BAPCPA’s Actual Impact in Chapter 11 Cases

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Introduction

This paper addresses some of the provisions of Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (“BAPCPA”), which altered the Bankruptcy Code in numerous ways, largely with the care of a barbarian swinging a club. October 17, 2005 was the effective date of the bulk of the amendments. This paper looks at developments over the past five years. A comprehensive analysis of the cases applying BAPCPA provisions is not possible. Even more challenging is the effort to determine whether BAPCPA had the consequences its drafters intended, which I leave to others. This paper focuses on selected BAPCPA provisions, primarily in business cases, and their treatment in reported decisions.

1. INVOLUNTARY PETITIONS

Prior to 2005, the Ninth Circuit held that the language of § 303(h) did not disqualify a creditor from being a petitioning creditor just because there was a dispute as to a portion of the creditor’s claim, where the undisputed portion still satisfied the threshold.

Congress amended the portion of § 303 at issue in Focus Media in 2005 as part of BAPCPA. The amendments added language that the bona fide dispute concerning a creditor’s claim could be “as to liability or amount.”

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1 Rob Charles is a partner at Lewis and Roca LLP. The views expressed in this paper are no doubt abhorrent to Lewis and Roca and its clients.
5 All citations are to the Bankruptcy Code, Title 11, United States Code, except where otherwise indicated.
6 In re Focus Media, 378 F.3d 916, 926 (9th Cir. 2004).
7 See 11 U.S.C. § 303(h)(1) “the debtor is generally not paying such debtor’s debts as such debts become due unless such debts are the subject of a bona fide dispute as to liability or amount . . . .”).
Courts disagree on whether this language rejects the *Focus Media* approach. The overwhelming majority of courts hold that the addition of “as to liability or amount” overrules cases like *Focus Media* so a dispute as to any amount of the debt disqualifies the creditor, even if the undisputed portion is well above the threshold.\(^8\) A few disagree.\(^9\) The problem with the cases on both sides is that there is only minimal analysis of whether and why § 303’s amendment should change the result.

*Euro-American* is a typical case that finds § 303’s amendment overruled *Focus Media*. Its analysis does no more than note the prior rule, state the fact that there was an amendment, and then conclude that the amendment must have changed the result, without analyzing why.\(^{10}\) Here is the court’s entire analysis:

> The phrase “as to liability or amount” was added to § 303(b)(1) and (h)(1) following the phrase “*bona fide* dispute” by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. *Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, Pub.L. No. 109-8, §§ 1234(a)(1)(A) and (a)(12), 119 Stat. 23 (April 20, 2005). Prior to the amendment, a dispute limited to the amount was not a “*bona fide* dispute” as to the entire claim, at least under § 303(b)(1). E.g., *In re Focus Media, Inc.*, 378 F.3d 916, 926 (9th Cir. 2004) (“a dispute as to the amount of the claim gives rise to a *bona fide* dispute only when (1) it does not arise from a wholly separate transaction and (2) netting out the claims of the debtors could take the petitioning creditors below the amount threshold of § 303”) (internal quotation marks omitted); *Key Mech. Inc. v. BDC 56 LLC* (*In re BDC 56 LLC*), 330 F.3d 111, 120 (2d Cir. 2003) (*bona fide* dispute exists “where a claim for offset arises out of the same transaction and is directly related to the creditor's underlying claim, and, if valid, could serve as a complete defense to that claim”); see *In re Sims*, 994 F.2d 210, 221 (5th Cir. 1993) (claim that petitioner failed to mitigate damages would serve only to reduce creditor's damage and

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\(^9\) *Compare In re Demirco Holdings, Inc.*, 2006 WL 1663237, 3-4 (Bankr. C.D. Ill. 2006) (“With the dearth of committee comments and legislative history available to interpret BAPCPA, this Court cannot presume that Congress added the phrase ‘as to liability [or] amount’ with the intent that claims of involuntary petitioners must now be fully liquidated . . . so that no dispute exists as to any portion of such claims.”).

