

HOW THE BANKRUPTCY REFORM ACT WILL CHANGE THE EXISTING BANKRUPTCY CODE

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Reform Act") was signed into law (Public Law No. 109-8) On April 20, 2005. The changes contained in the Reform Act to the Bankruptcy Code are the most significant revisions since the current version of the Code was enacted in 1978. Some highlights that you should be aware of include:

1. Preference Defense Liberalized

One of the statutory defenses available to preference defendants has been liberalized in favor of the creditor. In order to prevail on the ordinary course of business defense under the Reform Act, the creditor must prove that (1) the debt was incurred in the ordinary course of business, (2) made in ordinary terms between the parties (subjective prong) or (3) made according to ordinary business terms (objective prong). Prior to the Reform Act, all three elements needed to be established for the defense and now proof of either the subjective prong or the objective prong will trigger the defense.

2. Shorter Time Periods for Assuming Commercial Real Property Leases

Non-residential real property leases must be assumed by the earlier of 120 days after the filing of the petition or the confirmation of the plan of reorganization. If the lease is not assumed during this time period, it lease is automatically deemed rejected and must be immediately surrendered. The time to decide whether to assume or reject the lease may be extended for an additional 90 days for cause, but any additional periods after 90 days may be extended only with the consent of the landlord, each time an extension is requested.

3. Streamlining Smaller Chapter 11 Business Cases

The Reform Act provides for a simplified process to reorganize small businesses. Small businesses are generally defined as businesses that have \$2 million or less of debts. These cases are now subject to the small business provisions unless a creditors' committee is formed. The small business provisions require simplified reporting, a standardized form disclosure statement and plan of reorganization, shortened time periods for filing and confirming a plan, expands the grounds for dismissal or conversion and limits in some circumstances the application of the automatic stay. These provisions were enacted to move small business cases more quickly through the Chapter 11 process.

4. Employment Contracts As Fraudulent Conveyances

Due to the recent wave of corporate scandals, the drafters of the Reform Act were extremely concerned with making the necessary changes to prevent future corporate scandals and accounting fraud, as typified in cases such as Enron, Arthur Andersen and WorldCom. The Reform Act provides that benefits paid for an insider under an employment contract may be avoidable as a fraudulent conveyance if it was not entered into in the ordinary course of business. Additionally, the plaintiff in the avoidance action is not required to prove insolvency as part of its prima facie case.

5. Expansion of Reclamation Rights

The right of a seller to reclaim goods sold to a debtor has been expanded. The seller now has 45 days before the commencement of the debtor's bankruptcy case and after

receipt of the goods to assert reclamation rights (expanded from 10 days under the prior Code). Additionally, the seller has up to twenty (20) days to reclaim goods if the 45-day period expires after the commencement of the case (expanded from 10 days under the prior Code). Even if the seller fails to make a timely written demand, the Reform Act provides that such failure does not waive the seller's administrative claim under the Code.

6. Time Extended between Bankruptcy Discharges

An individual may not receive a discharge in a Chapter 7 bankruptcy if the debtor received a discharge in a Chapter 7 or Chapter 11 within eight years of filing its current case. No discharge is allowed in a Chapter 13 if the debtor received a discharge in either a Chapter 7, 11 or 12 within four years of filing the present case or if a Chapter 13 case was filed within two years of the pending case. This change will force some debtors to wait longer periods of time before discharging their obligations.

7. Relief from Serial Filings

If a Chapter 7, 11 or 13 is filed within one year of a prior bankruptcy dismissal, the automatic stay in the second case terminates within thirty (30) days unless the debtor shows that the second case was filed in good faith. If a second repeat filing (case #3) takes place within one year, the automatic stay does not go into effect unless the debtor demonstrates that the third filing is in good faith.

8. Restrictions on Homestead Exemption

Two years of residency is now required in order to claim the exemption for a homestead permitted under a particular state law. If the debtor does not meet the residency requirement, the governing law

to determine the homestead exemption is where the debtor resides during the 180 days preceding the two-year period before the filing of the petition (the time approximately between two years and two and a half years before the filing of the petition). This will eliminate the debtor changing their residency just before filing for bankruptcy protection only to take advantage of a particular States favorable homestead exemption.

9. Simplifying Individual Chapter 11 Cases

Individual Chapter 11 cases will look more like Chapter 13 bankruptcy cases. For example, all post-petition acquisition of assets will become part of the bankruptcy estate. Also, the debtor's plan of reorganization may be funded with future earnings and, if required, the debtor must meet the "best efforts test" by calculating the inclusion of at least five (5) years of disposable income in the proposed plan. And, as in Chapter 13, an individual Chapter 11 debtor will be discharged only after completing payments required under the plan.

10. The Effective Date of the Reform Act

The provisions of the Reform Act generally go into effect on October 17, 2005; however, there are several exceptions that make some provisions effective upon enactment (April 20, 2005). You can determine when other earlier changes are effective by referring to www.clla.org/newswire/new_code_docs/ccla-PubLaw109-8-effectivedates.pdf. For example, Sections 308, 322 and 330, all relating to matters involving the homestead exemption are effective on the date of enactment, as provided in Section 1501(b)(2). Section 324, concerning the district courts' exclusive jurisdiction over matters pertaining to professions employed in bankruptcy cases, applies to cases filed after the date of enactment.

There will be technical corrections to the bill which will address procedural anomalies and certain substantive issues in the Reform Act prior to the effective date later this year.

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