

**BANKRUPTCY REFORM ACT: FUNDAMENTAL CHANGES IN
BUSINESS BANKRUPTCIES**

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I. EFFECTIVE DATE

Generally speaking, the Bankruptcy Abuse Prevention and Consumer Protection Act (the “Reform Act”) takes effect 180 days after enactment. That date is October 17, 2005.

Different effective dates for specific provisions are sprinkled throughout the Reform Act. Below is a table of these exceptions. The exceptions to the general rule are noted in each section that appears below

TABLE OF EXCEPTIONS TO GENERAL EFFECTIVE DATE¹		
Heading/Subject	Bankruptcy Code Section	Effective Date/Applicability 5.256 Section
Homestead exemption – reduction and limitation of exemption; delay of discharge	11 USC § 522	Applicable to cases commenced on or after the date of enactment. § 1501(b)(2)
“Exclusive jurisdiction in matters involving bankruptcy professionals”	28 USC § 1334	Applicable to cases filed after the date of enactment. § 324(b).
“US Trustee Program filing fee increase”	28 USC §§ 589a(b), 1931 (note)	Effective during the 2 year period beginning on date of enactment. § 325(d)
“Uniform national reporting requirements” (small business debtors)	11 USC § 308	Effective 60 days after the date on which rules are prescribed under section 2075 of title 28. § 434(b).
“Improved bankruptcy statistics” (consumer bankruptcies)	28 USC § 159	Effective 18 months after date of enactment. § 601(c).
“Audit procedures” (individual chapter 7 & 13 cases)	11 USC §§ 521(a), 727(d); 28 USC § 586	Effective 18 months after date of enactment. § 603(e).
“Permanent reenactment of	11 USC chapter 12	Effective July 1, 2005.

¹ This table is taken from the United States Bankruptcy Code Booklet, April 2005 Black Line Edition.

chapter 12”		§ 1001(a)(2).
“Certain claims owed to governmental units”	11 USC §§ 1222(a)(2), 1231(b)	Effective on date of enactment but is applicable only to cases filed on or after such date. § 1003(c).
“Preferences” – the Deprizio Rule	11 USC § 547	Applicable to any case that is pending or commenced on or after date of enactment. § 1231(b).
“Transfers made by nonprofit charitable corporations”	11 USC §§ 363(d), 541, 1129(a)	Applicable to any case pending or filed on or after date of enactment. Before confirming a chapter 11 plan, Court must consider whether this section would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor after the date of the filing of the petition. § 1221(d)
“Bankruptcy judgeships”	28 USC § 152(a)	Effective on date of enactment. § 1223(e).
“Involuntary cases”	11 USC § 303	Effective on date of enactment but is applicable to cases filed before, on and after such date. § 1234(b).
“Enhanced disclosures under an open end credit plan” (amending the Truth in Lending Act)	15 USC § 1637	Effective on later of (a) 12 mos (section 1301 is 18 mos) after the date of enactment or (b) 12 mos after the publication of final regulations by the Board. §§ 1301(b)(2), 1302(c)(2), 1303(b)(2), 1304(b)(2), 1305(b)(2), 1306(b)(2).
“Employee wage and benefit priorities”	11 USC § 507(a)	Effective on date of enactment but is applicable only to cases filed on or after such date § 1406.
“Fraudulent transfers and obligations”	11 USC § 548	Look back expansion applies to cases commenced more than one year after the date of enactment. Avoidance provision effective on date of enactment but is applicable only to cases filed on or after such date. § 1406.
“Payment of insurance benefits to retired employees”	11 USC § 1114	Effective on date of enactment but is applicable only to cases filed on or after such date.

		§ 1406.
“Debts nondischargeable if incurred in violation of securities fraud laws”	11 USC § 523(a)(19)(B)	Not clear. Section 1404(b) makes the amendment effective 7-30-02. However, Section 1406 makes the amendment effective on the date of enactment and applicable to cases commenced on or after the date of enactment.
“Appointment of trustee in cases of suspected fraud” (mgmt of debtor or debtor’s public financial reporting)	11 USC § 1104	Effective on date of enactment but is applicable only to cases filed on or after such date. § 1406.

