THE BANKRUPTCY ABUSE AND CONSUMER PROTECTION ACT OF 2005: *AN OVERVIEW OF KEY AMENDMENTS TO THE BANKRUPTCY CODE*

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I. Introduction[1]

After seven failed attempts and massive lobbying by banks and credit card companies, the *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005* (S. 256) (the "2005 Act") was finally passed by the Senate on March 10, 2005 and was approved by a vote of 302-126 in the House of Representatives on April 14, 2005. On April 20, 2005, President Bush signed the 2005 Act into law, thereby enacting the most sweeping changes to this country's bankruptcy laws since the Bankruptcy Code was adopted in 1978.

To a large degree, the focus of the 2005 Act is the "belt tightening" required for individual consumer debtors to obtain a discharge in bankruptcy. Prior to the 2005 Act, there was no "means testing" done by the bankruptcy courts before determining whether a debtor was entitled to a Chapter 7 discharge. The 2005 Act, however, changes the old system and requires "means testing" for debtors. As a result, it will be much more difficult for individual consumer debtors who filed for bankruptcy relief after the effective date of the 2005 Act to obtain a discharge in bankruptcy.

The "means testing" and other "belt tightening" provisions of the 2005 Act certainly were subject to much criticism up until the President signed the 2005 Act into law. For example, on February 16, 2005, a consortium of about 90 law professors wrote to the Senate and complained that the 2005 Act is like "swatting a fly with a shotgun." The law professors asserted that, while although the bankruptcy filing rate more than doubled in the last decade, the filing rate is a symptom of a sickness in the way in which credit is marketed to consumers as opposed to widespread abuse of the bankruptcy process. As a result, the law professors contend that means testing is unnecessary in our bankruptcy process and, at the end of the day, will deny honest consumers access to the bankruptcy courts.

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[1] All information contained herein is intended for informational purposes only, and does not contain legal advice. By this publication, the authors do not intend to be considered "Debt Relief Agencies," and strongly encourage all parties to consult the Bankruptcy Code, codified at 11 U.S.C. §§ 101 et seq., as amended by the 2005 Act, prior to taking any legal actions. This outline is for educational purposes only and does not constitute an opinion of the Court. This outline may not be cited as an authority in any proceeding or for any purpose.

All of the criticism of the 2005 Act is now moot, and debtors and their lawyers must now learn to live with the 2005 Act. This outline[2] is intended to summarize some of the key provisions affecting consumer and business debtors, as well as creditors and equity holders, to give an overview of several of the most significant amendments to the Bankruptcy Code by the enactment of the 2005 Act.

II. Consumer Cases

Although the 2005 Act made significant amendments to the entire Bankruptcy Code, some of the most significant (and certainly, the most well-published) changes are the provisions implementing "needs-based bankruptcy," commonly known as "means testing." By those changes, debtors whose median income is equal to, or above the median income level for debtors similarly situated as the debtor (as determined by Census reports for the region adjusted changes in the consumer price index) may be prohibited from seeking relief under Chapter 7 of the Bankruptcy Code. Other significant changes include the requirement that individuals receive credit counseling prior to filing, attorney certification, debtors' inability to file serial cases, limitations to the automatic stay, limitations on homestead exemptions, and amendments to the priorities for unsecured claims.

A. Prevention of Abuse and Means Testing

Needs-based bankruptcy is designed to force those debtors who have the ability to repay creditors into Chapter 13 rather than Chapter 7 liquidation. Under the old "substantial abuse" provisions of Section 707(b) of the Bankruptcy Code, conversion of a Chapter 7 case to a Chapter 13 restructuring or, alternatively dismissal of the case, was required if the Chapter 7 liquidation was found to be a "substantial abuse" of the bankruptcy process. The needs-based provisions of the 2005 Act removes the "substantial abuse" provisions of the Bankruptcy Code. Under the old law, whether "abuse" was "substantial" enough to warrant conversion or dismissal was left to the discretion of the bankruptcy court. The 2005 Act appears to remove much of the flexibility permitted by the previous provisions in Section 707(b) of the Bankruptcy Code, and replaces such provisions with more rigid presumption of "abuse" provisions.

Specifically, the 2005 Act lowers the "substantial abuse" standard for dismissal or conversion to a standard mandating conversion or dismissal if mere "abuse" is found. The 2005 Act does not define the term "abuse." Therefore, prior case law defining "substantial abuse" may prove to be relevant in any case where "abuse" is alleged to have occurred.

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[2] One of the amendments outside the scope of this outline relates to bankruptcy appeals. Under the 2005 Act, Congress revised Section 158 of Title 28 to permit the circuit courts to accept direct appeals of bankruptcy matters. Before the direct appeal is accepted, either the lower courts or the parties acting jointly must certify that the direct appeal is necessary to resolve either (1) a matter of first impression, (2) conflicting decisions, (3) a matter of public importance, or (4) a matter that would materially advance the progress of the case.

While the term “abuse” is not defined under the 2005 Act, the bankruptcy reform legislation does set forth certain circumstances in which a presumption for abuse may arise. Specifically, a presumption of abuse arises in a Chapter 7 case if the amount of a debtor’s “current monthly income,” as such term is defined in new Section 101(10A),[3] reduced by allowable expenses and multiplied by 60 (which is the maximum life of a Chapter 13 plan), exceeds the lesser of (a) $10,000, or (b) the greater of 25% of unsecured nonpriority claims or $6,000. In other words, a Chapter 7 debtor would remain eligible for Chapter 7 relief if his or her income net of expenses is less than $100 per month (or $6,000 over 5 years). At the high end, a debtor would not be eligible for Chapter 7 relief if his or her net income is equal to or exceeds $166.67 per month ($10,000 over 5 years). In the middle are debtors whose net monthly income is $100 - $166.66 ($6,000 - $9,999 over 5 years). If income less expenses multiplied by 60 is between $6,000 and $10,000, conversion or dismissal is only required if the debtor has sufficient income to pay 25 percent of nonpriority unsecured claims. So, in summary:

Net Income Over Expenses	Percentage of Distribution to Unsecureds	Eligibility for Chapter 7
$10,000 or greater	Does Not Matter	No.
$6,000 – $9,999	25% or greater	No.
$6,000 - $9,999	24.99% or less	Yes.

Notwithstanding the amendments to Section 707 which were intended, in part, to clarify and simply the “abuse” provisions of the Bankruptcy Code, several questions remain as a result of the new legislation. Some of the questions which courts will have to address going forward, include: (i) whether a filing is still abusive where net income over expenses is less than $6,000, but distributions would exceed 25%, (ii) the issue of “abuse” where debtors make purchases on the eve of bankruptcy which reduce the potential percentage of distribution to unsecured creditors repayment under 25%; (iii) the issue of whether the “special circumstances”, addressed in Section 707(a)(2)(B) which would rebut a presumption of abuse, will resemble the Brunner three-part test relating to non-dischargeability to student loans.

B. Calculation of Means Testing Under the 2005 Act

The 2005 Act sets forth parameters for determining net income and allowable expenses for purposes of conducting the means test required by Section 707(b) of the Bankruptcy Code. With respect to calculating current monthly income, income derived from all sources is used. The definition of “current monthly income” in revised Section 101 of the Bankruptcy Code is a hypothetical number derived from the average gross income from all sources for a debtor (or debtors, if it is a joint filing) for the 6 month period leading up to the bankruptcy petition date. The only exclusions to the term “current monthly income” are Social Security payments and payments to certain victims. By way of example, the statute expressly provides that

[3] Note, the debtor’s current income is augmented by that of the debtor’s spouse under the means test, even in a non-joint case, unless the debtor submits a sworn statement reflecting that the spouses are separated.

payments received by the debtor for the benefit of dependents of the debtor would be included as "current monthly income."

