

*Client Alert**Bankruptcy Abuse Prevention and  
Consumer Protection Act of 2005**by: Vincent E. Lazar, Paul V. Possinger and Jerry L. Switzer, Jr., Partners, Jenner & Block LLP**Table of Contents*

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**O**n April 20, 2005, President George W. Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act"). After years of attempts to pass comprehensive bankruptcy reform legislation, this controversial bill swept through the United States Senate and House of Representatives with only a few amendments. The full text of the Act (including numerous consumer and individual chapter 7 provisions that are not discussed in this client alert) is available by clicking [here](#).

The Act makes the most sweeping changes to the U.S. Bankruptcy Code since its enactment in 1978. Although much of the Act is targeted at preventing perceived individual consumer abuses of the chapter 7 process, the Act also includes dozens of other amendments to the Bankruptcy Code that will significantly impact commercial bankruptcy proceedings. The Act also makes important changes to non-bankruptcy laws, particularly in the consumer credit area. Among other things, the Act:

- Limits extensions of the exclusive period for debtors to file plans of reorganization
- Shortens the time within which non-residential leases must be assumed/rejected
- Limits and establishes standards for key employee retention plans
- Creates chapter 15 to implement the Model Law on Cross-Border Insolvency
- Makes it more difficult for debtors to discharge tax obligations
- Prohibits preference lawsuits in non-consumer cases seeking to recover less than \$5,000
- Permits assumption/assignment of unexpired leases without the cure of historic non-monetary defaults that are incapable of being cured
- Creates new Truth In Lending Act disclosure requirements

The following is a summary of the Act's impact on key aspects of the Bankruptcy Code that are relevant in commercial cases.

## **Assumption or Rejection of Leases and Contracts**

- *Cure of Non-Monetary Defaults Under Unexpired Non-Residential Leases.* Section 328 of the Act establishes new guidelines under section 365(b)(1) of the Bankruptcy Code for the assumption by a debtor or trustee of a defaulted unexpired lease of non-residential real property. To assume or assign an unexpired lease of real property, a debtor or trustee need not cure past non-monetary defaults if it is impossible to cure such defaults. However, performance of the non-monetary obligation is required at and after the time of assumption, and any pecuniary losses resulting from past defaults must be compensated. The effect of this amendment upon the assumption of real property leases is to override the impact of *In re Claremont Acquisition Corp., Inc.*, 113 F.3d 1029 (9th Cir. 1997) and its progeny, in which the court held that because of a historic non-monetary default (violation of a franchise agreement prohibition against "going dark") that could not be cured, the agreement could not be assumed or assigned upon assumption. The Act also clarifies that when a trustee need not cure a non-monetary default, any penalty rate or penalty provision relating to the non-monetary default also may not be enforced. This amendment becomes effective 180 days after passage of the Act, which is October 17, 2005, and will apply only to cases filed on or after that date.
- *Time to Assume Real Property Leases.* Section 404 of the Act amends section 365(d)(4) of the Bankruptcy Code to set a firm deadline by which non-residential real property leases must be assumed. A debtor now has until the earlier of (i) 120 days after the order for relief or (ii) entry of a confirmation order to assume or reject an unexpired lease of nonresidential property, and the court's ability to extend that period is limited only to an additional 90 days. The court has no discretion to grant any further extension absent written consent of the lessor. Therefore, absent lessor consent (and assuming all statutorily permitted extensions are granted), unexpired leases of nonresidential real property must be assumed or rejected, at the latest, within 210 days (seven months) after the commencement of the bankruptcy case. Previously, courts had broad discretion to extend this period of time, and routinely extended the time for assumption/rejection of unexpired leases of non-residential real property until confirmation of a plan. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Administrative Claim.* Section 445 of the Act adds a new category of administrative expense claim entitled to priority under section 503 of the Bankruptcy Code. New section 503(b)(7) provides for the allowance as an administrative expense, for the two-year period following the later of the rejection date or the date of actual turnover of the premises, of all monetary obligations due under a nonresidential real property lease previously assumed and subsequently rejected (excluding penalty provisions), less any payments the lessor receives or will receive from persons other than the debtor. Previously, the majority of case law indicated that the entire balance owed under a previously assumed lease could be claimed as an administrative expense in the event of

subsequent rejection of the lease. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Personal Property Leases.* Section 309 of the Act adds new section 365(p) of the Bankruptcy Code concerning assumption and rejection of leases of personal property. It provides that if a lease of personal property is rejected or not timely assumed under section 365(d) of the Bankruptcy Code, then the property is no longer considered property of the estate and the automatic stay is automatically terminated. This amendment also modifies the Bankruptcy Code to specify new procedures for the assumption and cure of personal property leases by individual debtors. These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
  - *Aircraft Terminal Lease Provisions.* Section 328 of the Act makes technical amendments to section 365 of the Bankruptcy Code to delete historical aircraft terminal lease provisions which, pursuant to the 1992 Rail Safety Enforcement and Review Act, were effective for only a 12-month period. These amendments make clear that (i) the time period for a trustee or debtor to assume or reject a gate lease is the same as for other non-residential real property leases, (ii) a trustee or debtor need, or assume and assign all gate leases at an airport to the same person, and (iii) a trustee or debtor is not restricted from assigning a gate lease if a “termination event” has occurred.
- Chapter 11 Cases**
- *Limitations on Extensions of Exclusive Period to File Plan and Solicit Acceptances.* Section 411 of the Act amends section 1121(d) of the Bankruptcy Code to provide that (i) the 120-day period for filing a plan may not be extended beyond a date that is 18 months after the petition date, and (ii) the 180-day period for soliciting votes on a plan may not be extended beyond a date that is 20 months after the petition date. The court has no discretion to further extend the foregoing periods. Previously, courts had discretion to grant an unlimited number of extensions of the exclusivity periods, and routinely granted such extensions. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
  - *Utility Security Deposits.* Section 417 of the Act amends section 366 of the Bankruptcy Code to improve the rights of utilities in chapter 11 cases. While in non-chapter 11 cases section 366(b) of the Bankruptcy Code still provides for a 20 day grace period for a debtor to provide adequate assurance of payment to a utility, new subsection 366(c) allows, in chapter 11 cases, a utility to alter, refuse, or discontinue utility service if the utility does not receive adequate “assurance of payment” that is satisfactory to such utility within 30 days of the petition date. Under new section 366(c), assurance of payment cannot include an administrative expense priority claim, but may include a cash deposit, a letter of credit, a certificate of deposit, a surety bond, a prepayment of utility consumption, or another form of mutually agreed security. The amendment further provides that a court may order modification of such assurance of payment upon the motion of a party in interest after notice and a

