

# Bankruptcy Abuse Prevention and Consumer Protection Act of 2005: Impact on Business Bankruptcies

Presented to: Manufacturers Clearing House  
Trade Creditors' Group

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# Momma Don't Let Your Babies Grow up to be Bankruptcy Lawyers

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# BAPCPA

- Impact on Trade Creditors
- Changing the Dynamics of Chapter 11 Reorganization
- Key Additional Provisions

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# BAPCPA's Impact Upon Trade Creditors

- Amendment affecting Creditor Committees
- Preferences and Fraudulent Conveyance Actions
- PMSI
- Reclamation Rights
- New Administrative Claim

# Amendment Affecting Creditor Committees

- Courts are now actively involved in Committee membership issues
- Committees must share information with and solicit input from unsecured creditors who are not on the Committee
- A Committee member, who retains its own attorney or accountant, will not be reimbursed except under extraordinary circumstances

# Committee Membership

## (§ 1102(a)(4))

Old law: Trustee appointed committee, listened to complaints and rarely did anything about complaining creditors; very limited judicial oversight – primarily removing insiders

New law: (1) Upon request by a creditor, Court may order U.S. Trustee to change membership if Court determines the change is necessary to insure adequate representation of creditors

(2) Small creditor may be included if debt owing, in comparison to annual gross revenue of that creditor, is disproportionately large

# Committee Membership

Dissemination of information:

“A committee appointed under subsection (a) shall -

- (A) provide access to information for creditors who -
  - (i) hold claims of the kind represented by that committee; and
  - (ii) are not appointed to the committee;
- (B) solicit and receive comments from the creditors described in subparagraph (A); and
- (C) be subject to a court order that compels any additional report or disclosure to be made to the creditors described in subparagraph (A).”



# Dissemination of information

## Good News

- Creditors not on the Committee now have a voice
- Committee members now held accountable by the constituency they represent

## Bad News

- Committee members now held accountable by the constituency they represent
- Less information from the Debtor
- Public debtor nightmare
- Subject to order compelling additional reporting to creditors
- Claims buyers' dream

# Dissemination of information

One commentator bemoans “the statute does not provide for mechanisms by which the Committee can refuse to release such information, or alternatively, condition the circumstances under which the Court can order such information not be disclosed.”

- Confidentiality Agreements: Enemy Turned Ally
- Motion to Compel
- Monthly reports with Debtor’s opportunity to object
- Bottom line – Obtain Court’s blessing

# PREFERENCES

- A. Trustee's burden of proof remains the same
- B. Eliminating small nuisances (a/k/a "shake downs")
  - Preferential transfer must exceed \$5,000 (§ 547 (c)(9))
  - Preferential transfer to non-insider business defendants of less than \$10,000 must be filed in the district which the Defendant resides (28 U.S.C. § 1409(b))
  - **Practical impact: Preferences less than \$10,000 may be demanded, but unlikely to be pursued**

# New Ordinary Course of Business Defense

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

(2) to the extent that such 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 such transfer was--

(A) ~~in payment of a debt incurred by the debtor~~made in the ordinary course of business or financial affairs of the debtor and the transferee; or

(B) ~~made in the ordinary course of business or financial affairs of the debtor and the transferee; and~~ (C) ~~made according to ordinary business terms;~~

# New Ordinary Course of Business Defense

Two disjunctive, alternative defenses

1. Preferential payment was made in the ordinary course of the Debtor's and the Creditor's/Defendant's business

-OR-

2. Made in accordance with ordinary business terms

# Fraudulent Conveyances

- Look back period changed from one year to two years
- Amended to expressly include insider employment contracts
  - Do not have to show insolvency
  - To extent prepetition KERP is not in the ordinary course of business

# Fraudulent Conveyances (con't)

- Ten year look back for § 548(c)
  - (a) Self-settled trust or similar device where the Debtor is the beneficiary
  - (b) Actual intent to hinder, delay or defraud any entity to which the debtor was **or became** indebted to after such transfer was made
  - (c) College education trust??
  - (d) Actual intent – anticipation??