The "allowable expense" items permitted under revised Section 707(b) of the Bankruptcy Code are relatively tight, and follow IRS standards. For example, a 4 person family having gross annual income of approximately $4,000 per month (or $48,000 per year) would be subject to the "National Standards for Allowable Living Expenses" set forth below:

Item	Amount
Food	$ 640
Housekeeping Supplies	$ 61
Apparel & Services	$ 189
Personal Care Products and Services	$ 53
Miscellaneous	$ 188
Total	**$1,131**

The debtor can also add an additional 5% in allowable expenses for food and clothing, if such increase is demonstrated to be "reasonable and necessary."

Debtors would also have allowable expenses for "Local Standards" for housing and transportation. A debtor living in Allegheny County having a family of 4 would also therefore be permitted to include in his allowable expense items the following allowances:

Allowance	Amount
Housing and Utilities	$1,347
Transportation	$ 380 (for 2 cars) [$286 for 1 car]

Accordingly, under the current scheme, the $4,000 per month income family, would have an allowable expense budget of approximately $2,800. Such number can be subject to an upward adjustment for domestic support obligations, 15% of gross income for charitable contributions, and approximately $133.33 per month (or $1,500 in aggregate) for public or private school expenses. Payments to creditors are generally excluded from the determination of monthly expenses, except payments to certain secured creditors.

It remains unclear whether, if actual expenditures by a debtor are less than the National Standards or Local Standards, the debtor may still include the National Standards and Local Standards in the means-test calculation. Additionally, there may be issues whether debtors' allowable expenses are flexible. For example, if an individual is self-employed and has no employer funded health insurance, can the debtor include in the "allowable living expenses" the cost of funding health insurance (which could be around $1,000 per month for a 4 member family)? What about insurance for the automobile? Is it included in the transportation expenses? Presumably so, but does the court have discretion under the "compelling circumstances" test to deviate from the schedules? The same is true for upkeep and maintenance of a home. What if a furnace needs to be replaced and winter is fast approaching? Can this item be included in the expense category? Can daycare be included if both husband and wife work?

Each of these items appear on their face to be compelling, but it will be something that courts will have to address sooner as opposed to later.

C. Standing to Prosecute Motions to Dismiss Pursuant to Section 707(b)

In terms of the process, the 2005 Act increases the scope of parties who may file a motion to dismiss or to convert under Section 707. Previously, only the United States trustee or the court on its own motion could move to convert or dismiss a Chapter 7 for substantial abuse. Under the 2005 Act, any party in interest may move for the conversion or dismissal of a Chapter 7 case if the case is filed by a debtor whose annual family income exceeds the median family income in the state where the debtor resides. If the debtor's family income is less than the median family income applicable, then only the United States trustee or the court the motion may seek conversion or dismissal pursuant to Section 707(b)(6).

In determining whether a filing is presumptively abusive, the following is required by Section 704(b):

- Not less than 7 days prior to the meeting with creditors, the debtor is to provide the United States trustee with its tax returns, etc. per Section 521 of the Bankruptcy Code. If the documentation is not provided, the case may be dismissed. The tax returns must be provided to any creditor requesting a copy.
- No later than 10 days after the meeting of creditors occurs, the United States trustee is required to submit a report as to whether "abuse" should be presumed.
- No later than 30 days after filing the report relating to abuse (i.e., no later than 40 days after the meeting of creditors), the United States trustee must file either a motion to dismiss or convert, a statement of whether the median income for the debtor exceeds (or is less than) the established medians, or a statement as to why a motion is not appropriate.

Under 704(b)(1)(B), if abuse is presumed, the court is to give notice to creditors within 5 days of the United States trustee filing its report.[4] Note, however, that this provision is inconsistent with Section 342(d), which requires that the clerk mail notices of abuse within 10 days after the date of the filing of the petition that the presumption of abuse has arisen.

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[4] Because only individual debtors with regular income are eligible for Chapter 13, individual debtors who lack sufficient income which is "regular" that fail the means test can have their cases converted to a Chapter 11. Congress appears to have contemplated this result and have amended pertinent Chapter 11 provisions to keep them in line with Chapter 13, such as (1) adding provisions that state property acquired by the debtor post-petition is property of the estate (Section 1115), (2) imposes a 5-year best efforts requirement (Section 1129(a)(15), and (3) adding that individual consumer debtors in Chapter 11 do not receive a discharge until after they complete their plan (Section 1141(d)(5)).

D. <u>Attorney Certification and Possible Sanctions</u>[5]

Additional provisions of the 2005 Act that have gained much attention are the attorney certification provisions and the provisions that permit the sanctioning of debtor's attorneys for filings that prove to be incorrect. Specifically, under the 2005 Act:

Certification of Schedules: A debtor's attorney must certify, under penalty of sanctions, the accuracy of the debtor's bankruptcy schedules, and conduct a "reasonable investigation" before making such certification. The certification must also state that the petition and schedules are ascertained to be correct "after inquiry."

Under Section 707(b) of the Bankruptcy Code, the court or any party in interest may seek an order compelling an attorney to reimburse the trustee for reasonable costs in prosecuting a motion filed under Section 707(b). Note, the statute provides that the court "may" award costs (and a civil penalty) in such circumstances, but the use of the word "may" means it is discretionary. The statute also indicates that the costs awarded are costs of the trustee in prosecuting the motion. The question therefore now raised by the drafting of the statute is whether the costs of a creditor in prosecuting a 707(b) motion are compensable? The answer is probably no under Section 707(b) of the Bankruptcy Code, but the amount of costs incurred by the creditor may form a basis in the calculation of any civil penalty that may be assessed under Section 707(b). In addition, while Section 707(b) may not have any costs awarded in favor of a moving creditor, Bankruptcy Rule 9011 still is probably a viable alternative to a moving creditor.

No matter the tool used by a trustee or creditor to seek sanctions against the debtor's attorney for a violation of the certification provisions of Section 707 of the Bankruptcy Code, the new amendment does provide some predicates to a finding that sanctions are warranted. These predicates are:

1. That a motion for conversion or for dismissal under Section 707(b) has been filed and granted; and

2. The action of the attorney in filing of the Chapter 7 case violated Bankruptcy Rule 9011.

This section, as much as any, has been the subject of numerous questions, including what is a "reasonable investigation"? What does "after inquiry" mean? Must debtor's attorneys hire an auctioneer or appraiser to appraise all of the debtor's property? Does debtor's counsel have an obligation to visit the sites where the debtor's property is located to take an inventory?

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[5] Under new Section 526 of the Bankruptcy Code, attorneys who represent consumer debtors for a fee must advertise their services with a disclosure that they are a "debt relief agency." If they fail to do so, Sections 527 and 528 subject the attorneys to loss of fees, damages, and injunctive remedies. If the debt relief agency intentionally or negligently causes the debtor to not comply with the bankruptcy code, and the case is converted or dismissed under Section 707(b), the debt relief agency can also be liable to the debtor for harm caused.

Certification of Reaffirmation Agreements: For Chapter 7 bankruptcies, consumer debtors have historically been able to choose to "reaffirm" (i.e., maintain liability for) certain debts. In prior practice, the attorney had to certify that the reaffirmation is voluntary and does not impose an undue hardship on the debtor, if the debtor desired to reaffirm the debt without an order of the court. In the absence of such a certification (i.e., in instances where the attorney did not represent the debtor), the debtor (or creditor) was required to file a motion with the court seeking approval of the reaffirmation agreement. The substantive modification of these requirements under the 2005 Act at new Section 524(k) of the Bankruptcy Code is that:

- The attorney must now certify that the debtor is able to pay off the debt. These provisions place an attorney in an untenable position in Chapter 7 cases where the debtor lacks a meaningful amount of disposable income.

