

Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA): Impact on Business Bankruptcies

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Bankruptcy Abuse Prevention
and Consumer Protection Act
(BAPCPA)
a/k/a
**Business Bankruptcy Act of
2005**

Business Bankruptcy Act of 2005

WINNERS

1. Trade creditors
2. Commercial landlords
3. Utilities
4. Parties to financial contracts
5. Very small business debtors
6. Lawyers
7. Foreign debtors with U.S. operations
8. Taxing authorities
9. Investment bankers

LOSERS

1. Debtors
2. Senior management of debtors
3. Insiders of debtors
4. Individual Chapter 11 debtors
5. Committees
6. Real estate developers
7. Bankruptcy Judges

INTRODUCTION

General Counsel's Perspective

Suppliers

Contracting Parties

The Debtor's
Perspective

Suppliers

Reclamation Rights
Administrative Claim
Official Unsecured Creditors' Committee
Preferences
Fraudulent Conveyances
PMSI
Involuntary Bankruptcy

Reclamation Rights (§546(c))

- a) Old law:
 - i) 10 days from delivery of goods
 - ii) Bankruptcy during 10 day period - written demand within 20 days from delivery of goods
- b) New law:
 - i) 45 days from delivery of goods
 - ii) Bankruptcy filed during 45 day period – written demand within 20 days from filing of bankruptcy
- c) **Consequences to suppliers**
 - i) More deliveries subject to reclamation – 10 days to 45 days
 - ii) More time to send written demand – 20 days from delivery vs. 20 days from filing (maximum 19 days vs. 64 days)
 - iii) Need injunction – no lien or administrative claim

New Administrative Claim (§503(b)(9))

- Goods sold to Debtor in ordinary course of business within 20 days before bankruptcy
- Independent of reclamation
- Critical vendor?

Official Unsecured Creditors' Committee (§1102(a)(4))

- Committee membership
 - a) Increased judicial role
 - b) Small creditors
- Thou Shall
 - a) Provide creditors with access to information
 - b) Solicit and receive comments from creditors
 - c) Subject to Motion to Compel
- Impact
 - a) Publicly traded information
 - b) Debtor's excuse for not providing information
 - c) Claim purchaser's abuse
 - d) Court's blessing / C.A.

Preferential Transfers (§547)

- Reduces small preference shake downs
- Improves ordinary course of business defense

Old law:

New law:

Payments made in ordinary course of business
of debtor and creditor

and

or

Made according to ordinary business terms

Fraudulent Transfers (§548)

- Look back period changes from 1 year to 2 years
- Expressly adds employment agreements with Insiders
- 10 year look back for self-settled trusts or similar devices

PMSI (§547)

Extends date by which a creditor must perfect a PMSI

New law:

20 days after delivery of goods

Involuntary Bankruptcy

- Clarifies bona fide dispute: as to both liability and amount
- Potential criminal exposure for fraudulent involuntary petitions (18 U.S.C. §157)

Contracting Parties



Real Property Leases

Financial Contracts

Real Property Leases

- Enables Debtor to assume unexpired lease even though cannot cure non-monetary default
- Significant change: maximum time to assume unexpired lease – 210 days
 - a) Impact:
 - i) Will cause mistakes assuming contracts = greater administrative claims
 - ii) More pre-bankruptcy planning in retail cases
 - b) Cap on administrative claim generated by assumed leases subsequently rejected

Financial Contracts

- Swaps, commodity contracts, forward contracts, derivatives, repurchase agreements
- International Swaps and Derivatives Association (ABI Journal):
 - 1990 estimate - \$1 trillion outstanding
 - 2004 estimate - \$183 trillion outstanding

Financial Contracts

- Limitation of automatic stay
Old law: permitted liquidation of contracts
New law: Permits liquidation, termination and acceleration
- New section 561 – Master Netting Agreements (§561)
- New section 562 governs timing for measuring damages in conversion to non-debtor party's liquidation, termination or acceleration of financial contract or debtor's rejection of a financial contract

Debtor's Perspective

Impact Upon Chapter 11 Debtors

- More expensive
 - Suppliers' administrative claim
 - Expand reclamation rights
 - Utilities
 - Labor issues
 - Taxes to be paid quicker and less dischargeable
 - Litigation and legal fees to increase

Impact Upon Chapter 11 Debtors

- Management retention and compensation

KERP

- a) Must have bona fide offer
- b) Less than 10 times average amount given to non-management employees; or less than 25% of prior year's compensation

No severance to Insiders unless

- a) Part of program applicable to all full time employees;
and
- b) Less than 10 times average severance to non-management employees

Incentive payments?

Impact Upon Chapter 11 Debtors

- Management Control

Appointment of Chapter 11 Trustee/Conversion to Chapter 7

- Broader grounds
- Reduces Court's discretion
- Increases U.S. Trustee's role

Investment Bankers

- Removes per se prohibition

Exclusivity

- 120 / 180 days
- Extensions for cause – cannot be extended past 18 / 20 months

§ 363 Sale of Substantially All Assets

- Appointment of “Consumer Privacy Ombudsman” to protect “personally identifiable information”

Impact Upon Chapter 11 Debtors

Pre-Package Plans

Generally, old law problem: Upon plan solicitation – creditors could leverage Debtor

Involuntary bankruptcy

- a) State law pre-judgment remedies
- b) Credit dries up – cash flow crisis
- c) Once bankruptcy filed – no plan solicitation until disclosure statement is approved

Pre-Package Plans

New law – Plan acceptance/rejection may be solicited from creditors – without previously approved disclosure statement as long as:

- a) The solicitation complies with applicable non-bankruptcy law; and
- b) Creditors solicited before bankruptcy in compliance with applicable non-bankruptcy law

Pre-Package Plans

- Prevents a few creditors from destroying the case for the benefit of all creditors
- Enables a debtor to file bankruptcy in the middle of solicitation period without the process grinding to a halt
- Pre-package plans should become more popular

Specific
Chapter 11
Cases

Specific Chapter 11 Cases

- Small Business Chapter 11
- Single Asset Real Estate Bankruptcies
- Healthcare Insolvencies
- Foreign Debtors with U.S. Operations
- Non-Profit Chapter 11

Small Business Chapter 11

- a) Secured and unsecured debt < \$2 million
- b) Excludes Insider debt
- c) No Committee
- d) Increased financial reporting
- e) Disclosure statement limited or not even necessary
- f) Exclusivity extended from 120 to 180 days

Single Asset Real Estate Bankruptcies

- a) Monthly adequate protection payments may be from rents
- b) Payment in amount of non-default interest rates
- c) Prohibits transfer of ownership or several bankruptcy filings as part of a scheme to hinder, delay and defraud creditors

Healthcare Insolvencies

- a) Protection of patient records
- b) Appointment of Ombudsman to monitor quality of patient care and to represent interests of patients
- c) Requirements relating to closing healthcare facilities and transferring patients

Foreign Debtors with U.S. Operations

- a) Adopts model law on cross-border insolvency
 - drafted by United Nations
- b) Objectives
 - i) Cooperation between U.S. courts and competent authorities of foreign countries
 - ii) Greater legal authority should encourage trade and investment
 - iii) Promote fair and efficient administration to preserve value for all interested parties
- c) Reorganize “foreign proceedings”
 - Automatic stay applies

Conclusion

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MANKOFF

"Relax, honey—change is good."

Conclusion

BAPCPA

- More expensive
- Greater scrutiny of insiders
- Increased trade creditors' rights
- Less judicial discretion
- Faster resolution of retail and other complex cases