# PMSI

## **Expansion of time to perfect a PMSI (as a preference defense)**

A creditor has a defense to a preferential transfer lawsuit if the transfer is a security interest created to secure new value

Old law: Had to perfect PMSI within 20 days after debtor receives the property subject to the PMSI

New law: Changes 20 to 30

( § 547(c)(3)(B))



# Rights of Reclamation (§ 546(c))

- ~~Old law:~~ Provide written demand for reclamation of goods within ~~100 days after delivery of goods~~
- (a) If bankruptcy filed during the ~~100 days~~ –  
creditors have 20 days after ~~delivery of goods~~  
~~to reclaim goods~~ Bankruptcy is filed
  - (b) Minority view: ~~whether subject to secured~~  
~~creditors' rights~~ Gone
  - (c) Must make written demand to obtain return of goods
  - (d) Eliminates Court's option of granting administrative claim; or (ii) a lien in lieu of reclamation

# Reclamation (con't)

Net Effect:

(a) Look back to include deliveries 45 days before bankruptcy

(b) Notice deadline:

20 days **after bankruptcy**, instead of 20 days from receipt of goods

# Reclamation (con't)

## Example

Delivery of goods 48, 30, 15 and 5 days before bankruptcy

Old law: only delivery 5 days before bankruptcy is subject to reclamation, as long as reclamation letter is sent within 20 days after the delivery—since 10 day period had not expired by the time of Bankruptcy.

New law: deliveries 30, 15 and 5 days before bankruptcy subject to reclamation, as long as reclamation letter sent within 20 days after bankruptcy.

# Trade Suppliers' New Administrative Claim

What if –

- (a) Forget written reclamation demand?
- (b) Lender has a prior lien on inventory and is undersecured?
- (c) No reclamation right!

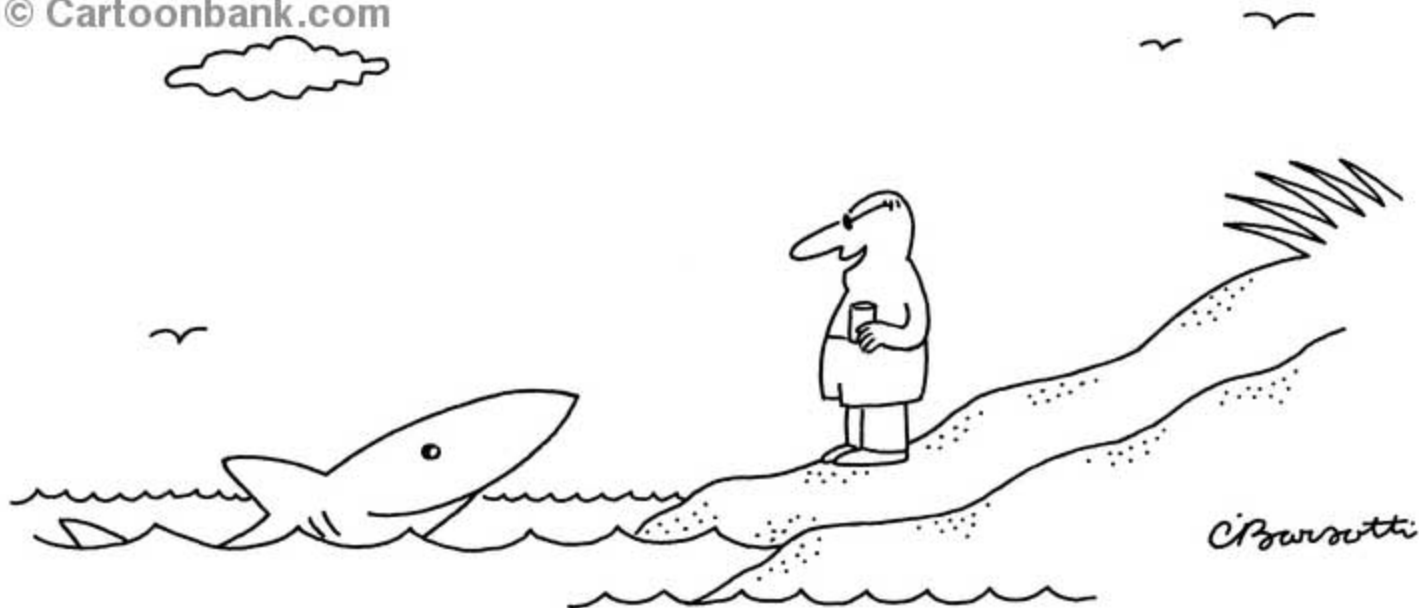
New Law (§ 503(b)(a))