hearing. In assessing the adequacy of an assurance of payment, a court may not consider (1) the absence of security prior to filing of the bankruptcy petition, (2) the timeliness of payments by the debtor prior to the date of filing of the bankruptcy petition, or (3) the availability of an administrative expense priority. Finally, the amendment allows a utility to recover or set off against a chapter 11 debtor's pre-petition security deposit without notice or an order of the bankruptcy court. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Pre-Filing Solicitation of Plan Votes.* Section 408 of the Act revises section 1125 of the Bankruptcy Code to clarify that votes to accept or reject a plan of reorganization may be solicited from a holder of a claim or interest before commencement of the case if the votes are solicited in a manner complying with applicable nonbankruptcy law. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Waiver of Creditor Meeting in Cases Involving Pre-Filing Solicitation of Plan Votes.* Section 402 of the Act revises section 341 of the Bankruptcy Code to provide that, upon request of a party in interest, the court may order that the U.S. Trustee not convene a meeting of creditors or equity security holders if the debtor has filed a plan for which acceptances have been solicited prior to commencement of the case. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Disclosure Statements.* Section 431 of the Act amends section 1125 of the Bankruptcy Code to provide more flexibility in the disclosure statement process. Section 431 of the Act amends section 1125(a)(1) of the Bankruptcy Code to require a court, in determining whether a disclosure statement is adequate, to consider the complexity of the case, the benefit of additional information to creditors and other parties in interest, and the cost of providing such additional information. Section 431 of the Act also amends section 1125 of the Bankruptcy Code to expressly permit the court to conditionally approve a disclosure statement, and allows the debtor to solicit acceptances of the plan based upon such conditioned approval. The amendment further provides that the final hearing on approval of the disclosure statement may be combined with the confirmation hearing. These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

## **Employee/Retiree Benefits**

- *Limitation on Allowance of Wages, Bonuses and Severance Pay.* Section 331 of the Act amends section 503 of the Bankruptcy Code to prohibit the payment as an administrative expense certain retention bonuses, severance pay, and transfers or obligations incurred outside of the ordinary course of business, including transfers for the benefit of officers, managers, or consultants hired after the petition date. Under these amendments:
  - Post-petition retention bonuses to insiders of the debtor cannot be allowed or paid unless the bankruptcy court finds that (1) the retention bonus is essential because the person has a *bona fide* job offer for the same or better compensation, (2) the

person's services are essential to the survival of the business, and (3) the amount of the retention bonus is not greater than ten times of the average retention bonus offered to non-management employees within the same calendar year or, if no such retention bonuses were offered to non-management employees, the bonus is not more than 25 percent of any similar transfer or obligation incurred for the same person during the prior calendar year.

- Severance payments to an insider cannot be allowed or paid unless the court finds that the payment is part of a program generally applicable to all full-time employees and the amount of the payment is not greater than 10 times the average severance pay to non-management employees during that same calendar year.
- Transfers and obligations made or incurred outside the ordinary course of business, including those for the benefit of officers, managers, and consultants hired after the petition date, cannot be paid unless the facts and circumstances of the case justify such transfers or obligations. Read literally, this provision could prohibit the allowance and payment of all types of post-petition transfers outside of the ordinary course of business (not only transfers to insiders or professionals).

These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Retiree Benefit Protections.* Section 1403 of the Act amends section 1114 of the Bankruptcy Code to provide that upon motion of a party in interest, the court must order

reinstatement of retiree benefits if the debtor modified them during the 180-day period prior to the petition date and was insolvent on the date of modification, unless the court finds that the balance of the equities clearly favors such modification. This amendment is designed to prevent the occasional practice of evading the Bankruptcy Code's proscription against modification of retiree benefits by modifying the benefits immediately before the bankruptcy filing. This amendment is effective immediately, but does not apply to any pending cases.

- *Administrative Expense Claim May Include Back Pay.* Section 329 of the Act modifies section 503(a) of the Bankruptcy Code by expanding the list of permissible administrative expense claims to include certain wages and benefits awarded as back pay (resulting from a debtor employer's post-petition violation of law), if the court determines that the award will not substantially increase the probability of layoff or termination of current employees or nonpayment of domestic support obligations during the case. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Continued Administration of Employee Benefit Plans.* Section 446 of the Act modifies Section 521 of the Bankruptcy Code to require that if a debtor served as administrator of an employee benefit plan on the petition date, then the debtor must continue to perform the obligations incumbent upon such a plan administrator. Section 446 of the Act also modifies sections 704 and 1106(a) of the Bankruptcy Code to impose these duties upon a chapter 7 or chapter 11 trustee. This amendment becomes effective

180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *U.S. Trustee Responsible for Appointing Retired Employee Committee.* Formerly the bankruptcy court could appoint a committee of retired employees under section 1114(d) of the Bankruptcy Code. As amended by Section 447 of the Act, section 1114(d) now provides that the U.S. Trustee appoints the committee of retired employees after the bankruptcy court orders the creation of such a committee. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Extended Priority of Employee Wage and Benefit Claims.* Section 1401 of the Act amends section 507(a) of the Bankruptcy Code to raise the ceiling on employee wage and benefit claims entitled to priority distributions from \$4,925 to \$10,000. The Act also extends the “look-back” period for determining which employee wage and benefit claims are entitled to priority treatment from 90 days to 180 days prior to bankruptcy (or cessation of debtor’s business). These amendments are effective immediately, but do not apply to any pending cases.

## **Avoidance Actions and Exemptions**

- *Ordinary Course Defense for Preference Actions.* Section 409 of the Act amends section 547(c)(2) of the Bankruptcy Code to make it easier for preference defendants to establish an ordinary course of business defense. The defense now can be established by showing that the preferential 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 that such transfer was made either: (1) in the ordinary course of the debtor’s and the transferee’s financial affairs or business, or (2) in accordance with ordinary business terms. Prior law required the recipient of a potentially preferential transfer to establish both of the latter grounds in order to assert an ordinary course of business defense. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to bankruptcy cases filed on or after that date.
- *\$5,000 Threshold for Preference Complaints.* Section 409 of the Act amends section 547(c)(2) of the Bankruptcy Code generally to prohibit a bankruptcy trustee or debtor in a non-consumer bankruptcy case from avoiding a potentially preferential transfer if the aggregate value of all property that constitutes or is affected by such transfer is less than \$5,000. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to bankruptcy cases filed on or after that date.
- *Fraudulent Transfer Look-Back Period.* Section 1402 of the Act amends section 548 of the Bankruptcy Code to extend from one year to two years the look-back period during which fraudulent transfers and obligations incurred by either a debtor or partnership debtor may be avoided under Section 548 of the Bankruptcy Code. This amendment becomes effective one year after passage of the Act, on April 20, 2006.
- *Insider Transfers.* Section 1402 of the Act adds a new provision to section 548 of the Bankruptcy Code, which provides that transfers for less than reasonably equivalent value made to or for the benefit of an insider, or obligations incurred to or for the benefit of