II. CREDITORS’ COMMITTEE

The Reform Act expressly provides that the Bankruptcy Court may change the composition of a creditors’ and equity holders’ committees that are appointed by the United States Trustee on request of a party in interest and after notice of a hearing. 11 U.S.C. § 1102(a)(4). The Bankruptcy Court can order the United States Trustee to add to the committee a small business concern creditor if that creditor “holds a claim (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.” 11 U.S.C. § 1102(a)(4).

The Reform Act also increases the committee member’s 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. 11 U.S.C. § 1102(b)(3). It is unclear how the committee members who 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 waives the committee’s attorney/client privilege.

III. RECLAMATION

The Reform Act provides a trade vendor (A) an administrative expense claim (11 U.S.C. § 503(b)(9)) and (B) an expanded right to reclaim goods (11 U.S.C. § 546(c)). Technically, the administrative expense claim is not a “reclamation claim.” Indeed, 11 U.S.C. § 546(c) – the provision establishing a right to reclaim – makes explicit that the failure to provide notice of the reclamation claim does not preclude a creditor from asserting an administrative expense claim. Nonetheless, section 503(b)(9) was clearly enacted with “reclamation creditors” in mind.

A. Administrative Claim

1. The Statutory Language

11 U.S.C. § 503(b) of the Bankruptcy Code has been amended to grant a trade vendor an administrative expense claim for the value of any goods received by a debtor within 20 days prior to the debtor's bankruptcy filing, provided the goods were sold to the debtor in the ordinary course of such debtor's business. Section 503(b)(9) provides:

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including –

• • •

(9) 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 the debtor in the ordinary course of such debtor's business.

11 U.S.C. § 503(b).

2. Application Of The Plain Language

To be entitled to an administrative expense claim under section 503(b)(9), a trade vendor must demonstrate: (1) the value of goods sold, (2) the goods were received by the debtor within 20 days before the filing, and (3) the goods were sold in the ordinary course of the "debtor's business."

By its plain language, section 503(b)(9) administrative claim appears to be independent of any security interest in the goods received or proceeds thereof. Therefore, the administrative expense claim appears to exist independent of any defense to the validity of a reclamation claim such as "valueless." It also appears to be independent of various other state law defenses to a reclamation claim including consumption and commingling. Finally, there is no requirement to demonstrate insolvency. Thus, section 503(b)(9) appears to grant a trade lien vendor an important right.

3. Questions To Be Answered

The trade vendor administrative claim is an entirely new concept. Significant questions exist concerning the interpretation of section 503(b)(9), the resolution of which will affect the scope of the trade vendor's right. These include:

- i. How will "value" be interpreted in determining the amount of the allowed administrative expense claim?
- ii. Will "value" of the goods be the contract price?

- iii. Will the contract price be a presumption that can be rebutted or otherwise subject to reductions or discounts?
- iv. How will ordinary course of the debtor's business be construed?
- v. If the vendor is entitled to an administrative expense claim, when will it be paid: (1) at the outset of the case, (2) at confirmation pursuant to 11 U.S.C. §§ 1129(a)(9)(A) and 507(a)(2), or (3) at some other point in time?
- vi. If not paid at the outset of the case, how will Courts address an administrative expense claimant's right to adequate assurance?
- vii. Is the administrative expense claim retained if a vendor reclaims the goods?
- viii. What is a "good"?
- ix. Does this section include mixed goods and services?

B. The Right To Reclaim

1. The Statutory Language

The right to reclaim goods is separate and distinct from an administrative claim. This right is found in 11 U.S.C. § 546(c), which provides:

(c)(1) Except as provided in subsection (d) of this section and in section 507(c),² 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 sections 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 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

² The reference to section 507(c) appears to be a "technical" error. The proper reference should likely be section 507(b).

(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.

(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).

11 U.S.C. § 546(c).

2. Application Of The Plain Language

To reclaim goods, a vendor must demonstrate that (1) the goods were sold in the ordinary course of the “seller’s business,” (2) the debtor received the goods while insolvent, (3) the debtor received the goods within 45 days of the commencement of the case, and (4) the vendor gave written demand to reclaim the goods (i) not later than 45 days after receipt, or (ii) not later than 20 days after the commencement of the case if the 45 days expired after the commencement.