- Before filing the reaffirmation, the debtor must execute a statement disclosing the debtor's income, the debtor's actual current monthly expenses, and the resulting balance available to pay the debt proposed to be reaffirmed. If the income is insufficient to pay the reaffirmed debt, the reaffirmation is presumed to present an undue hardship on the debtor, and such presumption lasts for a period of 60 days from the filing of the reaffirmation. During the 60 day time period, the Court is to determine whether the debtor can rebut the presumption and if the debtor wants to reaffirm the debt under such circumstances, the debtor must submit an explanation which the Court must find "satisfactory."[6]

E. Limits on the Breathing Spell: Section 362 and Abusive Filings

1. Serial Filings

First Repeat Filing: To combat issues raised by serial bankruptcy filings, the 2005 Act adds a new Section 362(c)(3) which provides for the termination of the automatic stay 30 days after the filing if the new case is filed within one year of the dismissal of an earlier case. There is a safe harbor, however, under Section 362(c)(3), which permits the stay remaining in effect if the debtor or other party in interest demonstrates that the second case was filed in good faith with respect to creditors sought to be stayed.

Second Repeat Filing: If a second repeat filing is made by the debtor within the one-year period, the automatic stay will not be automatic (i.e., does not go into effect). Rather, it is incumbent upon the debtor or other party in interest to obtain the imposition of the stay by demonstrating that the third filing is in good faith with respect to the creditor sought to be stayed.

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[6] Creditors are allowed under new Section 524(l) to receive payments prior to the filing of a reaffirmation agreement "which the creditor believes in good faith to be effective" regardless of whether the agreement is approved by the court.

2. ***In Rem* Relief**

In drafting the 2005 Act, Congress was concerned about schemes whereby the bankruptcy process was used to stay creditor collection efforts, all while the debtor was transferring its assets fraudulently to friends or family members. The end result of the hypothetical problem was that the transferred asset always remained one step ahead of the creditor collection efforts. The 2005 Act attempts to deal with this problem by affording creditors with *in rem* relief, and modifications of the stay towards that end. Under amended Section 362(d)(4) of the Bankruptcy Code, the automatic stay will be terminated in favor of a creditor if the court determines that the filing was part of a scheme to hinder, delay or defraud a creditor involving:

- The transfer of an ownership interest in real estate without the approval of the creditor or court order;
- Multiple bankruptcy filings involving the realty; or
- The 2005 Act further provides that if the creditor obtains relief from stay under Section362(d)(4) of the Bankruptcy Code, the creditor may record the relief from stay order. It further provides that the recorded relief from stay order is binding in any case filed by any party under the Bankruptcy Code within 2 years of the entry of the order. A party in interest, however, may have the stay reinstated in the subsequent case by demonstrating that the subsequent case was filed in good faith, for good cause or for changed circumstances warranting the reinstatement of the stay.

3. **Relief From Stay For Residential Real Estate**

To combat problems faced by residential landlords who have been stayed by bankruptcy filings by tenants who merely intend to delay the efforts of the landlord without any realistic hope of curing defaults under a residential real estate lease, the 2005 Act contains some relief from stay provisions which inure in favor of residential landlords. Specifically:

- *Continued Eviction Proceedings:* Section 362(b)(22) excepts from the automatic stay, the continuance of eviction proceedings in instances where the landlord obtained a judgment for possession prior to the filing of the bankruptcy petition.

- *Endangerment Relief:* Section 362(b)(23) also excepts from the automatic stay evictions based on "endangerment" of the rented property or "illegal use of controlled substances" on the property. Section 362(b)(23) will be triggered if (a) the eviction proceeding was commenced before the filing of the bankruptcy case, or (b) if the endangerment or illegal use occurred within 30 days before the bankruptcy filing.

In terms of invoking the automatic stay exceptions of Section 362(b)(22) and 362(b)(23), the 2005 Act provides at new Section 362(l) and 362(m) that the debtor can contest the applicability of these sections. Particularly, as to Section 362(b)(22), the debtor can contest the stay exception by filing, within the 30-day period, a certification that applicable nonbankruptcy law allows the lease to remain in effect upon the debtor's cure of the default. The debtor would be able to keep the stay in effect after 30 days by filing a further certification that the cure

amount had been paid within 30 days of the bankruptcy filing. As to new Section 362(b)(23), the 2005 Act requires that the landlord file a certification that the endangerment provisions of Section 362(d)(23) apply and the debtor may contest the landlord's certification by filing a counter certificate. Under either circumstance, the bankruptcy court is required to hold a hearing on the debtor's assertions within 10 days to determine if the situation giving rise to the exception to the stay has been remedied.

4. <u>Maximum Time for Ruling on Stay Relief Motions</u>

Section 362 requires that bankruptcy courts hold preliminary hearings on relief from stay motions within 30 days of the creditor filing the motion. The 2005 Act takes this "speedy" hearing requirement further in cases filed by individual debtors. According to new Section 362(e)(2), the stay terminates automatically if the Court does not render a decision within 60 days. The 60-day period, however, can be extended by agreement of the parties or if the court finds "good cause" to extend the time period for a finite period. As to the latter, the Court must make specific findings of the good cause and identify the period on which the stay expires if no decision is rendered.

5. <u>Exception to Automatic Stay for Support Obligations</u>

Augmenting the fact that support obligations are non-dischargeable, revised Section 362(b) now contains several exceptions to the stay that relate to the enforcement of support obligations. For example, income withholding to pay support obligations, suspension of driver's license privileges for non-payment of support, and intercepting tax refunds to pay support obligations are excepted from the automatic stay.

6. <u>Innocent Violations of the Automatic Stay and Notices to Creditors</u>

Under the prior Code, the automatic stay can be violated generally in instances where the creditor had no notice of the bankruptcy filing. The same holds true under the 2005 Amendments. However, new Section 342(g) provides that the creditor would not be subject to a monetary penalty for violating the automatic stay or for failing to turnover property unless given proper notice of commencement of the case under Section 342. In instances where there was prior creditor communications, amended Section 342(c)(2)(A) provides that notice is not "effective" unless served at an address filed by the creditor with the Court or at an address stated in two communications from the creditor to the debtor within 90 days of the filing of the bankruptcy case (or 180 days of filing the case if the creditor was prohibited from communicating with the debtor in the more-recent 90-day period.) To be effective, the notice must include the creditor's account number used in the communication.

F. **Expansion of Duties**

In addition to the current filing requirements, the 2005 Act imposes additional filing duties upon consumer debtors and/or their attorneys. These duties include:

1. *Certification of Credit Counseling*. Section 109(h) of the Bankruptcy Code now provides that debtors are ineligible for relief under any chapter of the Bankruptcy Code unless such individual first obtained budget and credit counseling within the 180-day period prior to the filing of a bankruptcy case from an "approved nonprofit budget and credit counseling agency." There are exceptions to the rule including "exigent circumstances" obviating the requirement. In order to fall within the safe harbor, however, the debtor claiming "exigent circumstances" must (1) file a certification describing the exigent circumstances, which must be "satisfactory to the court," (2) state that the debtor had sought the required briefing at least 5 days prior to the bankruptcy without being able to obtain it, and (3) complete the credit counseling within 30 days after the bankruptcy filing. There is also a safe harbor for debtors who are disabled, incapacitated, or in an active military combat zone. In the latter circumstances, the debtor must file a certification identifying the safe harbor in which such person falls. The debtor who has completed credit counseling must also file a certificate obtained from the credit counseling agency which (1) describes the services provided, and (2) identify any debt repayment plan developed.[7]

2. *Statement that Debtor Received and Read Section 342(b) Notice*. Section 521 has been amended to require that the debtor's attorney and/or petition preparer file a certificate advising the court that it has provided the debtor with the notices required by Section 342(b) of the Bankruptcy Code (so that debtor understands that types of bankruptcy relief available to him or her, and the effects of false filings). Alternatively, in a pro se case, a certificate of the debtor that notice has been received and read. .