- an insider, under an employment contract and not in the ordinary course of business, made within two years before the petition date, may be avoided. Such transfers may be avoided irrespective of whether the debtor was solvent at the time of the transfer. This amendment is effective immediately, but does not apply to any pending cases.
- *Avoidance of Transfers to Self-Settled Trusts.* Section 1402 of the Act amends the Bankruptcy Code to provide for the avoidance, as a fraudulent transfer under section 548 of the Bankruptcy Code, of any transfer of a debtor's property made within the ten-year period preceding a bankruptcy that is (a) made to a self-settled trust or similar device; (b) by the debtor; (c) where the debtor is a beneficiary of such trust or similar device; and (d) the debtor made such transfer with actual intent to hinder, delay, or defraud an entity to which the debtor was or became, on or after the date that such transfer was made, indebted. This amendment is effective immediately, but does not apply to any pending cases.
  - *Homestead Exemption Limited for Fraud.* Section 308 of the Act amends section 522 of the Bankruptcy Code to cap the value of a debtor's interest in most real property that may be claimed as exempt under applicable law in situations involving fraudulent transfers. Where non-exempt property is converted to exempt property within the ten-year period preceding the bankruptcy case, the homestead exemption is reduced to the extent that the real property interest was acquired with the intent to hinder, delay or defraud a creditor. This amendment is effective immediately, but does not apply to any pending cases.
  - *Limitation on Exemption of Recently-Acquired Homestead Property.* Section 322 of the Act amends section 522 of the Bankruptcy Code to provide that a debtor may not exempt homestead and certain other real property interests acquired during the three-year, four-month (1215-day) period preceding the bankruptcy filing to the extent the value of the property value exceeds \$125,000 (the principal residence of a family farmer is exempted from this limitation). Section 322 of the Act further provides that if the debtor has committed certain felonies or has violated certain laws, the look-back period does not apply, and therefore the \$125,000 homestead cap applies irrespective of how long ago the debtor acquired the property. The \$125,000 limit may be raised by the court to the extent reasonably necessary to support the debtor or dependents. This amendment is effective immediately, but does not apply to any pending cases.
  - *Cap on IRAs.* Section 224 of the Act amends section 522 of the Bankruptcy Code to impose a \$1 million cap (periodically adjusted to reflect changes in the Consumer Price Index) on the value of the debtor's interest in an individual retirement account established under either Section 408 or 408A of the Internal Revenue Code (other than a simplified employee pension account under IRC Section 408(k) or a simple retirement account under IRC Section 408(p)) that a debtor may claim as exempt property. The cap may be increased by the court if required in the "interests of justice." This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *DePrizio Loophole.* Section 1213 of the Act amends section 547 of the Bankruptcy Code to further clarify 1994 amendments to the Bankruptcy Code that were intended to (but did not completely) override *Levit v. Ingersoll Rand Fin. Corp. (In re DePrizio)*, 874 F.2d 1186 (7th Cir. 1989) and its progeny. In 1994, section 550 of the Bankruptcy Code was amended to prohibit the recovery from a non-insider creditor of a transfer made for the benefit of an insider during the extended one-year look-back period applicable to insiders; however, no similar change was made to section 547 of the Bankruptcy Code, which resulted in the anomaly that even though under section 550 *recovery* from non-insiders of transfers made between 90 days and one year before the petition date was prohibited, section 547 still permitted the *avoidance* of transfers (including security interests) granted during that period. Section 1213 of the Act amends Section 547 of the Bankruptcy Code to provide that, if a trustee avoids a transfer made to a non-insider between 90 days and one year before the petition date that benefited an insider, then such transfer shall be considered to be avoided only with respect to the insider. *This amendment is effective immediately, and also applies retroactively to any case now pending.*
- *Credit Counseling Repayment Plans.* Section 201 of the Act amends section 547 of the Bankruptcy Code to prohibit the avoidance as a preferential transfer of any payments made by a debtor to a creditor pursuant to a repayment plan created by an approved credit counseling agency. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

## Tax Provisions

- *No Chapter 11 Discharge for Fraudulent Government and Tax Claims.* Section 708 of the Act adds new section 1141(d)(6) to the Bankruptcy Code, which provides that a corporate debtor will not receive a discharge from any debts: (1) owed to the federal or state government on account of fraud; or (2) for a tax or customs duty with respect to which the debtor made a fraudulent return or willfully attempted to evade or defeat. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Improved Plan Treatment for Tax Claims.* Section 710 of the Act amends section 1129(a)(9) of the Bankruptcy Code to require that a chapter 11 plan must provide, on account of unsecured priority tax claims, cash payments: (a) of a total value, on the effective date of the plan, equal to the allowed amount of such claims (same as prior version of such section); (b) over a period ending no later than five years after the petition date (the prior version of such section allowed payments over six years after date of assessment); and (c) in a manner no less favorable than that accorded to the most favored nonpriority unsecured claim provided for in the plan (other than convenience class claims under section 1122(b)). This provision also applies to secured tax claims that would have qualified as unsecured priority claims but for their secured status. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Chapter 11 Disclosure Statement.* Section 717 of the Act amends section 1125(a)(1) of

the Bankruptcy Code to provide that in order to contain “adequate information,” disclosure statements must include a discussion of the potential material federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Treatment of Tax Liens in Chapter 7 Cases.*

Section 701 of the Act makes several modifications to the Bankruptcy Code relating to secured tax claims and liens. First, Section 701(a) of the Act modifies section 724(b) of the Bankruptcy Code to limit the instances in which secured *ad valorem* taxes are subordinated in a chapter 7 liquidation to other claims, providing that only (i) claims for wages, salaries, and commissions entitled to priority under (newly renumbered) section 507(a)(4) of the Bankruptcy Code; and (ii) claims for contributions to employee benefit plans entitled to priority under (newly renumbered) section 507(a)(5) of the Bankruptcy Code, may be paid ahead of such *ad valorem* taxes (the amendment fails to include post-petition wage claims in this carve-out, resulting in the anomaly that *ad valorem* taxes may be subordinated to pre-petition priority wage claims but not to post-petition wage claims). Second, section 724 of the Bankruptcy Code is amended to provide that, as to non-*ad valorem* secured tax claims, (i) chapter 7 administrative expense claims, and (ii) chapter 11 administrative expense wage claims, are the only types of administrative claims that may be paid ahead of secured tax claims (an unusual result of this amendment is that non-wage chapter 11 administrative claims may

not be paid ahead of secured tax claims, but pre-petition priority claims identified in sections 507(a)(2)-(7) of the Bankruptcy Code still may be paid ahead of secured tax claims). Third, before a tax lien on real or personal property may be subordinated pursuant to section 724, new section 724(e) of the Bankruptcy Code requires that the chapter 7 trustee exhaust all other unencumbered estate assets and, consistent with section 506(c) of the Bankruptcy Code, recover from the property securing an allowed secured claim the reasonable, necessary costs and expenses of preserving or disposing of such property. Finally, section 701(b) amends section 505(a)(2) of the Bankruptcy Code to prevent a bankruptcy court from determining the amount or legality of an *ad valorem* tax on real or personal property if the applicable period for contesting or re-determining the amount of the claim under nonbankruptcy law has expired. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Fuel Tax Claims.* Section 702 of the Act adds new section 501(e) to the Bankruptcy Code, which provides that a claim for fuel use taxes may be filed by the base jurisdiction designated under the International Fuel Tax Agreement and shall be allowed, if at all, as a single claim. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Interest Rate for Tax Claims.* Section 704 of the Act creates new section 511(a) of the Bankruptcy Code, which establishes applicable non-bankruptcy law as the basis for determining the interest rate to be applied