Under revised section 546(c), the right of reclamation applies for a significantly longer timeframe than under its predecessor – 45 days as opposed to 10 days. The notice period is similarly expanded. Thus, it expands (at least in this instance) the right to reclaim. But, there is now an express recognition that the vendor’s right to reclaim is “subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof;” therefore, the valueless defense applies. Finally, revised section 546(c) is also significant for what it eliminates. It struck the former language bestowing on the Court authority to grant vendors an administrative claim or trade lien. The revised section also eliminates any reference to section 2-702 of the UCC.

3. Questions To Be Answered

While the mechanics of asserting that right remain the same, the right to reclaim appears to be expanded under section 546(c). Certain revisions, however, may have unintended consequences that may curtail the right to reclaim:

- i. Does the elimination of the Court’s authority to grant vendors an administrative claim or trade lien bar a Court from granting that relief?
- ii. Does the vendor have an absolute right to reclaim/only the right to reclaim?
- iii. Does the automatic stay bar the recovery of the goods because it is 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” under 11 U.S.C. § 362(a)(3)?
- iv. Can a reclamation creditor obtain relief from the stay under 11 U.S.C. § 362(d)?

- v. Is a reclamation creditor barred from reclaiming the goods even if the secured lender is oversecured because the goods are still subject to a lien?
- vi. Does the elimination of reference to section 2-702 of the UCC create an independent right to reclaim under the Bankruptcy Code?
- vii. Does the elimination of the reference to section 2-702 of the UCC negate the applicability of principles underlying or case law interpreting that section when construing section 546(c) of the Bankruptcy Code?
- viii. Does the right to reclaim (as well as the administrative expense claim) simply foster more litigation between the debtor and the creditors' committee at the outset of the case?

C. Recommended Course Of Action For A Creditor

First, ensure that the requisite written notice of the reclamation claim has been conveyed in accordance with section 546(c). It remains an open question of whether the debtor cannot consume goods that were in existence at the time of the receipt of that written demand. Therefore, it behooves the creditor to move for a determination of the scope of the reclamation claim early, if not immediately. A creditor can also move at that time for the allowance and payment of its administrative expense claim. This will likely afford the creditor greater leverage in determining the scope of its reclamation claim as it appears to be the generally accepted law of the District of Minnesota (but not necessarily in other districts) that an administrative expense claim must be paid upon motion. Stated differently, the debtor cannot simply pay that administrative expense claim at confirmation.

IV. AVOIDANCE ACTIONS: PREFERENCES AND FRAUDULENT TRANSFERS

A. Effective Date

As noted above, the Reform Act applies to cases commenced after October 17, 2005. It is important to remember that the operative date is the date the bankruptcy petition was filed, and not the date the adversary proceeding (i.e. the preference or fraudulent transfer action) was commenced.

It will likely be a year or more before the avoidance action amendments take effect. Avoidance actions are often not commenced until near the running of the two-year statute of limitation. Thus, it will likely be almost two years before the Reform Act takes full effect. As always, there are exceptions to this rule. These exceptions are noted below.

B. Preference Actions

1. Ordinary Course Defense

Under current law, a creditor may shield a transfer in the “ordinary course” from avoidance if the transfer was made:

- (A) in payment of a debt incurred in the ordinary course of business or financial affairs of the debtor and the transferee;
- (B) in the ordinary course of business or financial affairs of the debtor and transferee; and
- (C) according to ordinary business terms.

11 U.S.C. § 547(c)(2).

The Reform Act only requires a creditor to show that 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 and was made:

- (A) in the ordinary course of business or financial affairs of the debtor and the transferee; or
- (B) according to ordinary business terms.

The disjoining of the final two elements should make it easier to protect transfers under the ordinary course defense. Some commentators, however, speculate that trustees will more aggressively pursue preference actions. Thus, it is conceivable that the intended effect of the amendment may be muted.

2. Perfection of Purchase Money Security Interests

11 U.S.C. § 547(c)(3)(B) has been amended to increase the time for perfection of purchase money security interests from twenty to thirty days after the debtor received possession of such property.