\(^{10}\) 357 B.R. at 712 n.8.
not create *bona fide* dispute). The 2005 amendment presumably eliminated the second part of the test. *See* 2 ALAN N. RESNICK & HENRY J. SOMMER, COLLIER ON BANKRUPTCY ¶ 303.03[2][b], at 303-30 (15th rev. ed. 2006). As a result of the amendment, any dispute regarding the amount that arises from the same transaction and is directly related to the underlying claim should render the claim subject to a *bona fide* dispute. *Id.*

It is odd that *Euro-American* relies on Collier’s for support of its belief that the 2005 amendment changed the test, because Collier’s analysis is neutral at best, and in fact slants slightly towards the view that the amendment did not overrule the *Focus Media* approach. Yet, numerous cases follow *Euro-American*’s bald conclusion without questioning it.

The best explanation as to why § 303’s amendment should change the *Focus Media* rule was in *Excavation, Etc.* In *Excavation*, the court reasoned that under *Focus Media* “the only dispute as to amount is a dispute over the entire claim, or at least a big enough dispute that netting out would take the claim below the monetary threshold.” Therefore, the court concluded that reading the phrase “liability or amount” to allow a partially-disputed claim to stand read the amendment out of the statute. In short, the *Excavation* court appears to be saying Congress intended to do something by its amendment, and allowing continued application of *Focus Media* would render the amendment meaningless as it would return the issue to the *status quo ante*.

There is reason to doubt *Excavation*’s analysis. In *DemirCo Holdings, Inc.*, the court reasoned that the purpose behind the amendment was to clarify Congress’ original legislative intent. *DemirCo* reasoned that the phrase “*bona fide dispute*” was originally meant to encompass disputes as to liability or amount, but that courts had gradually begun to focus on liability, only. Accordingly, adding the phrase “as to liability or amount” just clarifies Congress’ original intent.

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11 *Id.*
12 *2 COLLIER ON BANKRUPTCY ¶ 303.11[2] at 303-34 (16th Ed. 2010) (rhetorically asking “Why shouldn’t the undisputed, noncontingent portion of a petitioning creditor’s claim count? Why disqualify the creditor in toto? Why effectively bar that creditor’s access to the bankruptcy forum?”).*
15 *Id.*
17 *Id.*
18 *Id.*
DemirCo declined to find that the amendments overruled the Focus Media approach:

With the dearth of committee comments and legislative history available to interpret BAPCPA, this Court cannot presume that Congress added the phrase ‘as to liability and amount’ with the intent that the claims of involuntary petitioners must now be fully liquidated either by agreement or judgment so that no dispute exists as to any portion of such claims. Without clear legislative intent, this Court cannot presume such a change in the law and declines to do so.19

DemirCo has only been cited twice, once by the same court in a later decision in the same matter, and once by a case that declined to follow it.

There are two possible ways that it may be possible for a creditor with a disputed portion of its claim to qualify as a petitioning creditor.

The first is to take on the uphill fight. The reasoning in the current cases superficial and unpersuasive. One could argue the standard for when there is a bona fide dispute as to the amount of a claim. The objective standard for when there is a bona fide dispute is akin to the summary judgment standard: “[I]f there is either a genuine issue of material fact that bears upon the debtor’s liability, or a meritorious contention as to the application of law to undisputed facts, then the petition must be dismissed.”20 The statement of the rule in Lough lends further support to the notion that Congress was trying to get courts to stop focusing on a dispute about liability to the exclusion of considering disputes as to the amount of the claim. The legal question is whether there are sufficient claims that meet a dollar threshold. Given that question, a dispute about a portion of the claim that is well above the threshold would not be “material” and therefore does not meet the “bona fide dispute” standard. If a court were to follow this argument, it is honoring Congress’ intent that the court consider both disputes as to liability and amount, while following the directive that the dispute only disqualify the creditor if it is bona fide.

A challenge in making this argument is that it comes close to an argument made by the losing party in one of the most-often cited cases for the view that the amendments overruled the Focus Media approach.21 In the party’s brief, it made an argument that to be a bona fide dispute the dispute had to reduce the claim

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20 *In re Vortex Fishing Sys., Inc.*, 277 F.3d 1057, 1064 (9th Cir. 2002) (quoting *In re Lough*, 57 B.R. 993, 996-97 (Bankr. E.D. Mich. 1986)).
below the threshold amount. While similar to the argument suggested, it did not reference how the test for a *bona fide* dispute mirrors the summary judgment standard. Looking at the *Mountain Dairies* decision, one cannot determine what argument was made. But if the opponent is diligent, it will find the brief and it would suggest that this argument has been rejected before.