3. *Additional Statements and Schedules*. Section 521(a) of the Bankruptcy Code has been amended to impose a number of new production requirements on debtors. For example, debtors now are required to file the following: (a) pay stubs for the 60 day period prior to the filing of the case (this is what is usually required by local rule in most jurisdictions); (b) statement of anticipated postpetition income or expenditure increases expected over the 12-month period following the petition date; (c) itemized monthly net income; (d) debtor's most recent tax return or statement as to why no tax return has been filed; (e) a continuing duty to provide tax returns in the case from commencement until termination (and must be submitted to any creditor timely requesting it); (f) annual statement of income and expenses in a Chapter 13 case; (g) disclosure of qualified educational accounts and TAP accounts; and (h) if requested, a

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[7] The idea here is to encourage the debtor to seek an out-of-court solution with creditors. The qui pro quo for these provisions is that the new statute provides that unsecured debts may be reduced by up to 20% if a creditor "unreasonably" refuses to negotiate with an approved credit counseling agency proposing payment of 60 percent of the debt over the period of the loan or a reasonable extension.

photo identification. Any individual debtor must also file with the court copies of tax returns, amended tax returns, or transcripts of the same for tax years that ended during the 3 years before the case was commenced.

4. *Perform Statement of Intentions*. Debtor must perform stated intention within 30 days after the first date set for the meeting of creditors or the stay is automatically lifted under Section 362(h) of the Bankruptcy Code. Section 521 statement of intention is no longer limited to consumer debts, but has also been expanded to property securing business debts. If the obligation at issue is secured by a purchase money security interest ("PMSI"), and the debt is not reaffirmed, redeemed or surrendered within 45 days of the meeting of creditors, the automatic stay is immediately lifted so that the creditor may exercise its remedies.[8] While the general 30 day period set forth above could be extended for "cause", the 45 day period for PMSI's cannot.

G. Roll-Back of the "Fresh Start"

1. Expansion of Non-Dischargeable Debts in Section 523 and 1328 of the Bankruptcy Code

Limits on When Discharge May Be Obtained: Under revised Section 727(a)(8) of the Bankruptcy Code, Chapter 7 discharge for individual consumers may only be granted once every 8 years (up from once every 7 years).

Limits on Chapter 20 Discharge: Under new Section 1328(f) of the Bankruptcy Code, the ability to pursue a "Chapter 20" is curtailed. Under new Section 1328(f), a Chapter 13 debtor will be denied a discharge if the debtor received a discharge (1) "in a case filed under Chapter 7, 11, or 12 . . . during the 4-year period preceding the date of the order for relief", or (2) "in a case under Chapter 13 . . . during the 2-year period preceding the date of such order [for relief]."

Instructional Courses for Financial Management as Pre-Requisite to Discharge: Under new Sections 727(a)(11) and 1328(g) of the Bankruptcy Code, debtors seeking a discharge must, as a prerequisite to obtaining the discharge, complete an approved "instructional course concerning personal financial management." The Clerk will maintain a list of approved courses and a standard for approval of the course is that the course must be provided "without regard to the debtor's ability to pay any fee for the course." Telephone and internet courses are possible "if effective." Disabled, incapacitated, or military personnel in active combat zones are exempt from the instructional course requirement.

All Educational Loans Are Non-Dischargeable: Revised Section 523(a)(8) of the Bankruptcy Code now expands the definition of educational loans that are non-dischargeable (absent a showing of undue hardship) to include all qualified loans for education purposes (not just federally guaranteed loans).

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[8] Section 722 of the Bankruptcy Code has been amended to make clear that redemption requires full payment of an allowed secured claim at the time of redemption.

Non-Dischargeable Debts for Luxury Goods and Credit Cards: The 2005 Act amends Section 523(a)(2)(C) to now provide that certain consumer debts are presumed to be fraudulent such as (a) obligations for luxury goods incurred with 90 days (note this is an increase from the 60-day limitation under the old statute) prior to the filing of a case in the amount of $500 (note this a reduction from $1,225 under the old statute), (b) cash advances for more than $750 (note this is a reduction from $1,225 under the old law) under an open-ended credit plan incurred within 70 days (note this is an increase from 60 days under the old law) of filing.

Non-Support Property Settlements or Claims for Equitable Distribution: Non-support obligations incurred from divorce or separation (i.e., equitable distribution obligations) are now non-dischargeable under Section 523(a)(15), notwithstanding any hardship imposed on the debtor or whether the asset in question is not reasonably necessary for the support or maintenance of the claimant.[9]

Injuries Caused by Driving Under the Influence: The 2005 Act also adds "vessel" and "aircraft" to the non-dischargeability provisions of the statute at Section 523 relating to non-dischargeability of claims for injuries caused while driving under the influence.

2. Limitations on Exemptions

Limits on Where You Can Elect a Homestead. The domiciliary requirement to claim a state homestead exemption is increased from 180 days to 730 days (2½ years) under amended Section 522(b)(3) of the Bankruptcy Code. If the debtor resided in multiple states during the 730-day period leading up to the petition date, the state exemption that the debtor could select are those exemptions of the state where the debtor lived for a majority of the time for the 180 days or longer. If the debtor does not meet any of these requirements, then the debtor may elect only the federal exemption if it desires to make an election.

Limits on Amount of Homestead Exemption. Regardless of the level of state exemptions, new Section 522(p) provides the debtor may exempt up to $125,000 of interest in a homestead that was acquired or added within the 1,215 days leading up to the petition date (approximately 3 years and 4 months). This equity/homestead limitation does not include equity rolled over from one house to another within the same state (i.e., the equity acquired from the most recent house is the one that is operative).

No Homestead Exemption in Cases of Fraud. In an attempt to address the Bilzarian case, the 2005 Act provides at new Section 522(q) that if an individual debtor is convicted of securities fraud, fiduciary fraud or some additional torts or crimes, the debtor forfeits the right to take a homestead exemption in excess of $125,000. This limitation, however, is not applicable if the homestead property is "reasonably necessary for the support of the debtor and any dependent of the debtor." If a Section 522(q) proceeding is pending, the discharge for a

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[9] Section 507(a) has also been amended under the 2005 Act to make support obligations first priority obligations subject only to the expenses incurred by the trustee in administering assets that might otherwise be used to pay support obligations.

debtor cannot be issued and is delayed pending the outcome.

Limits on What Constitutes Household Goods. Household goods for purposes exemption planning and lien avoidance (of a nonpossessory, nonpurchase money security interest) under the 2005 Act (new Section 522(f)(4)) are limited to: clothing, furniture and appliances. Electronic equipment is limited to 1 radio, 1 television, 1 VCR and 1 personal computer. Exemptions are also granted for linens, china, crockery, kitchenware, educational materials and equipment for the use of the debtor's minor children, medical equipment and supplies, and furniture (exclusively for the use of the debtor's minor dependent children). Exceptions to these exemptions include: artwork not created by the debtor, jewelry and antiques worth more than $500 (except wedding rings), and motor vehicles (cars, boats, watercraft, etc.).

Avoidance of Asset Protection Trusts. A new section 548(e) allows a trustee in bankruptcy to avoid transfers by a debtor into a self-settled trust or similar device if made by the debtor within 10 years of the petition date 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."

3. Some Give-Backs

Congress did provide some relief to debtors in the 2005 Act. Namely the 2005 Act revised Section 541 to clarify the law and provide that funds placed within an educational retirement account at least 365 days prior to the petition date are excluded from property of the estate; provided however, funds contributed between the 1st and 2nd year of the bankruptcy filing cannot exceed $5,000. Section 541 of the Bankruptcy Code was also amended to reflect that ERISA-qualified plans funded by employee contributions are excluded from property of the estate as well.