3. Domestic Support Obligation

11 U.S.C. § 547(c)(7) has also been amended. The former section protected bona fide payments of alimony, maintenance, or support to a spouse or child. The Reform Act now protects a transfer “to the extent such transfer was a bona fide payment of a debt for a domestic support obligation.” The definition of domestic support obligation reveals that the defense remains largely the same except that it is now expanded to protect alimony, maintenance, or support payments made to governmental units.

4. Not Primarily Consumer Debt Case Threshold

The Reform Act adds section 547(c)(9). In cases where the “debts are not primarily consumer debts,” creditors who have received less than \$5,000 are not subject to avoidance actions. The rationale appears to be to protect creditors from having to incur costs of defending these small avoidance actions. The mechanics of this provision are illustrated by a chart, which appears at the end of Section IV (D).

5. Grace Period for Perfecting a Transfer

The Reform Act amends section 547(e)(2) to extend the grace period to perfect a transfer from ten days to thirty days.

6. Alternative Repayment Schedule

Subsection 547(h) has been added to protect payments made as part of “an alternative repayment schedule” created by an “approved nonprofit budget and credit counseling agency.” Approved credit counseling agencies are identified by the United States Trustee and are available on the Bankruptcy Court’s website, www.mnb.uscourts.gov. Currently, there are a limited number of such agencies identified.

7. DePrizio

The Reform Act adds 11 U.S.C. § 547(i). It clarifies the previous DePrizio “fix” that recoveries of preferences arising from benefits to insiders of the debtor are limited to recoveries from insiders only. No recoveries are permitted against non-insider parties, which may have benefited from the transfer such as lenders paid by the debtor whose debts had been guaranteed by the insiders. This change applies to all pending cases as of April 20, 2005, the date the Reform Act was signed by the President.

C. Fraudulent Transfers

1. The Lookback

The Reform Act expands the lookback period from one year to two years. This change applies to all bankruptcy cases commenced after April 20, 2006.

2. Transfer Under A Key Employee Retention Plan

The Reform Act amends section 548(a)(1) to specifically provide that “any transfer to or for the benefit of an insider under an employment contract” may be avoided as a fraudulent transfer. 11 U.S.C. § 548(a)(1). However, it may only be avoided if a debtor received less than a reasonably equivalent value, and payment was “not in the ordinary course of business.” It is not necessary to demonstrate insolvency to avoid a transfer to or for the benefit of an insider under an employment contract. This provision applies to all cases commenced after April 20, 2005.

3. Self-Settled Trust

Finally, the Reform Act expressly provides that the trustee may avoid any “transfer” of an interest of the debtor in property that was made on or within ten years before the date of the filing of the petition if:

- (A) the transfer was made to a self-settled trust or similar device;
- (B) such transfer was by the debtors;
- (C) the debtor is the beneficiary of such trust or similar device; and
- (D) the debtor made such transfer with the actual intent to hinder or delay or defraud an existing or future creditor.

11 U.S.C. § 548(e)(2).

Transfer is a defined term. It includes any direct or indirect disposition of property, whether voluntarily or not. 11 U.S.C. § 101(54). As it relates to 11 U.S.C. § 548, the Reform Act explicitly provides it includes a disposition made in anticipation of a money judgment, settlement, civil penalty, equitable order, or criminal fine incurred by or which the debtor believes would be incurred by: (A) any violation of the securities laws; or (B) fraud, deceit or manipulation in a fiduciary capacity or in connection with the purchase or sale of any security registered under federal securities law.

D. Venue/Form Selection

28 U.S.C. § 1409(b) has been amended to provide that an action to avoid a non-consumer debt against a non-insider for less than \$10,000 must be filed in the district in which the defendant resides (as opposed to the district where the bankruptcy case is pending). That same section also requires actions to recover a money judgment of or property worth less than \$1,000 or consumer debt of less than \$15,000 (previously, \$5,000) to be commenced in the district in which the defendant resides (again, as opposed to the district where the bankruptcy case is pending). The mechanics of this provision (as well as the not primarily consumer debt case threshold) are illustrated by the following chart.

