, the Act and the amendments made by it (1) are effective 180 days after April 20, 2005 (<i>i.e.</i> , October 17, 2005) and (2) shall not apply to bankruptcy cases commenced before the effective date

This Client Alert contains general information of interest to clients and others and does not constitute legal advice.

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¹⁰ Section 1403 applies to bankruptcy cases commenced under the Bankruptcy Code on or after April 20, 2005. Act § 1406(b)(1).

¹¹ Section 1404 is retroactively effective as of July 30, 2002, the date of enactment of the Corporate and Criminal Fraud Accountability Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (commonly known as the Sarbanes-Oxley Act). Act § 1404(b).

¹² Section 1405 applies to cases commenced under the Bankruptcy Code on or after April 20, 2005. Act § 1406(b)(1).