H. Some Additional Changes Applicable to Chapter 13's

1. Expanding Nobleman

Under revised Section 1325(a) of the Bankruptcy Code, consumer debtors may not "strip-down" collateral in Chapter 13 that is secured by a PMSI when the collateral is either (a) a motor vehicle and the debt was incurred within 2 ½ years of the petition date; or (b) the collateral was any other "thing of value" and the debt was incurred within one year of the date the petition was filed. In essence, revised section 1325(a) expands Nobeleman in some instances.

2. Dewsnup Enforced

As to any lien that might be stripped down under Section 1325(a)(5) of the Bankruptcy Code, the 2005 Act provides that, upon payment of the secured claim, the creditor is allowed to retain its lien until the full amount of the claim is paid or the plan is completed. In essence, the Chapter 13 plan cannot provide for a release of the lien at plan confirmation or upon Section 506 bifurcation without the creditor's consent.

3. Adequate Protection Payments

Section 1325(a)(5)(B) has been added to the Bankruptcy Code which now requires that Chapter 13 plans provide for payment of secured claims in equal installments at least equal to provide adequate protection (i.e., arrearage plus diminution must be covered by payment if reinstatement is sought, plus regular payment). The debtor, under Section 1326 must also make the preconfirmation adequate plan payments directly to the secured creditor (and supply proof of payment to the trustee) thereby reducing the amount of trustee compensation in a Chapter 13.[10]

4. Best Efforts

The best efforts test of Section 1325(b) has been amended to provide that in the absence of no objection by the trustee or creditors, Chapter 13 plans must either pay unsecured creditors in full with interest or else provide that all of the debtor's disposable income will be contributed to the plan for its minimum term. "Disposable income" is defined in Section 1325(b)(2) as "current monthly income," other than child support income,[11] not necessary to provide support for the debtor or a dependent of the debtor.

5. Plan Length

Where the debtor's income is greater than the applicable median, the "best efforts" test for Section 1325(b) of the Bankruptcy Code now requires that the plan must have either a five-year term or a period long enough to pay unsecured creditors in full plus interest, whichever is less. Plan length for debtors having income less than the median can have a 3-year term as long as they are using their best efforts.

6. Reduction of the Superdischarge

As the Bankruptcy Code now automatically requires certain debtors to pursue the Chapter 13 alternative, there is no longer a need to incentivize debtors to file a Chapter 13. Consequently, the "super discharge" has been eliminated.[12] The debts still covered by the Chapter 13 discharge are personal property claims for willful and malicious injury (Section 523(a)(6)), debts incurred to pay non-dischargeable tax obligations (Section 523(a)(14)), and debts arising from property settlements in divorce or separation proceedings (Section

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[10] These same requirements apply to payments to lessors.

[11] As set forth above, note that support income is used to calculate the means test in instances where the debtor's income is more than the applicable median income.

[12] Claims for (1) unfilled, late filed or fraudulent tax returns (Section 523(a)(1)(B) and (C)), (2) fraud and credit card misuse (Section 523(a)(2)), non-noticed claims (Section 523(a)(3)), claims for breach of fiduciary duty and embezzlement (Section 523(a)(4)), personal injury or wrongful death caused by the debtor's willful or malicious acts (Section 523(a)(6). As to the latter, the exception in Section 1328 applies to "willful or malicious injuries" and the exception in 523 is "willful and malicious injury" claims. It therefore appears that the discharge in Chapter 13 is more restrictive, which may not be an unintended consequence.

523(a)(15)).[13]

7. Interest on Nondischargeable Obligations

Under existing law (Leeper) in the Third Circuit, post-petition interest on non-dischargeable claims continues to accrue. New Section 1322(b)(10) allows a Chapter 13 plan to pay such interest "only to the extent that the debtor has disposable income available to pay such interest after making provision for full payment of all allowed claims."

8. Timing of Confirmation Hearing

New Section 1324 places timing restrictions on the confirmation hearing and requires that it not take place earlier than 20 days after the meeting of creditors. This revision eliminates the practices of some courts to hold confirmation hearings on the same date as the Section 341 meeting. The court, however, could have an earlier hearing if it determines that an earlier hearing is "in the best interests of creditors and the estate" and "there is no objection." The Court therefore must provide notice and an opportunity for creditors to object to an earlier confirmation hearing. As to the outside date for the confirmation hearing, the court requires the confirmation hearing to take place no later than 45 days after the meeting of creditors.

9. Cure of Late Filed Tax Returns

A new Section 1308 was added to the Bankruptcy Code, which now requires the debtor to file before the Section 341 meeting all tax returns that should have been filed during the 4-year period prior to the filing of the bankruptcy case.

10. Treatment of Loans from Pension and Profit Sharing Plans

As set forth above, excepted from the automatic stay are efforts of pension or profit sharing plans to recover loans made from the debtor's interest in the funds. A new Subsection 1322(f) of the Bankruptcy Code has been added which augments these provisions and precludes the debtor from "materially altering" the terms of such loans and provides that the amounts paid on such loans are not "disposable income."

11. Treatment of Support Obligations

Under new Subsection 1325(a)(8) of the Bankruptcy Code, a plan cannot be confirmed unless the debtor is current in payments of any postpetition domestic support obligations. Section 1328 has also been amended to provide that the discharge will not be granted unless the debtor certifies at the conclusion of the plan that the debtor is current on such obligations. Failure to make post-petition support obligations is grounds for dismissal or conversion in new

[13] Creditors can be deemed to have violated the discharge in Chapter 13 if they fail or refuse to credit payments received under the plan, but only if the failure results in "material injury" to the debtor and (1) the plan payments are received according to the plan, and (2) the case is not dismissed.

Section 1307(c), whichever is in the best interest of creditors.

III. Small Business Cases

Small businesses debtors are defined by Section 101(51)(C) of the Bankruptcy Code as a person (including any affiliate of such person that is also a debtor) that has aggregate noncontingent, liquidated, secured and unsecured debtors of no more than $2 million who is engaged in commercial or business activities other than the business of owning or operating real property or activities incidental thereto (i.e. not single asset real estate debtors).

Pursuant to the new Section 1116 of Bankruptcy Code, small business debtors have new additional duties including:

- filing within 7 days of the petition either: (A) its most recent balance sheet, statement of operations, cash-flow statement, and federal income tax return; or (B) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no federal tax return has been filed;
- attend, through its senior management personnel and counsel, meetings scheduled by the Court or the United States Trustee, including initial debtor interviews, scheduling conferences, and Section 341 meetings unless the Court waives that requirement upon a finding of extraordinary and compelling circumstances;
- timely file all schedules and statements of financial affairs, unless the Court, after notice and a hearing, grants an extension, which shall not extend such time period to a date later than 30 days after the date of the order for relief, absent extraordinary and compelling circumstances;
- file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;
- maintain insurance;
- timely file tax returns and other required government filings and timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and
- allow the United States Trustee, or a designated representative of the United States Trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.

Some of these requirements are not new, and merely codify the previous duties of the small business debtor. More significant, however, are the new reporting requirements for small business debtors under new Section 308 of the Bankruptcy Code.

Under Section 308, small business debtors must "periodically" file financial reports containing information, including the debtor's profitability, reasonable approximations of the debtor's projected cash receipts and cash disbursements over a reasonable period, comparisons of actual cash receipts and disbursements with projections in prior reports, whether the debtor is in compliance with the requirements of title 11 and timely filing tax returns and other filings and paying taxes and administrative expenses when due. In the event that a small business debtor

fails to meet those reporting requirements without a reasonable justification, the Court may dismiss or convert the bankruptcy case to Chapter 7 pursuant to Section 1112(b)(2)(B)(i).