Suppliers who deliver goods within **20** days before bankruptcy receive an administrative claim for the unpaid invoices

Administrative Claim Means: Trade Suppliers = Lawyers

Critical Vendor doctrine suspended?

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*"Impressed? Well, wait until I tell you about this next case."*

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# Changing the Dynamics of Chapter 11 Reorganization

- Exclusivity
- Pre-Package Plans
- Executory Contracts and Unexpired Leases
- KERP limitations
- 363 Sales
- Conversion to Chapter 7/Appointment of Chapter 11 Trustee
- Utilities
- Small business bankruptcies

# Changing the Dynamics of Chapter 11 Reorganization

- Exclusivity
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- Unexpired Leases of Non-Residential Real Property
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# Changes to Reorganization

## Exclusivity (§ 1121)

Old law: 120/180 days plus extensions as authorized by Court.

New law: 120/180 days plus extensions authorized by Court **not to exceed 18/20 months**

- Removes judicial discretion after 18 months
- Conversion/dismissal: failure to file or confirm a plan within the time frame set forth in a court order or the Bankruptcy Code ( § 1112(b)(4)(g))
- Smaller cases – likelihood of making it harder to extend exclusivity given Congressional intent of new law

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# Pre-Package Plans (§ 1125(g))

- Pre – BAPCPA
- Problem: Upon plan solicitation – creditors leveraged the Debtor
  - (a) Involuntary petition
  - (b) State court extraordinary, pre-judgment remedies
  - (c) Cash flow crisis – credit dries up
  - (d) Once bankruptcy filed – no plan solicitation until disclosure statement approved

# Pre-Package Plans (con't)

## New law:

- (a) Acceptance or rejection of a plan may be solicited from creditors – without a previously approved disclosure statement as long as
  - (i) The solicitation complies with applicable non-bankruptcy law; and
  - (ii) Creditors were solicited before the filing of bankruptcy case in a manner complying with non-bankruptcy law.
- Prevents a few creditors from destroying the case for the benefit of all creditors
- Enables a debtor to file bankruptcy in the middle of the solicitation period without the process grinding to a halt
- Pre-package plans will likely be more popular

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# Unexpired Leases of Non-Residential Real Property

- Changes from 60 to 120 days the date by which the Debtor must assume a non-residential lease or it will be deemed rejected
- The Court may only extend this deadline up to 90 days – or a maximum of 210 days from the petition date to assume or reject unexpired non-residential real property leases
- After 210 days, the deadline to assume may only be extended with the Landlord's consent

# Unexpired Leases (con't)

## Administrative Claims

- If Debtor assumes and subsequently rejects:
  - (a) Lease obligation – administrative claim for two years
  - (b) Remaining obligations on unsecured claim, subject to additional limitations
- Impact
  - (a) More pressure on Debtor to determine which leases to reject
  - (b) Prematurely assumed leases
  - (c) Difficulty in sale process
  - (d) Compare Strauss

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# Key Employee Retention Plans

“Dancing with the one  
who brought you . . .  
Ain’t such a good idea”

# KERP (con't)

- New Bankruptcy Code section significantly curtails the benefits an insider could receive for staying and working with debtor during debtor's financial crisis.
- New section limits, if not eliminates, KERP programs for insider officers and managers.