<u>Action</u>	<u>Debtor</u>		<u>Total Amount of Claim</u>	<u>Type of Debt</u>	<u>Barred from Filing Suit</u>	<u>Bring Suit Where Defendant Resides</u>
Preference	Debts Primary Consumer	Not	<\$5,000	N/A	X	
Money or Property	Judgment or Recover	N/A	<\$1,000	N/A		X
Money or Property	Judgment or Recover	N/A	<\$15,000	Consumer Debt		X
Money or Property	Judgment or Recover	N/A	<\$10,000	Non-Insider Business Debt		X

E. Post-Petition Transfers

The Reform Act amends section 549(c) to protect a “transfer of an interest in real estate” as opposed to a transfer of “property.”

V. UTILITIES

The Reform Act shifts the balance of power in negotiations with utilities, making it possible for a utility to alter, refuse or discontinue utility service without relief from the automatic stay and without Court approval if the debtor does not tender assurance of payment consistent with the new provisions.

A. “Assurance Of Payment”

The debtor has 20 days to furnish adequate assurance of payment after the order for relief. Assurance of payment is now defined to mean (not “include”):

- (i) a cash deposit;
- (ii) a letter of credit;
- (iii) a certificate of deposit,
- (iv) a surety bond,
- (v) prepayment of utility consumption, or
- (vi) another form of security that is mutually agreed on between the utility and the debtor or the trustee.

11 U.S.C. § 366(c)(1)(A).

B. Ability To Terminate Service

A utility may terminate service without relief from the automatic stay if the form and amount of adequate assurance payment is not “satisfactory” to the utility. Specifically, the statute allows the 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 services that is satisfactory to the utility.

11 U.S.C. § 366(c)(2).

Although section 366 authorizes the Court to modify the amount of the proposed adequate assurance payment, there is no requirement that the utility seek Court approval or relief from stay before terminating service. Presumably, the specific terms of this provision will override any general requirement that a creditor seek relief from stay before acting.

C. Motion For Reasonable Modification

If the debtor and utility are unable to agree on adequate assurance, the debtor must file a motion seeking reasonable modification of the amount of the deposit or other security interest to provide adequate assurance of payment. 11 U.S.C. § 366(b). A strict reading of the statutory language requires the debtor to offer adequate assurance prior to making the motion.

As noted above, assurance of payment is limited. The Reform Act explicitly provides that granting an administrative expense claim does not constitute assurance of payment. 11 U.S.C. § 366(c)(1)(B). It also prohibits the Court from considering the absence of security before the date of the petition and payment by the debtor of charges for utility service in a timely manner. 11 U.S.C. § 366(c)(3)(B).

D. Setoff Against Deposit

11 U.S.C. § 366(c)(4) permits the utility to set off against a security deposit without seeking relief from stay.

E. Practical Effect

The Reform Act will require that utility service be a “first day” consideration by the debtor. Debtors must immediately attempt to reach agreement with their utilities, and if they are unable to do so, they will need to seek relief from the bankruptcy court within the first 30 days of the case. Given the limitation on what can be considered assurance of payment, the Court will not have much leeway to grant relief.

VI. UNEXPIRED LEASES AND EXECUTORY CONTRACTS

The Reform Act grants landlords significant protections. These protections will likely force the debtor to assume leases earlier or convey to the landlord additional consideration. The Reform Act, however, restricts the rights of landlords in limited instances such as where a lease that was previously assumed has been rejected.

A. Time To Assume Or Reject Non-Residential Real Property Leases

Prior to the Reform Act, a debtor had 60 days from the commencement of the bankruptcy case to decide whether to assume or reject commercial real estate leases. This time period could, and typically was, extended by the Court for “cause” shown. The extensions were often granted as a matter of course through the time of confirmation of the plan of reorganization.

The Reform Act provides that the initial period of time for assumption or rejection is extended to 120 days after the order of relief or upon entry of an order confirming a plan, whichever is earlier. 11 U.S.C. § 365(d)(4). The Court may extend this period for 90 days for cause. If the Court grants the 90-day extension, it cannot further extend the period to assume or reject without “prior written consent of the lessor.” 11 U.S.C. § 365(d)(4)(B)(ii).