Under the 2005 Act, small business debtors lose some of the protections of the automatic stay. New Section 362(n) provides that the protections of the automatic stay do not apply to a bankruptcy case which was (a) a small business debtor case at the time the petition was filed, (b) a debtor in a small business case that was dismissed for any reason by an order that became final in the 2-year period ending on the date of the order for relief entered with respect to the petition, or (c) was a debtor in a small business case in which a plan was confirmed in the 2-year period ending on the date of the order for relief entered with respect to the petition unless the debtor establishes by a preponderance of the evidence that such entity acquired substantially all of the assets or business of such small business debtor in good faith and not to circumvent the intent of the statute.

Another significant change is that small business debtors will, at least initially, have a little more time to prepare and confirm their plans. Under Section 1121(e), as amended, only the debtor may file a plan until after 180 days after the date of the order for relief. This is an increase from the prior version in which small business debtors had an exclusive period only of 100 days. Similarly, by the prior version of Section 1121(e), debtors had to file their plans within 160 days after the petition date. By the 2005 Act, a debtor must file its plan and disclosure statement up to 300 days after the petition date. Under new Section 1129(f), once a small business debtor's plan has been filed, the Court must confirm the plan within 45 days. The only means by which a small business debtor may get an extension of those deadlines is if it is able to demonstrate by a preponderance of the evidence that it is more likely than not that the Court will confirm a plan within a reasonable period of time.

By these amendments, small business debtors will likely incur significant costs, including the hiring of accountants, to prepare all documents necessary for the new reporting requirements. The costs, however, may be balanced by the possibility that the bankruptcy process may become more streamlined.

IV. Business Bankruptcy Cases

A. Assumption/Rejection of Leases

For many retailer cases (e.g., K-Mart, Montgomery Ward, Frank's Nursery), this may be the most significant amendment in the 2005 Act. Previously, the debtor had 60 days from the date of the commencement of the case to decide whether to assume or reject its commercial real property leases, and at the expiration of the time period, the real property leases were automatically rejected. Of course, the deadline to assume or reject could be extended for cause, and in large cases in which the debtor had many leases which were integral to the debtor's operation, debtors were granted numerous extensions of the deadline to decide whether to assume or reject so that the issue could be addressed in the context of confirmation of a plan.

The 2005 Act permits debtors an initial period of 120 days to decide whether to assume or reject non-residential real property leases. This deadline is subject to only one extension for

an additional 90 days for cause. As a result, debtors will have a maximum of 210 days from the petition date to decide whether to assume or reject commercial real property leases unless a landlord provides a prior written consent to a subsequent extension of time.

This amendment was clearly written into the Bankruptcy Code to protect landlord interests by ensuring that debtors cannot indefinitely seek extensions of time to determine whether to assume or reject the lease. This amendment will have several effects. Debtors with real property leases (particularly where the debtor has a multitude of leases) will have to begin evaluating leases earlier, including prepetition. Of course, where the debtor a large retailer is an anchor tenant (e.g., K-Mart) where it will be significantly more difficult to find a new tenant to lease the space, landlords will be more inclined to give extensions of time for the debtor to decide than in the case of smaller debtors. Of course, this also will depend upon the value of the lease, subject to the market price, and the availability of other possible lessees.

Debtors were previously reluctant to assume leases until the last possible moment because once a lease was assumed all liability arising from that lease was a postpetition obligation. Accordingly, if a long-term lease was assumed during the bankruptcy and the debtor defaulted on that lease during the bankruptcy, all damages arising under the lease may have had an administrative priority which must be paid in full. Although debtors may have to assume contracts earlier than they would otherwise prefer, Congress did provide one mechanism of protection, set forth in Section 507(b)(7), so in the event that debtors default on assumed leases, all of the estates' assets are not used to pay landlords for assumed leases. Where a nonresidential real property lease is assumed and subsequently rejected, the landlord shall be entitled to an administrative claim which shall be no greater than two years of monetary obligations, excluding those arising due to a failure to operate or under penalty provisions, following the later of (i) the rejection date or (ii) the date of the actual turnover of the premises. The balance of the landlord's claim shall be allowed only as an unsecured claim, as limited by Section 502(b)(6).

It is worthy of note that leases for personal property are not changed by the 2005 Act.

B. Exclusivity

One of the more notorious amendments to Chapter 11 set forth in the 2005 Act is the amendment to Section 1121 which sets forth the exclusive period for a debtor to file a plan of reorganization. Previously, a Chapter 11 debtor had the exclusive right to file a plan of reorganization and obtain the requisite votes for the plan's acceptance during the first 120 days of the case. If the debtor had not confirmed a plan, within 180 days after the petition date, another party in interest could file its own plan. Under Section 1121(d), the debtor's exclusive right to file a plan could be extended by the bankruptcy court for cause. Further, there was no limit to the number of extensions that a debtor could receive. Under the 2005 Act, the initial time periods remain the same, however, a debtor may receive one extension of the exclusivity period for the filing of a plan for an additional year. Accordingly, a debtor may not have the exclusive right to file a plan more than eighteen months after the petition date.

Although it often is impossible for debtors to quickly formulate a viable plan of reorganization quickly in large or complex cases, it is often rare that other parties have the

impetus or ability to prepare and confirm their own plan. The 2005 Act may permit certain creditors to wait until the end of a debtor's exclusive period so that they may propose their own plan, but it is more likely that, if creditors oppose the continuation of the debtor's operation of the business or the continued exclusivity in the case, that they seek the conversion of the case or appointment of a trustee which would also terminate the debtor's right to exclusivity.

There is a special section for exclusivity in small business cases (supra, section III).

C. Insider Retention/Severance Bonuses

As part of the reforms spurred by cases such as Enron, Adelphia, and Worldcom, Congress strictly limited payments to insiders, including retention or severance bonuses. Specifically, under Section 503(c), as amended, debtors may not provide retention bonuses to insiders unless the court finds:

> (i) the bonus is essential to retain the individual because of a bona fide job offer from another business at the same or greater pay;
>
> (ii) the services provided by the person are essential to the survival of the business; and either--
>
> > (a) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the average transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or
> >
> > (b) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

Additionally, debtors may not make severance payments to an insider of the debtor, unless:

> (i) the payment is part of a program that applies to all full-time employees; and
>
> (ii) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made.

Finally, debtors may not make any other transfers or obligations to or for the benefit of insiders that are outside the ordinary course of business and not justified by the facts and circumstances of the case.

D. Creditors' Committees

By the 2005 Act, smaller unsecured creditors (or equity holders) have gained the ability to get more involved in the bankruptcy process. First, creditors (or equity holders) may seek to have the Court change the membership of an appointed committee "to ensure adequate representation." The Court may order that the United States trustee increase the number of

members of a committee if the court determines that the creditor holds claims which, "in comparison to the annual gross revenue of that creditor, is disproportionately large." By this subsection, a bankruptcy court may (but need not) appoint a large number of creditors to a committee based upon the size of those creditors.

This new provision may cause a significant divergence from the traditional constituency of committees in which the United States Trustee appoints the creditors with largest claims which represent the entire body of unsecured creditors. By the amendments, it is possible that small businesses with relatively de minimus claims in a mega-case could be appointed to a creditors' committee by virtue of the fact that their business is small.