to any tax claims (including administrative tax claims) entitled to interest under the Bankruptcy Code. New section 511(b) of the Bankruptcy Code provides that, with respect to interest on tax claims paid under a plan, the calendar month in which a plan is confirmed should be the applicable date for determining the rate of interest to be applied. This amendment generally will result in increased interest rates payable to taxing authorities. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Tolling of Priority for Tax Claims.* Section 705 of the Act amends section 507(a)(8) of the Bankruptcy Code to codify case law that generally tolled priority tax claim periods during the pendency of a previous bankruptcy case. Under this amendment, (i) during any time in which there was a stay of proceedings in a prior bankruptcy case or collection of an income tax was precluded by a confirmed bankruptcy plan, the priority is tolled, plus 90 days, or (ii) during any time in which an offer of compromise is pending, the priority is tolled, plus 30 days. Also, during any period in which the government is prohibited from collecting a tax as a result of a request by the debtor for a hearing and an appeal of any collection action taken against the debtor, the priority is tolled, plus 90 days. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Stay of Tax Proceedings Limited to Pre-Petition Taxes.* Section 709 of the Act amends section 362(a)(8) of the Bankruptcy Code to provide that the automatic stay applies to proceedings before the United States Tax Court only for (i) a corporate debtor's tax liability for taxable periods for which the bankruptcy court may determine the estate's liability pursuant to Section 505 of the Bankruptcy Code, and (ii) an individual debtor's tax liability for taxable periods ending before the petition date. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Avoidance of Statutory Tax Claims.* Section 711 of the Act revises section 545(2) of the Bankruptcy Code to prohibit the avoidance of statutory tax liens against property purchased by bona fide purchasers (as described in IRC Section 6323 or as described in other similar state or local laws). The IRC gives special protections to certain purchasers of securities and motor vehicles notwithstanding the existence of a tax lien, and this amendment is intended to prevent those protections from being used by a debtor or trustee to avoid an otherwise valid tax lien. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Payment of Post-Petition Taxes.* Section 712(a) of the Act amends 28 U.S.C. § 960 to clarify that, with certain exceptions, post-petition taxes incurred in the ordinary course of the debtor's business must be paid on or before the date when such taxes are due. This requirement does not apply to a property tax secured by a lien against property that is abandoned under section 554 of the Bankruptcy Code within a reasonable time after the lien attaches, or where payment is specifically excused under the Bankruptcy Code. Section 712(a) also cites circumstances where the payment of post-petition taxes may be deferred in a chapter 7

case until final distribution is made: if the tax was not incurred by the trustee, or if the court, prior to the due date of the tax, finds that the estate has insufficient funds to pay in full all administrative expenses that have the same priority of that tax. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Priority for Administrative Expense Tax Claims.* Section 712(b) of the Act amends section 503(b)(1)(B)(i) of the Bankruptcy Code to clarify that the administrative priority for certain tax claims applies to both secured and unsecured tax claims, as well as *in rem* and/or *in personam* property taxes. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Section 506(c) Surcharge for Ad Valorem Taxes.* Section 712 of the Act amends section 506(c) of the Bankruptcy Code to expressly permit a trustee to recover from a secured creditor the payment of all *ad valorem* property taxes with respect to property in which the secured party holds an interest. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Tardily-Filed Tax Claims.* Section 713 of the Act amends section 726(a)(1) of the Bankruptcy Code to require as a condition for payment of tardily filed priority tax claims in chapter 7 cases that a proof of claim be filed on the earlier of the date the trustee commences distribution, or ten days following the mailing to creditors of the summary of the trustee's final report (currently, the taxing authority only need file its claim prior to the trustee's commencement of distributions). This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Setoff Against Pre-Petition Tax Refunds Permitted.* Section 718 of the Act amends section 362(b) of the Bankruptcy Code to provide that the automatic stay does not apply (unless specified conditions are met) to the setoff of an income tax refund for a taxable period which ended before the petition date against an income tax liability for a taxable period which also ended before the petition date. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Priority Taxes "Incurred".* Section 706 of the Act amends section 507(a)(8)(B) of the Bankruptcy Code by replacing the word "assessed" with "incurred." This change is intended to eliminate the confusion that arises because some state and local tax laws do not use the federal concept of "assessment" of taxes. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Treatment of State and Local Taxes.* Section 719 of the Act makes a number of technical amendments to section 346 of the Bankruptcy Code. Among other things, it requires in bankruptcy cases that state and local tax procedures conform to the IRC for purposes of establishing uniform (i) division of tax liabilities and responsibilities between the estate and the debtor, (ii) tax consequences with respect to partnerships and transfers of

property, and (iii) taxable periods of a debtor. Section 719 also establishes special provisions related to the treatment of state and local taxes, including the creation of a separate taxable estate when done for federal tax purposes. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Conversion/Dismissal for Failure to File Returns.* Section 720 of the Act amends section 521 of the Bankruptcy Code to allow a taxing authority to request that the court dismiss or convert a bankruptcy case if the debtor fails to file a post-petition tax return or obtain an extension. If the debtor does not file the required return or obtain the extension within 90 days from the time of the request by the taxing authority to file the return, the court shall convert or dismiss the case, whichever is in the best interest of creditors and the estate. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Automatic Stay Inapplicable to Certain Post-Petition Tax Liens.* Section 1225 of the Act amends section 362(b) of the Bankruptcy Code to provide that the automatic stay does not apply to the creation or perfection of statutory liens for *ad valorem* property taxes or for special taxes or special assessments against real property (whether or not *ad valorem*) that are imposed by governmental units, if such taxes or assessments become due post-petition. This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Provision of Tax Documents to Court.* Section 1228(a) of the Act provides that the

court may not grant a discharge to an individual in a chapter 7 case unless requested tax documents have been provided to the court. Section 1228(b) of the Act provides that the court may not confirm a chapter 11 or 13 plan unless requested tax documents have been filed with the court. Section 1228(c) of the Act directs the court to destroy documents submitted in support of a bankruptcy claim not sooner than three years after the date of the conclusion of a bankruptcy case filed by an individual debtor under chapter 7, 11, or 13. In the event of a pending audit or enforcement action, the court may extend the time for destruction of such requested tax documents. (Note that Section 1228 of the Act does not define "requested tax documents," nor does it specify which sections of the Bankruptcy Code (if any) are being amended to implement this change in law). This amendment becomes effective 180 days after enactment of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