A debtor seeking additional time will be required to negotiate with the landlord. The outcome of these negotiations will be dependent upon the relevant lease market at the time the decision has to be made. In many instances, the landlord will require the payment of additional consideration for an extension.

B. Administrative Claim Upon Rejection Of Lease Previously Assumed

Generally speaking, caselaw provides that a landlord has an administrative expense claim entitled to priority under 11 U.S.C. § 503(b) for the rejection of a lease that was previously assumed during the course of the bankruptcy proceeding. See, e.g., In re Klein Sleep Products, Inc., 78 F.3d 18 (2d Cir. 1996). It also provides that 11 U.S.C. § 502(b)(6), which establishes a cap on damages arising from the rejection of a lease, does not apply to the lessor’s claim. Id.

The Reform Act places a two-year cap on the administrative priority claim for all payments due under an assumed then rejected lease. This two-year period starts the later of the rejection date or property turnover date. 11 U.S.C. § 503(b)(7). Damages for “going dark” and penalties are expressly excluded from the administrative claim. Id.

The Reform Act also provides that setoffs or reductions against the allowed administrative amount can only be taken for amounts “actually received or to be received” by the landlord from third parties (i.e. replacement tenants and guarantors). 11 U.S.C. § 503(b)(7). The notion that under state law that a landlord has a duty to mitigate its damages appears to be removed from the statute at least insofar as the administrative claim is concerned.

Finally, payments due under the lease after the two-year administrative claim window are treated like other damage claims arising from a rejected lease under the cap currently set forth in 11 U.S.C. § 502(b)(6). This cap, however, applies only to the lessor's claim for future rent after the two years administrative claim. Thus, a landlord will be entitled to an administrative expense claim for rent due under the first two years, and a general unsecured claim, which typically is one year's rent.

C. Cure Of Non-Monetary Defaults Of Unexpired Leases

Caselaw was split as to whether the debtor had to cure non-monetary defaults. The Reform Act resolves that issue. Under the Reform Act, the trustee or debtor in possession need not cure defaults that relate to a breach of a non-monetary obligation under an expired real property lease if it is "impossible" to be cured "at or after the time of assumption." 11 U.S.C. § 365(b)(1)(A). To the extent they are not impossible, the trustee must perform all non-monetary obligations under the lease at or after the time of assumption.

If the lessor of non-residential real property suffers any pecuniary losses as a result of the debtor's failure to perform its non-monetary obligations under the lease, those losses must be compensated as part of the cure. 11 U.S.C. § 365(b)(1)(A). The party may be entitled to receive consequential damages. For example, there is a loss in percentage rent due under the lease because the store was not open for a period of time.

D. Assignment Of Leases

The Bankruptcy Reform Act makes it clear that all the protections set forth in 11 U.S.C. § 365(b) for landlords shall be given full effect. These primarily relate to shopping center leases that contain provisions addressing radius, location, use and exclusivity provisions. The Reform Act now makes it clear that 11 U.S.C. § 365(f) cannot be utilized to cut off these provisions.

VII. KEY EMPLOYEE RETENTION PLANS AND OTHER LABOR ISSUES

Previously, no provision specifically addressed Court approval of key employee retention plans ("KERPs"). The Reform Act adds a subsection to 11 U.S.C. § 503 governing allowance and payment of administrative expenses to insiders. The effect of this provision is unmistakable. KERPs will very rarely, if ever, be approved.

On the other hand, the Reform Act expands employee wage and benefit priorities. It also attempts to protect retiree benefits by allowing the Court to reinstate these benefits under certain circumstances and also appoint a committee of retired employees.

A. KERPs

1. Pay To Stay

11 U.S.C. § 503(c)(1) prohibits a transfer or payment to an insider for the purpose of inducing the insider to remain with the debtor **unless** the Court finds –

- (1) the payment is essential to retention of the insider because the individual has a bona fide job offer from another business at the same or greater rate of compensation;
- (2) the services provided by the person are essential to the survival of the business; and
- (3) either the amount of money to be paid is not greater than ten times the mean payment of a similar kind given to non-management employees for any purpose during the calendar year in which the transfer to the insider is made (or the obligation is incurred); or if that is not applicable, the payment is no greater than 25% of the amount of a similar transfer (or obligation made or incurred) for the benefit of that person for any purpose during the preceding calendar year.