E. Conversion/Dismissal

Previously, Section 1112(b) of the Bankruptcy Code provided that a bankruptcy court may convert or dismiss a Chapter 11 case for "cause." A non-exclusive list of facts which may constitute cause was set forth in 1112(b)(1) which included an inability to effectuate a plan, unreasonable delay, failure to propose a plan, inability to effectuate substantial consummation of a confirmed plan. The 2005 Act states that the court shall dismiss or convert to Chapter 7, depending on the best interests of the creditors and the estate, if the movant establishes cause. Congress amended the non-exclusive list of facts which may constitute cause to include several new items, including:

- substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation;
- gross mismanagement of the estate;
- failure to maintain appropriate insurance that poses a risk to the estate or to the public;
- unauthorized use of cash collateral substantially harmful to 1 or more creditors;
- failure to comply with an order of the court;
- unexcused failure to satisfy timely any filing or reporting requirement established by this title or by any rule applicable to a case under this chapter;
- failure to attend the meeting of creditors convened under section 341(a) or an examination ordered under rule 2004 of the Federal Rules of Bankruptcy Procedure without good cause shown by the debtor;
- failure to timely provide information or attend meetings reasonably requested by the United States trustee (or the bankruptcy administrator, if any);
- failure to timely pay taxes owed after the date of the order for relief or to file tax returns due after the date of the order for relief;
- failure to file a disclosure statement, or to file or confirm a plan, within the time fixed by this title or by order of the court;
- failure to pay any fees or charges required under chapter 123 of title 28;
- revocation of an order of confirmation under section 1144;
- termination of a confirmed plan by reason of the occurrence of a condition specified in the plan; and
- failure of the debtor to pay any domestic support obligation that first becomes payable after the date of the filing of the petition.

Accordingly, under the 2005 Act, debtors will have a much shorter leash insofar as Congress has specifically delineated some of the acts or omissions which may constitute cause. That is not to say, however, that a debtor's actions or failure to act as required mandate the conversion or dismissal of the debtor's case. In the event that the debtor has not acted in accordance with its obligations under title 11, the debtor has the ability to prove that there were unusual circumstances and that conversion or dismissal is not in the best interest of the estate. Further, the debtor will have to prove that there is a reasonable likelihood of timely confirmation, and the grounds for granting the relief includes an act or omission for which there is a reasonable justification that will be cured within a reasonable period.

F. Appointment of a Trustee or Examiner

In addition to making it easier to have cases converted or dismissed, Congress, by the 2005 Act, made it easier for parties in interest to have trustees and examiners appointed in Chapter 11 cases. Specifically, under the prior version of the Bankruptcy Code, courts were to appoint a trustee for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor, or if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

By the 2005 Act, Congress specifically added that the court shall appoint a trustee or examiner if it finds that grounds exist to convert or dismiss the case under section 1112, as amended, but the court determines that the appointment of a trustee or examiner is in the best interests of creditors and the estate.

Further, under Section 1104(e), the United States Trustee shall move for the appointment of a trustee under subsection (a) 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.

V. General

A. Public Access to Information

As suggested by the title "The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005," Congress made a concerted effort to protect the personal information of individuals, including protecting information which may lead to identity theft or other personal records.

First, Congress revised Section 107 of the Bankruptcy Code, titled "Public access to papers," to include a new subsection which states that the bankruptcy court, for cause, may protect an individual from the disclosure of information which would create undue risk of identity theft or other unlawful injury to the individual or the individual's property. This protection is not limitless, however. If an entity acting pursuant to the police or regulatory power of a domestic governmental unit makes an ex parte application demonstrating cause, the bankruptcy court must allow that agency access to the protected information. Further, the United States trustee, bankruptcy administrator, trustee, and any auditor serving under section 586(f) of title 28 shall have complete access to all information contained in any paper filed or submitted in a bankruptcy case.

While the policy of protecting personal information is certainly important in light of the threat of identity theft, it is unclear exactly what an individual must prove for the bankruptcy court to find cause to protect personal information. This applies to both debtors and creditors. As a preliminary matter, it is unclear what "information" Section 107 refers to. Section 1028(d) of title 18, which is cited in Section 107(c)(2) does not define "information." Rather, it defines "means of identification" to include "any name or number that may be used, alone or in conjunction with any other information, to identify a specific individual, including . . . name, social security number, date of birth, official State or government issued driver's license or taxpayer identification number." While almost everyone can identify with the danger of disclosure of too much information, courts will have to strike a balance between privacy and permitting sufficient information to give creditors notice which will alert creditors of the debtor's bankruptcy filing. Similarly, from a debtor's prospective, while individual creditors must provide a certain amount of information to establish the basis for their claims, there may be a limit to the information which needs to be publicly disclosed.

In addition to establishing a means to protect personal information from public disclosure, Congress created two new interested parties to protect individual interests. First, Congress created a position of consumer privacy ombudsman in Section 332 of the Bankruptcy Code to address certain situations involving personally identifiable information which may be sold pursuant to 11 U.S.C. §363(b) to a party not affiliated with the debtor.

Specifically, Section 332 provides that where a debtor has (i) disclosed to individuals a policy which would prohibit the transfer of personally identifiable information to persons not affiliated with the debtor, and (ii) that policy is in effect on the petition date, the trustee may not seek to sell or lease personally identifiable information to any person unless the sale is consistent with such policy or after appointment of a consumer privacy ombudsman. In such a case, the

United States trustee must appoint a disinterested person to serve as the consumer privacy ombudsman in the case at least five days prior to the sale hearing. The consumer privacy ombudsman may appear at the hearing and may provide the Court with information to assist the court in its consideration of the facts, circumstances, and conditions of the proposed sale or lease of personally identifiable information, including the debtor's privacy policy, the potential losses or gains of privacy to consumers if such sale or such lease is approved by the Court, the potential costs or benefits to consumers if such sale or such lease is approved by the court; and the potential alternatives that would mitigate potential privacy losses or potential costs to consumers.

Ultimately, however, neither Section 363(b)(1) nor Section 322 states how much, if any, weight the bankruptcy court must give to the consumer privacy ombudsman or the debtor's prepetition non-disclosure policies. In contrast to the patient care ombudsman (discussed below), Section 332 does not state that the consumer privacy ombudsman represents any interest. Rather, his position appears to be largely investigatory so that he may apprise the Court of the debtor's policies, the effects of the proposed sale, and potential alternatives at the sale hearing.

By the 2005 Act, Congress also created the position of patient care ombudsman in Section 333 of the Bankruptcy Code for cases in which the debtor is a health care business. In each such case, the Court must, within 30 days after the commencement of the case, appoint a disinterested person as the patient care ombudsman unless it finds that the appointment of such ombudsman is not necessary for the protection of patients under the specific facts of the case. Where the debtor is a health care business that provides long-term care, then the United States trustee may appoint the State Long-Term Care Ombudsman appointed under the Older Americans Act of 1965 for the State in which the case is pending. If the United States trustee does not appoint a State Long-Term Care Ombudsman, the Court shall notify the State Long-Term Care Ombudsman appointed under the Older Americans Act of 1965 for the state in which the case is pending. A patient care ombudsman is charged with the following duties: monitoring the quality of patient care provided to patients of the debtor, reporting to the court about the quality of those patients, and if such ombudsman determines that the quality of patient care provided to patients of the debtor is declining significantly, filing with the court a motion or a written report.

Additionally, new Section 351 provides where a health care business filed for bankruptcy relief under Chapters 7, 9, or 11, and the trustee cannot afford to store patients records as required by law, the trustee must attempt to provide the patients or the insurance provider notice that patient records will be destroyed. This notice will occur through publication, direct notification to the patient, insurance carrier, and family member or contact person for that patient. If the patient records still have not been claimed, the trustee must request that the federal governmental agencies accept the patient records. Only after a year has passed in which the patient records have not been claimed by the person, insurance carrier, family member or governmental agency, may the trustee destroy the patient records.

Congress also amended Section 503 to create a administrative priority claim for closing a health care business, including disposing the patients' records or transferring patients from a health care business. It is not clear, however, what a trustee can do where the estate does not have sufficient funds to go through the lengthy (and potentially expensive process) of giving

notice regarding the records, including the advertising of the destruction of these records. Moreover, the estate must continue to bear the expense of maintaining the records for at least one year.