## **Liens, Security Interests and Reclamation**

- *Increased Period of Time to Perfect Security Interests.* Section 403 of the Act amends section 547(e)(2) of the Bankruptcy Code, which formerly rendered security interests voidable as preferential transfers if they were perfected within the preference period and more than the applicable statutory period (formerly ten days) after the grant of the security interests. The amendment extends the permitted statutory perfection period to 30 days. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Time for Perfection of Purchase Money Security Interests.* Section 1222 of the Act amends section 547(c)(3) of the Bankruptcy Code to provide that secured parties now have 30 days within which to perfect purchase money security interests in order to avail themselves of a defense to preference lawsuits. The pre-amendment period was 20 days. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
  - *Expansion of Reclamation Rights.* Section 1227 of the Bankruptcy Code amends section 546(c)(1) of the Bankruptcy Code to provide that a seller of goods has a right to demand the return of goods sold to an insolvent debtor within 45 days prior to the commencement of a bankruptcy case, as opposed to only 10 to 20 days under prior law. The demand must be made in writing. If the goods are sold less than 45 days prior to the petition date, the seller is granted 20 days after the petition date to demand its goods in writing. The amendment also grants to the seller an administrative claim under section 503(b) of the Bankruptcy Code for goods delivered in the ordinary course within 20 days before the bankruptcy case, regardless of whether the seller properly asserted its reclamation rights, and states that a seller's reclamation rights are still subject to the rights of a senior security interest in the goods. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
  - *Warehouseman's Lien Unavoidable.* Section 406 of the Act creates new subsection 546(i) of the Bankruptcy Code, which prohibits the debtor or trustee from avoiding a warehouseman's lien for costs incidental to the storage and handling of certain goods. The new provision specifies that any lien created by a state statute similar to Section 7-209 of the Uniform Commercial Code shall be unavoidable by the trustee. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
  - *Collateral Held by Third Parties.* Section 1230 of the Act amends section 541 of the Bankruptcy Code to exclude from property of the bankruptcy estate certain tangible personal property (other than securities or written or printed evidence of indebtedness or title) pledged or sold by the debtor as collateral for a loan or money advance, where: (1) the pledgee or transferee possesses such property; (2) the debtor has no obligation to repay or redeem; and (3) neither the debtor nor the trustee has exercised any right to redeem in a timely manner. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- Bankruptcy Professionals**
- *Exclusive Bankruptcy Court Jurisdiction over Lawsuits Against Bankruptcy Professionals.* Section 324 of the Act amends 28 U.S.C. § 1334 to grant the district court or bankruptcy court presiding over a bankruptcy case exclusive jurisdiction over actions pertaining to employment of professionals by the debtor or trustee under section 327 of the Bankruptcy Code, or related disclosure rules. This amendment was intended to override cases such as *In re Merry-Go-Round Enterprises, Inc.*, 222 B.R. 254 (D. Md. 1998), in which the bankruptcy court remanded a lawsuit against estate

professionals alleging, among other things, malpractice and fraud involving improper conflict-of-interest disclosures, to state court. This amendment becomes effective immediately, but does not apply to any pending cases.

- *Repeal of Automatic Disqualification of Pre-Petition Investment Bankers.* Section 414 of the Act modifies the Bankruptcy Code's definition of "disinterested person" to repeal conflict-of-interest proscriptions that *per se* disqualified the debtor's pre-bankruptcy investment banker from continuing advisory services as part of the bankruptcy proceedings. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Contingency Fee Arrangements.* Section 1206 of the Act amends section 328 of the Bankruptcy Code to provide that a trustee or a creditors' or equity security holders' committee may employ a professional person on a fixed or percentage fee basis, as well as on other bases already permitted. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Attorney Certification/Signature on Petition.* Section 102 of the Act amends section 707 of the Bankruptcy Code to provide that the signature of the attorney on the bankruptcy petition constitutes a certification that the attorney, after inquiry, has no knowledge that the information contained in the debtor's schedules is incorrect. This new language is contained in section 707, and appears to be applicable only to individual consumer cases. Similarly, the attorney's signature on a

petition, pleading or written motion constitutes a certification that the attorney, after inquiry, has determined that the pleading is well grounded in fact and is either warranted by existing law or is based on a good faith argument for extending existing law. Section 707 also establishes mechanisms for the court to order the debtor to reimburse the trustee for all reasonable costs (including reasonable attorney's fees) in prosecuting a motion under section 707(b) of the Bankruptcy Code to dismiss the debtor's case for substantial abuse, and to pay an appropriate civil penalty to the trustee or the United States Trustee. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

## Health Care Business Cases

- Section 1102 of the Act adds a new section 351 to the Bankruptcy Code specifying requirements for the disposal of patient records in a health care business bankruptcy case where there are insufficient funds to pay for the storage of records in accordance with applicable federal or state law. The requirements chiefly consist of providing notice to the affected patients and specifying the method of disposal for unclaimed records. They are intended to protect the privacy and confidentiality of a patient's medical records in the custody of a health care business in bankruptcy.
- Section 1103 of the Act amends section 503(b) of the Bankruptcy Code to provide that the costs and expenses of closing a health care business (including the disposal of patient records or transfer of patients) incurred by a trustee, federal agency, or a department or agency of a state may be allowed as administrative expense claims.

- Section 1104 of the Act adds new section 333 to the Bankruptcy Code, which requires that the court order the appointment of an “ombudsman” to monitor the quality of patient care within 30 days after commencement of a chapter 7, 9, or 11 health care business bankruptcy case, unless the court finds that such appointment is not necessary for the protection of patients under the specific facts of the case. The ombudsman must be a disinterested person. The ombudsman must: (1) monitor the quality of patient care to the extent necessary under the circumstances, including interviewing patients and physicians; (2) report to the court, not less than 60 days from the date of appointment and then every 60 days thereafter, at a hearing or in writing regarding the quality of patient care at the health care business involved; and (3) notify the court by motion or written report (with notice to appropriate parties in interest) if the ombudsman determines that the quality of patient care is declining significantly or is otherwise being materially compromised. The provision requires the ombudsman to maintain any information relating to patients (including patient records) as confidential.
  - Section 1105 of the Act amends section 704(a) of the Bankruptcy Code to require a trustee or debtor to use all reasonable and best efforts to transfer patients from a health care business that is in the process of being closed to an appropriate health care business. The transferee health care business should be in the vicinity of the transferor health care business, provide the patient with services that are substantially similar to those provided by the transferor health care business, and maintain a reasonable quality of care.
  - Section 1106 of the Act amends section 362(b) of the Bankruptcy Code to provide that the automatic stay does not prevent the Secretary of Health and Human Services from excluding a debtor from participation in the medicare program or other specified federal health care programs.
- These health care business amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- Single Asset Real Estate Cases**
- Section 1201(5) of the Act amends the definition of “single asset real estate” to exclude property owned by a family farmer, and also to repeal the \$4 million cap on the amount of noncontingent, liquidated secured debts formerly contained in the definition of “single asset real estate.”
  - Section 444 of the Act amends section 362(d)(3) of the Bankruptcy Code to provide that a creditor whose claim is secured by an interest in single asset real estate may obtain relief from the automatic stay unless, before the later of 90 days after entry of the order for relief or 30 days after the court determines the debtor’s case is a single asset real estate, the debtor (i) has filed a plan of reorganization with a reasonable possibility of being confirmed within a reasonable time, or (ii) has commenced making monthly payments to each creditor holding such a claim (other than a claim secured by a judgment lien or unmatured statutory lien) from rents or other income generated by or from the property securing such creditor’s claim, in an amount equal to interest at the then applicable nondefault contract interest rate on the value of the creditor’s interest in the property (under

current law, interest payments are to be made at the fair market interest rate).