2. Severance

No severance payment may be made to an insider of the debtor unless –

- (1) the payment is part of a program generally applicable to all full-time employees; and
- (2) the amount of the payment is not greater than ten times the amount of the mean severance pay given to non-management employees during the calendar year in which the payment is made.

11 U.S.C. § 503(c)(2).

3. Non-Ordinary-Course Obligations

11 U.S.C. § 503(c)(3) also prohibits allowance or payment of transfers or obligations outside the ordinary course of business that are not justified by the facts and circumstances of the case.

B. Labor Issues

1. Back Pay Awards

Previously, the Courts occasionally related the priority of a back pay award to the date of the debtor's wrongful conduct. The Reform Act now provides that, without regard to the time of the debtor's conduct, they have priority if the Court determines that payment will not substantially increase the probability of layoff or termination of current employees or the nonpayment of domestic support obligations, where back pay was awarded after the commencement of the bankruptcy case. 11 U.S.C. § 503(b)(1)(A)(ii).

2. Employee Wage and Benefit Priorities

i. Increased Time Span

The Reform Act increases from 90 days to 180 days (before the earlier of the petition date or the date the debtor ceased business) the period for which wages, salaries, and commissions (including vacation, severance and sick leave) are entitled to administrative priority. This provision applies to cases filed after the date of enactment, April 20, 2005. 11 U.S.C. § 507(a)(4).

ii. Increased Amount

The Reform Act also increases the maximum amount of a claim for wages and employee benefit plan contributions from \$4,925 to a maximum of \$10,000 for each individual. 11 U.S.C. § 507(a)(4) and (5).

3. Reinstatement of Retiree Benefits

The Reform Act amends 11 U.S.C. § 1114 to permit the Court to reinstate retiree medical, disability, or death benefits that were 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 the modification. 11 U.S.C. § 1114(l). This amendment also applies to cases filed on or after the date of enactment.

4. Committee of Retired Employees

The Reform Act requires the Court, upon motion by a party in interest and after notice and a hearing, to order the appointment of a committee of retired employees if the debtor seeks to modify or not pay retiree benefits. 11 U.S.C. § 1114(d). The United States Trustee then has responsibility for organizing and appointing members to the committee.

5. Exclusion from Property of the Estate

The Reform Act excludes from property of the estate amounts withheld or collected for payments to certain employee benefit plans.

6. Mandatory Service as Plan Administrator

The Reform 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 filing of the petition. 11 U.S.C. §§ 521(a)(7) and 704(a)(11). In most ERISA plans, the employer is the plan administrator or appoints a plan administrator. This amendment codifies the position taken by the Department of Labor that a trustee has the obligation to continue to perform these functions or appoint someone to do so and to wind up the plans.

VIII. EXCLUSIVE PERIOD TO FILE AND OBTAIN ACCEPTANCES OF PLAN

Before the Reform Act, 11 U.S.C. § 1121(d) permitted a party in interest to seek to reduce or increase the 120 day period within which the debtor has the exclusive right to submit a plan of reorganization and the 180 day period within which the debtor must obtain acceptances of its proposed plan of reorganization. It did not limit the debtor's ability to continue to seek extension after extension, provided that the requisite cause was established each time. Motions by the debtor to extend this period were frequently granted. This gave the debtor significant control in plan negotiations and over the direction of the bankruptcy case.

The Reform Act limits the period of time that the extensions can be granted. The Court cannot extend the debtor's exclusive period for filing a plan beyond a date that is 18 months after the order for relief and the debtor's exclusive period for soliciting acceptances of the plan is limited to 20 months. It erects an absolute prohibition on extensions beyond the specified time periods.

These limits have been implemented to expedite bankruptcy cases, reduce the likelihood that debtors will linger in Chapter 11 for a protracted period of time, and reduce the influence that the debtor can exert on the plan process. These revisions will have the most serious impact on the larger, more complex and more contentious Chapter 11 cases. They may encourage creditors to stall negotiations toward a consensual plan in order to obtain the right to file competing plans in such cases.