B. Valuation of Secured Claims

The 2005 Act added a wrinkle to the valuation of assets for the purpose of determining whether a claim is secured in certain personal bankruptcy cases. Specifically, Section 506(b)(2) now provides that in individual Chapter 7 or 13 cases, the value of personal property securing an allowed claim shall be determined based on the replacement value of such property as of the petition date. This value does not include any deduction for costs of sale or marketing. Further, as to property acquired for personal, family, or household purposes, replacement value "shall mean the price a retail merchant would charge for property of that kind considering the age and condition of the property at the time value is determined."

This is clearly a partial codification of the United States Supreme Court's decision in Associate Commercial Corp. v. Rash, 520 U.S. 953 (1997) in which the Court adopted "replacement value" as the value for a vehicle, but stated in a footnote that "[R]eplacement value should not include certain items. For example, where the proper measure of the replacement value of a vehicle is its retail value, an adjustment to that value may be necessary. A creditor should not receive portions of the retail price, if any, that reflect the value of items the debtor does not receive when he retains his vehicle, items such as warranties, inventory storage, and reconditioning." 520 U.S. at 965, f.n.6.

C. Adequate Protection of Utilities

The amendments to Section 366 may be among the most significant changes for business bankruptcy cases, particularly where either the debtor has not created a cash reserve or its business is heavily dependent upon electricity, gas, or other utility services. Manufacturing companies and retail debtors with numerous locations may, in particular, be forced to set aside large deposits to utilities which it may otherwise need during its reorganization.

Previously, debtors were required to provide utilities with adequate assurance of payment. However, many courts found that utilities were adequately assured by the prior payment history and through allowance of administrative claims under section 503(b). The 2005 amendments modified Section 366 to specifically state that an administrative priority claim may not constitute an assurance of payment. Instead, "assurance of payment" is defined as "a cash deposit; a letter of credit; a certificate of deposit; a surety bond; a prepayment of utility consumption; or another form of security that is mutually agreed on between the utility and the debtor or the trustee." If a debtor does not provide adequate assurance of payment that is satisfactory to the utility within the first 30 days of a case, the utility may alter, refuse, or discontinue service.

Further, the Court may order modification of the amount of an assurance of payment. However, in determining whether an assurance of payment is adequate, the Court may not consider the absence of security before the date of the filing of the petition; the payment by the debtor of charges for utility service in a timely manner before the date of the filing of the petition; or the availability of an administrative expense priority.

Finally, Congress expressly provided that a utility may recover or set off a security deposit that the debtor provided to the utility prior to the petition date without any notice or an order of the Court.

D. Reclamation

Reclamation creditors may have been one of the largest beneficiaries of the 2005 amendments to the Bankruptcy Code. Specifically, Congress amended Section 546(c) to permit creditors who provide goods to debtors up to forty-five (45) days prior to the petition date to seek the return of all of those goods. This is an extension of the common law provisions for reclamation which, under Article 2-702 of the U.C.C. was ten (10) days from the date of delivery of the goods. Further, creditors may seek to do so twenty (20) days after the petition date rather than the ten (10) days as previously allowed under the Bankruptcy Code.

The 2005 Act codified reclamation claimant's rights relative to secured creditors. Section 546(c) specifically states that the rights of reclamation creditors are subject to the prior rights of a holder of security interests in those goods or proceeds thereof. Accordingly, where a debtor's assets are fully encumbered by a floating security interest on the debtor's inventory, reclamation claims are expressly junior to the secured creditor's rights. To the extent that it expressly makes reclamation claims junior to prior secured claims, the 2005 Act is consistent with case law. See, e.g., Allegiance Healthcare Corp, v. Primary Health Systems, Inc. (In re Primary Health Systems, Inc.), 258 B.R. 111, 118 (Bankr. D. Del. 2001).

Additionally, Congress added Section 503(b)(9) which gives creditors an administrative priority claim for goods which they sold to the debtor in the ordinary course of its business during the 20 days prior to the petition date. Further, even if a creditor does not timely provide a reclamation notice as required by Section 546, it may still assert an administrative priority for its claim under Section 503(b)(9).

This administrative priority will likely have additional implications upon reclamation creditors, including possible liabilities for any preferential transfers. Specifically, because reclamation creditors would have an administrative priority claim which would subsequently be paid in full, reclamation creditors may not be liable for avoidance of payment for goods tendered in the 20 days prior to the petition date where administrative claimants would be paid in full.

E. Preference Actions

In the last five years, numerous companies who did business with companies who filed for bankruptcy found themselves defendants in avoidance actions brought by debtors, trustees or liquidation trusts. Often these preference actions were brought in venues far from the defendants

and sought the return of transfers made in the ordinary course of business. In light of the expense of retaining counsel and sustaining their burden of proving all three of the prongs of the ordinary course of business defense, many of the defendants negotiated settlements.

In response to this spate of actions, Congress passed an amendment to Section 547(c)(2) which requires that defendants asserting the ordinary course of business defense need only prove that (i) the payment was for a debt that was incurred in the ordinary course of business or financial affairs of the debtor and defendant and (ii) either made according to the industry standard or made in the ordinary course of business or financial affairs of the debtor and the defendant. Accordingly, if the defendant can prove that the allegedly preferential payments were made in a manner consistent with the historical dealings of the parties, the defendant will not need to litigate the often expensive issue of whether the payment was made in a manner consistent with the industry standard.

Additionally, Section 547(c)(3) addresses the situation in which the transferee acquired a security interest through an enabling loan by which the debtor acquired property. Previously, the trustee could not avoid a security interest which the secured creditor perfected within 20 days of the debtor receiving possession of the property. By the 2005 Act, secured creditors' security interests may not be avoided where the debtor acquired property within 30 days of perfection.

Similarly, Congress amended Section 547(e)(2) for the purposes of Section 547, to provide secured lenders 30 days (rather than 10 days) from the date of the transfer to perfect their security interest without the transfer being avoidable as a preferential transfer.

In furtherance of Congress' stated intention to have debtors try to avoid bankruptcy by attempting to pay their debts through credit counseling, Congress created subsection 547(h). Section 547(h) provides that, if a creditor receives a transfer through an alternative repayment schedule created by an approved nonprofit budgeting and credit counseling agency, such payment may not be avoided.

Finally, if a debtor makes transfer within the insider period (i.e. 90 to 365 days before the petition date) to an non-insider for an insider's benefit, such transfer may be avoided only with respect to the insider.

F. Fraudulent Transfers

Section 548, which addresses fraudulent transfers, was also amended. Significantly, the fraudulent transfer period was doubled from one to two years prior to the petition date. Further, the list of avoidable fraudulent transfers was amended to include any transfer to or for the benefit of an insider under an employment contract.

Additionally, under Section 548(e), the fraudulent transfer period may extend as far as ten years prior to the petition date where (i) the transfer was made to a self-settled trust or similar devise, (ii) the transfer was made by the debtor, (iii) the debtor is the beneficiary of the trust, and (iv) the debtor made the transfer with actual intent to hinder, delay, or defraud the entity which the debtor was or became indebted to after the transfer was made.

The new two-year fraudulent transfer period now more closely mirrors the fraudulent transfer period under state law, however there may be, at least in the short terms, the potential issue that the new period is ex post facto. Accordingly, for cases filed immediately after the October 17, 2005 effective date, the debtor may have a legitimate argument that the trustee cannot avoid fraudulent transfers under section 548 which go back more than two full years. Similarly, debtors may not be liable for making transfers to self-settled trusts which go back ten years. In fact, it may take years until such liability is "grandfathered" into application.