These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

## **Ancillary and Cross-Border Cases**

Section 801 of the Act creates a new “chapter 15” of the Bankruptcy Code, adding 32 new sections to the Bankruptcy Code to incorporate the Model Law on Cross-Border Insolvency promulgated by the United Nations Commission on International Trade Law. Chapter 15 expands the scope of bankruptcy law and provides a statutory mechanism for dealing with cases of cross-border insolvency and for cooperation among U.S. courts, trustees, and debtors and their foreign counterparts. Among other things, chapter 15 prescribes guidelines for: (1) access of foreign representatives and creditors to federal and state courts; (2) recognition of a foreign proceeding; (3) relief within recognized foreign proceedings; (4) cooperation and direct communication with foreign courts and representatives; and (5) concurrent proceedings and the coordination of foreign and domestic proceedings. Chapter 15 provides a framework for a variety of cross-border situations, ranging from providing access for foreign creditors to domestic cases, to regulating simultaneous domestic and foreign proceedings for the same debtor, and its coverage includes the following issues:

- *Scope of Territorial Jurisdiction.* New section 1502, in addition to generally redefining basic terms for the purposes of chapter 15 cases to fit within the international context, establishes the boundaries of “within the territorial jurisdiction of the United States” for purposes of identifying tangible and intangible property that is subject to U.S. court jurisdiction, including any property subject to attachment or garnishment pursuant to federal or state action.
- *Authorization to Act in a Foreign Country.* New section 1505 gives trustees and examiners the power to act in a foreign country on behalf of a U.S. bankruptcy estate.
- *Assistance for Foreign Representatives.* New section 1507 establishes factors for determining when domestic courts should provide assistance to foreign representatives.
- *Recognition of Foreign Proceedings.* New sections 1515 and 1518 set out procedural steps for foreign representatives to take when applying for the recognition of a foreign proceeding by domestic courts and the substantive requirements for determining when recognition of a foreign proceeding is appropriate.
- *Commencement of a Chapter 15 Case.* New section 1511 establishes the procedural elements necessary for the commencement of involuntary and voluntary cases under sections 301 and 303 of the Bankruptcy Code by a duly recognized foreign representative.
- *Powers of Recognized Foreign Representatives.* New sections 1509, 1521 and 1524 define the scope of remedies and powers available to a duly recognized foreign representative. Some of these forms of relief and powers depend upon the recognition of a foreign proceeding, and include:
  - Staying the commencement of an individual action concerning the debtor’s assets, rights, obligations or liabilities;

- Staying execution on the debtor's assets;
  - Suspending the right to transfer, encumber or otherwise dispose of any assets of the debtor;
  - The right to examine any witnesses, and the taking of any evidence or discovery;
  - The power to administer or realize all or part of the debtor's assets within the territorial jurisdiction of the United States; and
  - The power to intervene in any state or federal proceedings where the debtor is a party.
- *Relief Available Upon the Filing of a Petition for Recognition and Upon Recognition of a Foreign Proceeding.* New sections 1519 and 1520 describe the scope of relief that may be granted at the request of the foreign representative upon the filing of a petition for recognition and upon recognition, including specific remedies for the protection of parties in interest and creditors. Emergency relief that may be granted upon the filing of a petition for recognition includes staying execution against the debtors' assets or entrusting the administration of the debtors' assets within the U.S. to the foreign representative. Once the foreign proceeding is recognized, the foreign representative gains the powers of a trustee, and may operate the debtor's business and may exercise a trustee's other rights and powers pursuant to sections 363 and 552 of the Bankruptcy Code.
  - *Access of Foreign Creditors.* New section 1513 establishes the rights of foreign creditors in domestic cases commenced under chapter 15.
  - *Notification to Foreign Creditors.* New section 1514 sets out the procedural mechanisms of providing proper notice to foreign creditors of chapter 15 cases.
  - *Cooperation between Domestic and Foreign Entities.* New sections 1525-1527 provide standards for communication among the United States courts, foreign courts, a trustee and foreign representatives.
  - *Commencement and Coordination of Domestic and Foreign Proceedings.* New sections 1528 and 1529 develop standards for the coordination of concurrent foreign proceedings and domestic cases commenced under chapter 15.
- Chapter 15 becomes effective 180 days after passage of the Act, on October 17, 2005.
- Small Business Bankruptcy Provisions**
- Section 431 of the Act amends section 1125 of the Bankruptcy Code to set forth mandatory factors for court consideration in determining whether the disclosure statement regarding a small business reorganization plan provides adequate information.
  - Section 432 of the Act amends the Bankruptcy Code to redefine a small business debtor generally as a person (including a debtor affiliate) with not more than \$2 million in aggregate non-contingent, liquidated secured and unsecured debts as of the petition date (excluding debts owed to affiliates or insiders).
  - Section 433 of the Act directs the Advisory Committee to propose for adoption standardized disclosure statements and plans of reorganization for small business debtors.
  - Section 434 of the Act amends the Bankruptcy Code by adding a new section

308, which creates uniform national reporting requirements for small business debtors.

- Section 436 of the Act amends the Bankruptcy Code by adding a new section 1116 of the Bankruptcy Code, which identifies duties and administrative procedures in small business reorganization cases, including serial filer provisions and expanded grounds for dismissal or conversion and appointment of a trustee.
- Section 437 of the Act amends section 1121(e) of the Bankruptcy Code to increase the periods of time in a small business reorganization case within which: (a) only the debtor may file a plan of reorganization (180 days after the order for relief); and (b) a plan and disclosure statement must be filed (300 days after the order for relief). The amendment also modifies the standards for extension of these periods.
- Section 438 of the Act amends section 1129 of the Bankruptcy Code by adding a new subsection (e) requiring confirmation of plans filed in small business reorganization cases within 45 days after the plan is filed.
- Section 441 of the Act amends section 362 of the Bankruptcy Code to provide that the automatic stay does not apply (with certain exceptions) in small business cases if the debtor is the subject of a pending case, or was the subject of a confirmed plan or dismissed bankruptcy case within two years prior to the petition date. This exception to the automatic stay also applies to any entity that acquires such a small business debtor's assets, unless the court finds that the entity's filing was in good faith.

These amendments become effective 180 days after passage of the Act, on November 14,

2005, with the exception of the new national uniform reporting requirements for small business debtors, which become effective 60 days after rules establishing the forms to be used to comply with the reporting requirements are promulgated.

## **Consumer Protections and TILA**

- *Reduction in Claim for Failure to Negotiate.* Section 201 of the Act amends section 502 of the Bankruptcy Code to provide that a court may reduce by up to 20% a dischargeable claim for an unsecured consumer debt filed by a creditor who unreasonably refused to negotiate a reasonable alternative repayment schedule proposed on behalf of the debtor by an approved credit counseling agency. The offer must have been made at least 60 days before the petition date, and provided for payment of at least 60% of the amount of the debt over a period not to exceed the loan term, or a reasonable extension thereof. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Post-Discharge Credit of Payments.* Section 202 of the Act modifies section 524 of the Bankruptcy Code to provide that with certain exceptions, a creditor's willful failure to credit payments received under a confirmed plan violates the discharge injunction if such failure causes material injury to the debtor. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Post-Discharge Communications.* Section 202 of the Act modifies section 524 of the Bankruptcy Code to provide that the

