

May, 2006

legal update



Amendments To The Bankruptcy Code

*By Michael J. Beyma, Esq.
and Timothy P. Johnson, Esq.*



Most provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") became effective on October 17, 2005. A major change for consumer bankruptcy is that if petitioners have sufficient income, they will be required to repay part of their debts. The Honorable John C. Ninfo, II has already generally made this the practice in the Bankruptcy Court in Rochester by requiring persons with sufficient income to file a Chapter 13 proceeding. Various other changes in the Act will undoubtedly increase the cost of filing personal bankruptcy cases and this could result in a lower number of filings. This article will primarily address the major changes which affect business creditors and debtors.

Preferences. The Act tightens the requirements for, and expands the defenses to, preference actions. Generally, a preference is a payment by a debtor within 90 of its bankruptcy filing for a pre-existing debt. If a creditor receives a preference, he may have to return the payment. Defendants may defend such a preference action by proving that the payment was made in the ordinary course of business. Under former law, a defendant had to prove that the payment was made in the ordinary course of business between the creditor and debtor (the subjective test, which could be proven by the creditor's testimony) and according to ordinary business terms (the objective test, which often required a costly expert witness). Under the new Act, a creditor only has to prove one of the two tests. In addition, preference actions on business debts of less than \$5,000 are subject to dismissal and preference actions for business debts of less than \$10,000 must be brought where the creditor is located (thereby making it more costly for the debtor/trustee to bring the action).

Commercial Leases. Under the previous law, a debtor had 60 days to assume or reject a non-residential lease. A court could, and often did, extend this period indefinitely. The Act provides for an initial period of 120 days and (if Court approved) one extension of 90 days. Landlords must approve any additional extensions. This change gives commercial landlords more power over bankrupt tenants.

Reclamation. Under the old law, sellers could reclaim goods sold to insolvent bankrupts before they filed bankruptcy if the seller acted within 10 days of the Bankruptcy filing. The Act lengthens this period to the longer of 45 days after sale of the goods or 20 days after the filing. In addition, if a creditor is unpaid for goods sold within 20 days of filing, they may file an administrative claim for the

300 Bausch & Lomb Place
Rochester, NY 14604
(585) 258-2800

www.underbergkessler.com

1900 Main Place Tower
Buffalo, NY 14202
(716) 848-9000

amount unpaid. (Administrative claims are paid after secured creditors but before unsecured creditors).

Creditors' Committee. The Act mandates that creditors' committees (1) provide information to creditors; (2) solicit and receive creditors' comments; and (3) upon Court order, provide creditors additional reports. It is unclear how creditors' committees might treat confidential information under the new Act. In addition, it appears that the Act may deter debtors from giving creditors' committees confidential information because it could be distributed to many parties.

Plan of Reorganization. The previous Bankruptcy Code allowed debtors a 120 day exclusive period to file a plan of reorganization, but this period could be indefinitely extended by the Court. The Act sets an outside exclusive period of 18 months. This might motivate debtors to negotiate and formulate a plan earlier.

Chapter 11 Trustees. Appointments of Chapter 11 trustees to replace management of Chapter 11 debtors have been relatively rare in the past. The Act mandates that the United States Trustee appoint a Chapter 11 trustee if there are reasonable grounds to believe that a debtor's management is guilty of fraud, dishonesty or criminal conduct in management or financial reporting.

New York Homestead Exemption. In a related action, New York State has increased the homestead exemption which may be claimed by New York residents who file for bankruptcy from \$10,000 to \$50,000 per person. This means that a husband and wife filing for bankruptcy keep the first \$100,000 of equity in their home as opposed to their creditors sharing in part of the same.

If you have any questions, contact Mike Beyma, Tim Johnson or your Underberg & Kessler attorney.