



## THE TOP SIX THINGS ONE SHOULD KNOW ABOUT THE NEW BANKRUPTCY REFORM LEGISLATION

On April 20, 2005, President Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") into law, ushering in some of the most substantial changes to the modern day bankruptcy code since its inception in 1978. In bankruptcy circles, this was a highly controversial piece of legislation, and the battle over its enactment had raged for approximately nine years. Most of the BAPCPA provisions will not become effective until October 17, 2005 and will only apply to bankruptcy cases filed on or after this date. This article summarizes some of the highlights of BAPCPA and its impact on the existing bankruptcy code (the "Code").

### 1. Filing Individual Consumer Cases Is Likely to Become More Difficult and Costly

- *New Means Test for Individuals.* In order to qualify for Chapter 7 relief, the BAPCPA provisions state that a debtor must pass either a "Median Income" test (debtor's current monthly income may not exceed the median income for a family of the same size in his or her state of residence) or a "Means" test (debtor's current monthly income as reduced for certain expenses may not exceed the amount allowed under the cost of living standards enacted by his or her state of residence).
- *Attorneys Must Review and Verify all Debtor Filings Submitted to the Court.* BAPCPA requires a debtor's attorney to make a "reasonable inquiry" in order to verify that all filings submitted to a court or to a bankruptcy trustee on behalf of a debtor are truthful and not misleading (including all related schedules, such as lists of a debtor's assets and liabilities). A court may impose sanctions on the attorney if the debtor's filings contain factual inaccuracies or provide an inadequate legal basis for submitting a Chapter 7 filing. This provision alone is likely to create a substantial roadblock to many attorneys serving as counsel to a Chapter 7 debtor.

### 2. Debtors Will Have to Comply with Strict New Chapter 11 Time Constraints

- *Strict Time Limit on the Assumption/Rejection of Non-Residential Real Estate Leases.* Under the existing Code, a reorganizing debtor in possession ("DIP") has sixty (60) days after filing in which to determine whether to assume or reject its existing non-residential real estate leases, after which it may seek an unlimited number of extensions "for cause" from the court, which extensions often have been granted. The BAPCPA provisions initially grant the DIP a 120 day assumption/rejection period but limit the extension period to be granted by the court "for cause" to a single ninety (90) day period. Additional extensions beyond the 210 day period require the prior written consent of the lessor. The effect of the new legislation will be to create enormous time pressure on large retail DIPs to make quicker decisions about exiting Chapter 11, thereby creating leverage in favor of lessors.
- *Strict Time Limit on Debtor's Exclusive Period for Filing a Chapter 11 Plan.* BAPCPA provides that the period in which a debtor has the exclusive right to file a disclosure statement and Chapter 11 plan may not exceed eighteen (18) months after the order for relief is entered and the periods in which a debtor has to obtain acceptances and rejections may not exceed twenty (20) months after the order for relief is entered. No extensions are permitted with regard to these "exclusivity" periods, unlike the prior law where extensions have been granted, in some cases, for three or more years.

### 3. Debtor-In-Possession Loans May Become More Costly and More Scarce in Chapter 11 Cases

- *Priority Amounts Raised For Wage Claims and Employee Benefit Plan Contribution Claims.* Under the existing Code, priorities for wage claims and employee benefit contribution claims

were capped at \$4,925 per person. Under BAPCPA, these amounts are raised to \$10,000, and the likely effect will be to increase both the difficulty of emergence from Chapter 11 and the cost of emergence.

- *New Administrative Claim for Pre-Petition Vendors Relating to Sales Made in the Ordinary Course of Business Within Twenty (20) Days Before the Bankruptcy.* This new administrative claim is limited to the value of the goods. Again, it appears that this provision is designed to increase the cost of Chapter 11 and the difficulty of obtaining a Debtor in Possession loan facility.
- *New Extended Reclamation Right Granted to Pre-Petition Vendor Relating to Sales Made in the Ordinary Course of Business Within Forty-Five (45) Days Before the Bankruptcy.* The pre-petition vendor must make such reclamation claim in writing not later than (1) 45 days after the receipt of the goods by the debtor or (2) if the 45 day period expires after the commencement of the bankruptcy case, then 20 days after the date of the case's commencement. One should note however, that this reclamation right is subject to the prior rights of any party who holds a prior perfected security interest in the goods, and in most cases will prove of limited utility to the vendor.
- As a result of the foregoing changes, a DIP will have to increase the budgeted expenses it seeks to have paid by the DIP lender at the outset of a Chapter 11 case.

#### **4. Unsecured Creditor Committee “War Chests” Will Become Smaller in Chapter 11**

##### **Settings**

- Under BAPCPA a trustee may not void an alleged preference payment if the debt was incurred in the ordinary course of business of both parties and the payment either (1) was made in the ordinary course of business of both parties or (2) was made according to ordinary business terms. Under the existing Code both (1) and (2) had to be met. Accordingly, it should be easier for a creditor to defend against a preference action if the payment was made in accordance with industry standards.

#### **5. Single Asset Real Estate Cases Will Likely Become Less Common**

- Under the existing Code, special provisions are made applicable to single asset real estate debtors, which category consisted of debtors which held a single property or project (including rental properties other than residential properties with fewer than four units) whose income was derived from and whose business consisted almost exclusively on such property or activities pertaining thereto and which debtor had no more than \$4,000,000 in secured debts. BAPCPA has eliminated the \$4,000,000 cap, thereby enlarging the universe of potential single-asset debtors and forcing them to pay monthly adequate protection to their respective lenders or otherwise file a plan of reorganization within ninety (90) days of their petition date.

#### **6. Asset Protection Trusts To Receive Increased Creditor Scrutiny**

- BAPCPA adds a new provision which permits a trustee to avoid any transfer by a debtor to an asset protection trust or similar device made within ten (10) years prior to the filing of the petition if the transfer was made with the “actual intent to hinder, delay or defraud any entity to which the debtor was or became, on or after the date that such transfer was made, indebted.” Such avoidance claims will likely be uncommon because “actual intent” cases aren't nearly as common as “constructive” fraudulent transfer cases.

***Taking Stock is presented for general informational purposes only, is not intended as legal advice, and cannot substitute for advice of counsel. If you have any additional questions about BAPCPA or its applicability, please contact Chris Horvay, Mark Leipold, Mark Abraham or the other attorneys in the Gould & Ratner Creditors' Rights and Bankruptcy Group at [info@gouldratner.com](mailto:info@gouldratner.com).***