discharge injunction does not apply to communications between a creditor having a claim secured by the debtor's residence and the debtor, if the creditor communicates with the debtor in the ordinary course of business and the communication is limited to seeking or obtaining periodic payments in lieu of *in rem* relief to enforce its lien. These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Reaffirmation Agreements.* Section 203 of the Act significantly modifies debt reaffirmation procedures under section 524 of the Bankruptcy Code for unsecured consumer debts. Among other things, it requires that certain specified disclosures be provided to the debtor at or before the time he or she signs a reaffirmation agreement; if the debtor is represented by counsel, the attorney must file a certification stating that the agreement represents a fully informed and voluntary agreement by the debtor, that the agreement does not impose an undue hardship on the debtor or any dependent of the debtor, and that the attorney fully advised the debtor of the legal effect and consequences of the agreement as well as of any default thereunder; and the debtor must submit a statement setting forth the debtor's monthly income and actual current monthly expenditures. These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Preservation of TILA Defenses in Section 363 Sales of Claims.* Section 204 the Act preserves a consumer debtor's Truth in Lending Act ("TILA") claims and defenses relating to predatory loans sold by a debtor or trustee. Section 204 of the Act amends section 363 of the Bankruptcy Code to provide that with respect to sales of any interest in a consumer transaction that is subject to TILA or any interest in a consumer credit contract, the purchaser of such interest remains subject to all claims and defenses that are related to such assets to the same extent that person would be subject to such claims and defenses if the sale was not conducted under section 363 of the Bankruptcy Code. These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *TILA Disclosures.* Sections 1301-1305 of the Act amend TILA to require numerous new disclosures, including: (1) specified minimum payment warnings applicable to an open-end credit plan upon which finance charges are accruing, and a toll-free number for consumers to call for more information; (2) for a credit extension secured by a dwelling that exceeds the dwelling's fair market value, that the interest on the excess portion of the extension is not deductible for federal income tax purposes; (3) if an introductory interest rate is offered, how long the introductory rate will apply and what interest rate will apply after the introductory period, and if the introductory rate is revocable, a general description of the circumstances that may result in such revocation; (4) certain conforming disclosures for internet credit card solicitations; and (5) if a late fee may be imposed, the date on which the regular payment is due or, if different, the earliest date on which a late fee may be charged, and the amount of the late fee to be imposed. These amendments to TILA become effective 12-18 months after the Board of Governors

of the Federal Reserve System promulgates implementing regulations.

- *No Termination of Credit For Failure to Incur Finance Charges.* Section 1306 of the Act modifies TILA to prohibit the termination of open-end consumer credit accounts before their expiration date solely because finance charges have not been incurred. This amendment to TILA become effective 12 months after the Board of Governors of the Federal Reserve System promulgates implementing regulations.

## Financial Contracts

- Section 907 of the Act amends the Bankruptcy Code by broadening and clarifying the definitions of the types of financial contracts that are “safe harbored” and may be terminated by contract counterparties notwithstanding the commencement of a bankruptcy case. Section 907 clarifies the definitions of key terms and industry practices used in connection with financial contracts, modifies section 362 of the Bankruptcy Code to expand exceptions to the automatic stay and prohibitions on set-offs involving financial contracts and master netting agreements, modifies sections 546 and 548 of the Bankruptcy Code to prohibit a trustee from avoiding transfers made in connection with master netting agreements or contracts covered thereby (other than transfers not for value); and adds a new section 561 to the Bankruptcy Code dealing with the termination, acceleration and liquidation of safe-harbored contracts. These amendments are intended to address, among other things, the substantial litigation that arose in *Enron* and other energy company bankruptcy cases concerning the status of master netting agreements and the right to liquidate and realize collateral after the termination of safe-harbored contracts by non-debtor counterparties. While the Act recognizes and protects “cross-product netting,” with the exception of the operations of clearing organizations the Act does not clearly resolve the status of “cross-party netting” – the practice of several parties entering into tri-lateral or multi-lateral netting arrangements for collateral management, cross-default, settlement and liquidation of financial contracts.
- Section 910 of the Act adds a new section 562 to the Bankruptcy Code, which specifies that damages under any terminated swap agreement, securities contract, forward contract, commodity contract, repurchase agreement or master netting agreement are calculated as of the earlier of (i) the date of rejection of such agreement by a trustee, or (ii) the date or dates of liquidation, termination or acceleration of such contract or agreement by the contract counter-party, and sets forth guidelines related thereto.
- Sections 901 through 906, 908 and 909 of the Act make numerous amendments to the Federal Deposit Insurance Act (FDIA) and the Federal Credit Union Act (FCUA). Among other things, the Act conforms FDIA and FCUA terminology for financial contracts to the terms used in the Bankruptcy Code; provides that the acceleration of a qualified financial contract with an insured depository institution which arises upon the appointment of the FDIC as receiver shall not be stayed; prohibits enforcement of “walkaway” clauses in qualified financial contracts; suspends certain termination rights of counterparties to a qualified financial contract with an insolvent bank until after the receiver’s appointment, or after receipt of notice that the contract has been transferred; specifies the circumstances for the disaffirmance or repudiation of

qualified financial contracts by a bank conservator or receiver; and provides the treatment of a master agreement as a single agreement and as a single qualified financial contract. The Act also amends the Federal Deposit Insurance Corporation Improvement Act of 1991 to make conforming amendments with respect to bilateral netting contracts, security agreements, clearing organization netting contracts, contracts with uninsured national banks, and contracts with uninsured Federal branches or agencies.

- Section 911 of the Act amends the Securities Investor Protection Act of 1970 to provide that neither the filing of a protective decree by SIPC nor any court protective order may be construed to prevent a creditor from exercising a contractual right to liquidate, terminate, or accelerate certain financial contracts. The amendment does allow for a stay of foreclosure upon any securities that have been collateral pledged, sold, or lent by the debtor.

The financial contract amendments to the Bankruptcy Code become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases commenced on or after that date.

### **Creditor Committees**

- *Compensation of Individual Member's Professionals Prohibited.* Section 1208 of the Act amends section 503(b)(4) to specifically exclude as an allowable administrative expense any claim for expenses incurred by an attorney or accountant for an individual member of a creditors' or equity security holders' committee. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Small Business Concern Representations on Committees.* Section 405 of the Act amends section 1102 of the Bankruptcy Code to authorize the U.S. Trustee to increase the membership of a committee of creditors or equity security holders to include a creditor that is a small business concern, following the court's determination that such creditor holds claims of the kind represented by the committee, and that the creditor's claims represent a disproportionately large portion of the creditor's annual gross revenue. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Obligations of the Committee.* Section 405 of the Act amends section 1102 of the Bankruptcy Code to require the official committee of unsecured creditors to provide access to information to, and solicit and receive comments from, unsecured creditors not appointed to the committee. The court may enter an order compelling the committee to provide any additional report or disclosure to such creditors. This amendment applies equally to official equity committees. The amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

### **Other Major Changes**

- *Chapter 12 - Family Farmers.* Sections 1001-1007 of the Act amend the Bankruptcy Code to make permanent chapter 12 of the Bankruptcy Code, relating to the adjustment of debts of a family farmer with regular annual income, and make other material changes to chapter 12. The permanent enactment of chapter 12 becomes effective July 1, 2005.