Collier’s suggests the other approach to getting around the amendment: the creditor could simply assert only the undisputed portion of its claim. In one case a creditor who was previously disqualified later successfully commenced an involuntary petition by asserting only the undisputed portion of its claim.

2. **TRUSTEE COMPENSATION**

Compensation for trustee’s fees is subject to a reasonableness standard and must be for actual, necessary services rendered by the trustee. Since the BAPCPA amendments, chapter 7 trustees are no longer subject to the factors listed in § 330(a)(3). Rather, chapter 7 trustees are to receive compensation as a commission based on § 326. Courts, however, disagree as to what this means.

The basic standard for compensation to a trustee is that it must be reasonable and for actual, necessary services. According to the Ninth Circuit, services that were not reasonably likely to benefit the debtor’s estate or necessary to the administration of the case will not be compensated.

The BAPCPA amendments to the Bankruptcy Code removed chapter 7 trustees from § 330(a)(3)’s list of professionals. Accordingly, compensation for chapter 7 trustees can no longer be based exclusively on the factors enumerated in § 330(a)(3). Additionally, § 330(a)(7) was added stating that reasonable compensation for a trustee is to be in the form of a commission based on § 326.

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22 2 COLLIER ON BANKRUPTCY ¶ 303.11[2] at 303-34 (16th Ed. 2010) (“Of course, as a practical matter, the prudent creditor will take the suggestion loudly whispered by some courts and simply assert the undisputed, non-contingent portion of its claim (citing In re Tobacco Road Assocs., LP, 2007 U.S. Dist. LEXIS 22990 (E.D. Pa. 2007)).

23 Compare In re Hentges, 351 B.R. 758 (Bankr. N.D. Okla. 2006) (dismissing involuntary petition in part because bank’s claim was disputed in amount), with In re Hentges, 350 B.R. 586, 596-598 (Bankr. N.D. Okla. 2006) (referred to as “Hentges II,” the bank’s claim was allowed to stand because it asserted only the undisputed amount); accord In re Staxxring, Inc., 2010 WL 2218935, 2 (N.D. Tex. 2010) (allowing creditor to be a petitioning creditor where it filed only based on the undisputed portion of its claim).


25 Strand, 375 F.3d at 860.

At least one court in the Ninth Circuit has examined the reduction of fees for chapter 7 trustees since BAPCPA. The McKinney court held that the BAPCPA amendments, namely § 330(a)(7), created a presumption that the statutory maximum allowed under § 326 is reasonable compensation. However, the court also held that the trustee is not automatically entitled to the statutory maximum. The trustee must still meet the reasonableness test for actual, necessary services. If after reviewing time records and other relevant information and factors, the court determines that the statutory cap of § 326 is disproportionate to the value of the services rendered, the court has the discretion to award a “reasonable commission” that is lower than the statutory maximum.

The Phillips court rejected McKinney’s presumption holding, but agreed that a trustee’s compensation must still be reasonable. The court in Phillips held that Congress’s removal of chapter 7 trustees from § 330(a)(3) prevents courts from considering the factors enumerated in that section. Courts, however, may consider the remaining Johnson factors in determining what is reasonable compensation. The court examined other post-BAPCPA cases addressing this issue and found that all of the courts held that the statutory maximum is not an entitlement, but merely a cap on reasonable compensation to chapter 7 trustees.

3. RECLAMATION

Absent having a secured claim, which might be an administrative expense, the next best position for a creditor is to have a “priority” unsecured claim. In most instances, where a creditor has provided goods pre-petition, the creditor’s claim for those goods will be treated as a non-priority, unsecured claim against the estate. In certain circumstances, however, the creditor may be entitled to a priority, via an administrative expense, for the value of goods provided to the debtor.

