

INSIDE:**MILWAUKEE BAR
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Newsletter**

- A Look Back at the 2005 MBA Annual Meeting
- Examining Class Action Fairness
- Names in the News
- President's Column

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Bankruptcy "Reform:" Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

PART TWO: *Impact on Business (Creditors and Debtors) and the Court*



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Although much of the hubbub surrounding the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") centered on the Act's impact on consumer debtors, there are many other changes to the Bankruptcy Code as a result of the Act. Depending upon which side of the creditor/debtor fence you sit on, these changes may be welcome.

Effects on the Business Creditor

Preference Claims

If you who have ever had to defend a preference action in a bankruptcy case, you will be pleased to know that the "ordinary course" defense will be easier to prove. Preferences are transfers that can be "equitably" recovered from some creditors for distribution to all creditors. One defense to a preference claim is that it was paid in the "ordinary course" of business. After the Act becomes effective in October, the current 3-pronged defense will become a 2-pronged one. Currently, a creditor must prove that a transfer was the payment of debt incurred in the ordinary course, paid in the ordinary course of the parties' business and according to "industry standard" terms. The Act changes the "and" to an "or" and thus making proof of this defense easier and less costly to defend.

Similarly, now, actions to recover money (preferences, for example) are brought in the jurisdiction in which the debtor's bankruptcy case is pending. This often means that defendants are forced to litigate matters in distant courts that add to their costs, but not to the plaintiff's. The Act amends current law to provide that these actions when against a non-insider of the debtor and seeking less than \$10,000 must be

commenced in the district where the defendant resides.

Finally, the preference statute has been amended to provide that preferences for less than \$5,000 are no longer "avoidable."

Reclamation Claims

Under current law, a seller asserting reclamation rights must make a written reclamation demand within 10 days after the debtor receives the goods or, if the 10-day period expires after the bankruptcy petition date, before 20 days after the debtor receives the goods. The Act now provides that a seller can make the written reclamation demand not later than 45 days after the debtor received the goods, or within the 20 days after the petition date if the 45 day period expires after the bankruptcy petition date. However, despite this apparent benefit to the seller of goods this extended period only applies if the debtor files a bankruptcy case. If no case is filed, the seller must still comply with the 10 day period established under state law. Thus, unless the seller has a working crystal ball and knows that a case will be filed, it is still prudent to comply with the 10 day rule. Finally, the Act clears up some legal uncertainty and provides that reclamation rights are expressly subject to the prior rights of a secured creditor.

New Administrative Claim

In addition, under the new law, even if a seller fails to provide a reclamation notice, the seller may still seek to have an administrative expense claim for the value of the goods received by the debtor within 20 days before the petition was filed if the goods were sold to the debtor in the ordinary course of its business. Administrative claims are supposed to be paid in full before unsecured creditors can be paid provided there are enough funds to do so.

Lessors of Real and Personal Property

Under the current law, a debtor has 60 days from the petition date to determine whether to assume or reject an unexpired, nonresidential

real property lease. Presently, when a debtor requests additional time in which to make that determination (which they typically do), courts generally grant the extensions. The Act on one hand expands the initial deadline to 120 days from filing, but severely limits a debtor's ability to seek unlimited extensions. Amended 11 U.S.C. §365 provides that a debtor may only be granted one, with a subsequent 90 day extension, and then only "for cause." After that time, any additional extension is possible only with the landlord's consent. With no consent, the lease is deemed rejected on the 210th day.

The automatic stay imposed upon a bankruptcy filing generally stops all activity against a debtor. However, changes to the automatic stay provision assist lessors in that regard. First, a lessor will not be subject to the automatic stay if a judgment for possession was obtained prior to the bankruptcy filing. Further, new section 365(p) provides that if a lease of personal property is rejected or not timely assumed under section 365(d), then the property is no longer property of the estate and the automatic stay is automatically terminated.

Effects on Business Debtors

The reorganization of a large chapter 11 debtor usually meant years in court because debtors were permitted to seek virtually unlimited extensions of the deadline to file a plan and disclosure statement. The Act tightens up this process for all cases filed after October. The Act eliminates the ability of chapter 11 debtors to seek unlimited extensions of time to file a plan and disclosure statement and establishes a date 18 months after the order for relief is entered as the absolute deadline for filing the plan and disclosure statement.

Effects on the Court System

Under the current law, appeals from the bankruptcy court are heard by the district court or, in some jurisdictions, a bankruptcy appellate panel. The new law amends 28 U.S.C. § 158(d)

to establish a procedure to facilitate appeals of certain decisions, judgments and orders. Basically, the Act now provides for direct appeal to the U.S. Court of Appeals if certain conditions are met and the applicable lower court, a majority of the litigants and the Court of Appeals agree that there should be a direct appeal.

The Act also extends four temporary judgeships and authorizes 28 additional bankruptcy judgeships. In determining the "official duty stations of bankruptcy judges," the Judicial Conference is to consider factors to facilitate better administration of cases (convenience of parties, geography, for example).

One notable change to the Code is the new chapter 15. It is not often that Congress adds a new chapter to the Bankruptcy Code, but the Act does just that and greatly expands and provides for the cooperation between the United States and foreign countries with respect to transnational bankruptcy cases. Although chapter 15 is a significant amendment to the Code, most people and practitioners are not even aware of its existence. As the economy continues to become more global, so does insolvency. Chapter 15 addresses the past confusion and absence of statutory guidance that has plagued United States bankruptcy courts dealing with foreign debtors and bankruptcy cases.

Finally, the new law not only presents the most sweeping changes to the Bankruptcy Code since 1984, it is, in a manner of speaking, a philosophical overhaul of the Code as well. Like any new statute, there will be uncharted territory for attorneys, and that will mean, inevitably, litigants turning to the courts to determine what the law means and how it is to be applied. Thus, an effect we all may see is more litigation and a greater workload for the Court.