- *Automatic Stay Modified to Permit Eviction.* Section 311 of the Act amends section 362(b) of the Bankruptcy Code to permit the continuation of an eviction or unlawful detainer action against a debtor residing as a tenant under a lease or rental agreement in residential property if: (1) the lessor obtained a judgment for possession prior to the petition date; or (2) possession is sought due to endangerment of the property or the illegal use of controlled substances, but in either case only if the lessor files and serves an appropriate certification of such facts. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Repeat Filings.* Section 302 of the Act amends section 362(c) of the Bankruptcy Code to discourage bad faith repeat bankruptcy filings. As amended, section 362(c) provides that, if a bankruptcy case of an individual debtor was pending within the preceding year but was dismissed (other than a case under a chapter other than chapter 7 after dismissal for substantial abuse under section 707(b) of the Bankruptcy Code), then the automatic stay shall terminate on the 30th day after the filing of the new case. The court may extend the stay as to any or all creditors (with such conditions as the court may impose) upon motion of a party in interest, provided that such party demonstrates that the new case was filed in good faith and the hearing on such motion is completed before expiration of such 30-day period. Under certain circumstances there is a presumption that the new case was not filed in good faith, including if the debtor had filed more than one bankruptcy case in the preceding year or failed to take certain actions in the prior case, which may be rebutted only with clear and convincing evidence to the contrary. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Automatic Stay Termination for Failure to Redeem/Reaffirm.* Section 305 of the Act amends section 362 the Bankruptcy Code to provide for the termination of the automatic stay as to personal property securing an individual debtor's consumer debt, or subject to an unexpired lease, and also provides that such personal property is no longer property of the debtor's estate, if the debtor fails to complete (within an accelerated time frame) an intended surrender or redemption of such property or reaffirmation of the related debt in order to retain such property, unless the court determines upon motion of the trustee that such property is of consequential value or benefit to the estate. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Charitable Organization Bankruptcies.* Section 1221 of the Act amends section 363(d) of the Bankruptcy Code to restrict the authority of a debtor or trustee to use, sell, or lease property of a nonprofit corporation or trust to uses in accordance with applicable nonbankruptcy law, and to the extent not inconsistent with any relief granted from the automatic stay. Section 1221 imposes similar restrictions with regard to plan confirmation requirements for chapter 11 cases. Section 1221 also amends section 541 of the Bankruptcy Code to provide that property of an estate of a nonprofit corporate debtor may be transferred to an entity that is not a nonprofit corporation, but only under the same conditions that would apply if the debtor was

not in bankruptcy. This amendment is effective immediately, and applies to any case that is now pending (although a court may not confirm a plan without considering whether this amendment would substantially affect the rights of a party in interest who first acquired rights with respect to the debtor after the petition date).

- *Direct Circuit Court Appellate Review.* Section 1233 of the Act modifies 28 U.S.C. § 158(d) to enable a circuit court of appeals to exercise direct appellate jurisdiction over a bankruptcy court order or decree. Direct appeal is available if (A) the bankruptcy court, the district court or the BAP, either *sua sponte* or upon motion of a party to a judgment order (or all of the appellants and appellees jointly), certifies that: (1) the order involves a question of law as to which there is no controlling decision of the circuit court or the Supreme Court, or involves a matter of public importance; (2) the order involves a question of law requiring resolution of conflicting decisions; or (3) an immediate appeal from the order may materially advance the progress of the case or proceeding in which the appeal is taken; and (B) the circuit court authorizes direct appeal of the order. The bankruptcy court, district court or BAP does not have discretion in certifying the appeal to the circuit court if the circumstances of (1), (2) or (3) exist, or if they receive a request made by a majority of the appellants and appellees to make the certification. A certified appeal to the circuit court does not stay any proceeding before the bankruptcy court, district court or BAP unless the lower court, or the circuit court, issues a stay pending appeal. A request for certification must be made within 60 days after entry of the order. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Venue.* Section 410 of the Act amends 28 U.S.C. § 1409(b) to provide that a proceeding to recover a debt (excluding a consumer debt) against a non-insider of the debtor that is less than \$10,000 must be commenced in the district where the defendant resides. In addition, the existing \$5,000 threshold for proceedings to recover a consumer debt is increased to \$15,000. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Prohibition on Sale of Personally Identifiable Information.* Section 231 of the Act amends section 363 of the Bankruptcy Code to prohibit a trustee from selling or leasing to unaffiliated third parties, personally identifiable information possessed by the debtor concerning an individual if it is contrary to the debtor's privacy policy, unless specified conditions have been met, or the court approves such sale or lease after a "consumer privacy ombudsman" has been appointed under new section 332 of the Bankruptcy Code. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *SRO Investigations and Actions Excepted from Automatic Stay.* Section 401 of the Act amends section 362 of the Bankruptcy Code to exclude from the scope of the automatic stay (1) the commencement of an investigation or action by a securities self-regulatory organization to enforce compliance with its regulations; (2) the enforcement of any order or decision obtained by such an

organization, other than for monetary sanctions; or (3) any act taken by the securities self-regulatory organization to delist, delete, or refuse to permit quotation of any stock that does not meet applicable regulatory requirements. The amendment only applies to “securities” organizations, and therefore similar actions by organizations that regulate commodities trading, including self-regulatory organizations such as the Chicago Mercantile Exchange or Chicago Board of Trade, may not be excluded from the scope of the automatic stay. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.

- *Condominium Fees.* Section 412 of the Act amends section 523(a)(16) of the Bankruptcy Code to broaden the protections accorded to community associations with respect to fees or assessments arising from a debtor’s interest in a condominium, cooperative, or homeowners’ association. Irrespective of whether or not the debtor physically occupies such property, fees or assessments that accrue during the period that the debtor or trustee has a legal, equitable, or possessory ownership interest in such property are nondischargeable. This amendment becomes effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Nondischargeability of Debts Incurred as the Result of a Securities Law Violation.* Section 1404 of the Act amends section 523 of the Bankruptcy Code make nondischargeable the debts of an individual that result from a securities law violation. This amendment purports to be effective retroactively to July 30, 2002 (the date of enactment of the Sarbanes-Oxley Act), but another section of the Act (Section 1406) would make this amendment applicable as of the date of enactment of the Act, April 20, 2005.
- *Expanded Grounds For Dismissal, Conversion, and Appointment of Trustee.* Section 442 of the Act amends section 1112(b) of the Bankruptcy Code to provide that if cause is shown, the court generally is required to convert or dismiss a chapter 11 case, “absent unusual circumstances” which must be specified by the court. The court is required to conduct the hearing on a motion seeking dismissal or conversion within a specified period of time, and amended section 1112(b) now includes a laundry list of facts that constitute “cause.” Section 442 of the Act also amends section 1104 of the Bankruptcy Code to provide that a trustee may be appointed instead of conversion or dismissal, if it is in the best interests of creditors and the estate. These amendments become effective 180 days after passage of the Act, on October 17, 2005, and will apply only to cases filed on or after that date.
- *Trustee in Cases Involving Suspected Fraud.* Section 1405 of the Act amends section 1104 of the Bankruptcy Code to require the U.S. Trustee to move for the appointment of a chapter 11 trustee if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor’s chief executive or chief financial officer, or members of the governing body who selected the debtor’s chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor’s public financial reporting. This amendment becomes effective immediately, but does not apply to any pending cases.

## Conclusion

There can be no doubt that the Act will have a tremendous impact upon individual debtors, creditors, professionals and others involved in consumer chapter 7 bankruptcy cases. The numerous amendments discussed in this Client Alert, however, will also have a material impact upon commercial chapter 11 cases. It remains to be seen whether the overall effect of the Act upon the administration of commercial chapter 11 cases will be positive.

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