28 Id. at 493.
29 Id.
30 Id. at 494.
31 Id.
33 Id. at 385.
34 These remaining factors are (1) the novelty and difficulty of the questions; (2) the skill requisite to perform the service properly; (3) the preclusion of other employment due to acceptance of the case; (4) the amount involved and the results obtained; (5) the “undesirability” of the case; and (6) whether the fee is fixed or contingent. Johnson v. Georgia Highway Express, Inc., 488 F.2d 714, 717-719 (5th Cir. 1974).
35 Id.
36 Id. at 388-89.
Under non-bankruptcy law, a seller of goods is entitled to “reclaim” goods delivered to a buyer who is insolvent at the time of delivery. This is known as a “reclamation claim” and arises under Article 2 of the Uniform Commercial Code, which governs sales of goods. Under Article 2, a seller has the right to reclaim goods from the buyer up to 10 days after receipt of the goods by the buyer.

The Bankruptcy Code preserves the right of a seller to reclaim goods under UCC Article 2. Provided the seller makes a timely written demand for reclamation of the goods, the seller is entitled to reclaim the goods from the buyer/debtor. In many cases, rather than giving the goods back to the seller, the debtor either (i) gives the seller a priority, administrative expense claim for the value of the goods subject to reclamation or (ii) grants the seller a lien in the goods or other property for this value.

Before BAPCPA, § 546(c) simply preserved a seller’s Article 2 right to reclaim goods. In other words, if the seller had made a demand for reclamation within 10 days of the debtor’s receipt of the goods (or 10 days after the petition date, if the UCC deadline fell after the petition date), then the seller had asserted a right to receive an expense of administration for the value of these goods.

Under BAPCPA, however, Congress amended § 546(c) to expand the reclamation claim of a seller beyond what is permitted in the non-bankruptcy context under Article 2 of the UCC. Now, a seller may assert a reclamation claim for the value of any goods sold within 45 days of the petition date. To obtain the benefit of this expanded period, the seller must make a written demand for reclamation within 45 days of receipt of the goods by the debtor or 20 days after the petition date (if the 45-day period from receipt falls after the petition date). Even if the seller fails make a timely written demand for reclamation, the seller is still entitled to an administrative expense claim for the value of goods delivered within 20 days of the petition date.

To make a written demand after the petition date, the seller should file a notice of reclamation claim in the buyer’s bankruptcy case. Even in cases where the seller has made a timely written demand for reclamation prior to the petition date, the seller should promptly file a notice of reclamation claim in the bankruptcy case.

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38 UCC § 2-702(1).
39 Id.
41 Id.
43 Id.
44 11 U.S.C. §§ 503(b)(9) and 547(c).
after the petition date, or should also seek to enforce a right to recover the reclaimed goods. 45

Thus where a creditor has sold goods 46 to a debtor, the vendor or supplier will be entitled to an administrative expense for the value of any goods delivered within 45 days of the bankruptcy filing. As an administrative expense, this claim must be paid before any payment on non-priority, unsecured claims. The administrative expense is not defeated by the rights of a secured creditor. 47

Unlike most expenses of administration, the reclamation claim is a prepetition claim for offset purposes. 48

4. AUTOMATIC STAY

4.1. Single Asset Real Estate

BAPCPA added language to the Code regarding single-asset real estate cases. Specifically BAPCPA added that a creditor cannot seek stay relief until 30 days after the court has determined the case to be a single asset real estate case. 49 This provision is an alternative to the 90 days after order of relief provision already included in the Code. It seems a debtor that does not identify itself as a single asset real estate debtor can delay the impact of § 362(d)(3) until the court determines the debtor’s status.

BAPCPA also modified the definition of single asset real estate. 50 The new provisions require that the property generates substantially all of the gross income of the debtor. 51 The interesting question is whether the debtor conducts a

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47 See Phar-Mor, Inc. v. McKesson Corp., 534 F.3d 502 (6 th Cir. 2008).
48 In re Brown & Cole Stores, LLC, 375 B.R. 873 (9th Cir. BAP 2007).
51 Id. BAPCPA also added language exempting family farmers from single asset real estate cases.
substantial business other than operating real property. Finally, BAPCPA removed any cap on the total debt a single asset real estate case can have.

In the past five years, courts have addressed a variety of SARE issues. The § 362(d)(3) alternative is not limited to consensual secured creditors. A motion seeking relief under § 362(d)(3) is premature if filed before the expiration of the 90 day period. The bankruptcy court should rarely extend the 90-day period. The combination of SARE provisions undercuts the secured lender’s usual argument that a SARE case should be dismissed or the automatic stay terminated for alleged bad faith.