IX. CONVERSION/DISMISSAL

Before the Reform Act, the Court could convert a reorganization case to a liquidation case or dismiss a case if it was in the best interests of the creditors. The Bankruptcy Code set forth a number of non-exhaustive factors.

The Reform Act significantly expands the definition of "cause" for dismissal or conversion of a Chapter 11 case to include benchmarks that are designed to facilitate the prompt identification and resolution of Chapter 11 cases that do not have a realistic prospect of reorganization. This test is no longer dependent on what is in the best interests of the creditors. The express items of "cause" listed in the statute include:

- (A) Substantial or continuing loss to or diminution of the estate in 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 one 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;

...

(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;

(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;

...

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

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

...

11 U.S.C. § 1112(b)(4).

A party opposing a conversion or dismissal must show that either there is a reasonable likelihood that a plan will be confirmed within the time frame established in 11 U.S.C. § 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 (except for certain omissions) that will be cured within a reasonable period of time fixed by the Court. 11 U.S.C. § 1112(b)(2)(B).

The Reform 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 not later than 15 days thereafter. The movant can consent to a continuance of the hearing on the motion. 11 U.S.C. § 112(b)(3).

The Reform Act also allows the Court to order the United States Trustee to appoint a trustee or examiner if grounds for conversion or dismissal exist. 11 U.S.C. § 1104(a)(3).

Dismissal or conversion appears to be mandatory unless cure is possible, even if the best interest of the 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. 11 U.S.C. § 1104(a)(3).

X. CONFIRMATION

A. Requirements For Confirmation Under 11 U.S.C. § 1129(a) Prior to The Reform Act.

1. Plan complies with Title 11.
2. Plan proponent complies with Title 11.
3. Plan has been proposed in good faith.
4. Payments made or to be made have been or will be approved by the Court.
5. Identity of certain parties has been disclosed.
6. Applicable regulatory commission has approved rate change.
7. Holder of impaired claim has accepted the plan or will retain or receive the value of the claim.
8. Class of claims has accepted the plan or is not impaired.
9. Plan provides for payment of
 - i. administrative claims and 502(f) unsecured claims are paid in full as of the effective date, and
 - ii. domestic support obligations; priority wage claims; employment benefit claims; claims of grain producers and fisherman; and claims arising from deposit of funds by individuals for household goods or services are paid in full or if they have accepted the plan by deferred cash payments.
10. Plan provides for payment of general unsecured claims over six years.
11. One friend rule has been satisfied – at least one impaired class has accepted the plan.
12. Plan is feasible.
13. United States Trustee fees have been paid.
14. Plan provides for continued payment of retiree benefits.

B. The Reform Act

The requirements for plan confirmation noted above remain in effect under the Reform Act. There are, however, three additional requirements.

Holders of section 507(a)(8) general unsecured claims (government priority) are now to receive regular installment payments in cash over a period not to exceed five years, which are not less favorable than the most favored nonpriority unsecured claim. 11 U.S.C. § 1129(a)(9)(C). Thus, unsecured tax claims can no longer be stretched over six years from assessment, while other unsecured claims are paid on a shorter or more favorable basis.

In addition, it will no longer matter whether the government claim is secured. Holders of secured claims that would otherwise meet the description of an unsecured claim of a governmental unit (section 507(a)(8)) must receive regular installment payments in cash over a period not to exceed five years in a manner not less favorable than the most favored nonpriority unsecured claim. 11 U.S.C. § 1129(a)(9)(D).

Finally, all transfers of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust must be made according to applicable nonbankruptcy law. 11 U.S.C. § 1129(a)(16).

XI. DISCHARGE

The Reform Act limits the extent to which a corporate debtor can discharge its obligations as part of the plan confirmation. 11 U.S.C. § 1141(d) clarifies that confirmation does not discharge a “corporation” from any obligation owed to a domestic governmental unit for a debt specified in section 523(a)(2) (obtaining credit, property, financial or refinancing through actual fraud, false pretenses, false financial statements). The corporate debtor also cannot discharge a debt for tax or customs duty that the debtor attempted to evade, or which it filed a fraudulent return.

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