# KERP (con't)

- Key employees must actually have a bona fide job offer at the same or greater compensation
- Services are essential
- Ceiling:
  - (a) Less than 10 times the average amount given to non-management employees during calendar year the obligation is incurred or paid; or
  - (b) If no non-management transfers made, then less than 25% of compensation of the key employee for any purpose during the prior calendar year

# KERP -Severance

## (§ 503(c)(2))

- No severance payments to insiders unless
  - (a) Part of a program generally applicable to all full time employees; and
  - (b) Amount is less than 10 times the mean severance pay given to non-management employees during the applicable calendar year
- § 503(c)(3) prohibits the payments of other transfers outside the ordinary course of business for the benefit of officers, managers or consultants hired after the petition date and not justified by the facts and circumstances of the case

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# § 363 Sales of Substantially All Assets

Consumer protection: Restricts the Debtor from selling “personally identifiable information” unless it is consistent with the debtor’s prepetition policy or the sale or lease is approved after the appointment of a “*consumer privacy ombudsman*.” (§ 363(b)(1))

# Consumer Privacy Ombudsman

Appointed by the U.S. Trustee at least 5 days before the sale hearing

(a) Provides Court with information about the impact of the proposed sale or lease upon “personally identifiable information” including

- Debtor’s policy
- Loss or gains to consumers
- Alternative and suggested ways to insure protection

(b) Paid by the bankruptcy estate

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# Conversion to Chapter 7

- BAPCPA expands grounds, but tightens up the standards. Instead of the Court “may” – now the Court “shall” . . .
- In addition to old standards
  - (a) Continuing loss
  - (b) Absence of reasonable likelihood of rehabilitation
  - (c) Revocation of plan or inability to effectuate a plan

- New grounds, if proven, the Court shall convert to Chapter 7 or dismiss the case:
  - (a) Gross mismanagement
  - (b) Unauthorized use of cash collateral
  - (c) Failure to timely file required reports or attend § 341 or Bankruptcy Rule 2004 examinations
  - (d) Failure to timely file disclosure statement and plan
- Hearing shall commence within 30 days of motion and decision within 15 days thereafter

# Appointment of Chapter 11 Trustee

- Grounds exist to dismiss or convert, but Chapter 11 Trustee is in the best interest of the estate
- U.S. Trustee must move for a Chapter 11 Trustee if debtor's governing representatives participated in actual fraud, dishonesty or criminal conduct

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# Utilities

- Huge cash drain to the debtor; significant departure from old law
- § 366 amended to provide adequate assurance of payment within 20 days
- Administrative claim ? adequate assurance, rather
  - (a) Cash deposit
  - (b) Letter of credit
  - (c) Certificate of deposit
  - (d) Prepayment
- Utility may offset prepetition deposit if non-payment without notice or court order

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# Small Businesses

- A “small business debtor” has total noncontingent liquidated debt (secured and unsecured) not exceeding \$2 million
- The \$2 million cap excludes debts owed to affiliates or insiders
- Only cases where no Committee is appointed

# Small Businesses (cont'd.)

“Small business debtors” are to file periodic financial reports:

- (a) Amount of money the debtor has earned or lost during the current and recent fiscal years;
- (b) Reasonable approximations of projected cash receipts and disbursements;
- (c) Comparisons of actual cash receipts and disbursements with projections in prior reports; and
- (d) Whether the debtor is timely filing tax returns and paying taxes.



# Small Businesses (cont'd.)

- Disclosure statements may be limited or not even necessary
- Plan exclusivity period increased from 120 to 180 days

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- Single asset real estate debtors – eliminates \$4MM debt cap, monthly interest payments required
- Involuntary bankruptcy petitions – bona fide dispute clarified as to liability or amount
- Investment bankers/financial advisors – liberalize disinterestedness requirements
- Compensation of professionals include fixed, percentage and contingency fee
- Potential reinstatement of retiree benefit plans modified 180 days prior to bankruptcy while the Debtor was insolvent

- Individual chapter 11 cases to include property acquired postpetition, minimum required distributions to unsecured creditors, post-confirmation amendments
- Health care bankruptcy – another ombudsman, patient record protections
- Cross-Border bankruptcies – much more like a U.S. bankruptcy
- Homestead rights
- Consumer means testing/attorney sanctions

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*"Run this up Legal's ass."*