5. UNEXPIRED LEASES

5.1. § 365 Lease Assumption/Rejection For Non-Residential Real Property

5.1.1. Deadline

Under BAPCPA, the trustee or DIP has 120 days after the petition date to assume or reject unexpired leases of nonresidential real property where the debtor is the lessee. Otherwise, the leases are deemed rejected. “The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.” The court’s approval, not merely the DIP’s request, must occur within the period. Thereafter, the time period for assuming a lease may only be extended upon the written consent of the lessor. One court held that seeking assumption is

58 Id.
59 Id. § 365(d)(4)(B)(i) (emphasis added).
61 Id. § 365(d)(4)(B)(ii).
sufficient, the court need not act on a timely request within the periods, which seems contrary to the plain language of the statute.

5.1.2. Non-Monetary Defaults

Section 365(b)(1)(A) requires the trustee or debtor in possession assuming an unexpired lease to cure defaults. The only exceptions are for ipso facto provisions and “the satisfaction of any penalty rate or penalty provision relating to a default arising from any failure by the debtor to perform nonmonetary obligations under the executory contract or unexpired lease.” When defaults occur that cannot be cured, the contract cannot be assumed. The same was true as to leases before BAPCPA. A store lease, for example, may require continuous operations during normal business hours. If the store is closed for a day, that default is a historic fact and can never be “cured.” “In 2005 Congress revised the language of § 365(b)(2)(D) by including the word “penalty” as a modifier to the word “provision,” making it clear that most non-monetary defaults are not exempted from the cure requirements.” However, Congress rejected this rule in opaque language in § 365(b)(1)(A), but only as to cure of historic non-monetary defaults under a nonresidential real property lease so long as the condition has been “cured by performance at and after the time of assumption in accordance with such lease.”

6. SECTION 366 UTILITY DEPOSITS

BAPCPA revised § 366 to reduce the flexibility of a DIP or trustee seeking to provide a utility with adequate assurance of payment by limiting what could be offered and empowering the utility if the trustee or DIP has not provided
“adequate assurance of payment for utility service that is satisfactory to the utility,” particularly in chapter 11.\textsuperscript{68} The court had some power to modify the amount of an assurance of payment. The utility could offset a security deposit without any order of the court.\textsuperscript{69}

In response, debtors in large cases developed a “first day” motion practice that attempted to circumscribe, with notice to utilities, the rights of the utility and to require the utility to come to court to dispute the offer of adequate assurance or to terminate service.\textsuperscript{70} This practice implicitly rejected the proposition that absent an agreement acceptable to the utility, and tender of payment, court intervention was required to protect against termination of utility service.\textsuperscript{71}

The protections afforded to utilities have been sought by a number of vendors, with mixed success.\textsuperscript{72}

7. **PREFERENCES**

7.1. **Ordinary Course of Business Defense**

In many cases, not only must a creditor work to get payment on its claim, it must also worry about holding on to what it has already been paid. Perhaps the most painful consequence of a debtor’s bankruptcy filing is a preference suit. Under the Bankruptcy Code, a trustee or debtor-in-possession may recover a “preference,” which is a transfer of an interest of the debtor in property (1) to or for the benefit of a creditor, (2) on account of an antecedent debt, (3) while the debtor is insolvent, (4) within 90 days before the filing of the petition (or one year if the transfer was to an “insider” of the debtor), and (5) that enables the creditor to receive more than it would have received on liquidation if the transfer had not

\begin{itemize}
\item \textsuperscript{68} See \textit{In re Astle}, 338 B.R. 855 (Bankr. D. Idaho 2006) (§ 366(c)(2) applies in chapter 11, not chapter 12).
\item \textsuperscript{69} 11 U.S.C. § 366(c).
\item \textsuperscript{70} See \textit{In re Circuit City Stores, Inc.}, 2009 WL 484553 (Bankr. E.D. Va. 2009); see also \textit{In re Syroco Inc.}, 374 B.R. 60 (Bankr. D. Puerto Rico 2007); but see \textit{In re Lucre, Inc.}, 333 B.R. 151 (Bankr. W.D. Mich. 2005).
\item \textsuperscript{71} See \textit{In re Bedford Town Condominium}, 427 B.R. 380 (Bankr. D. Md. 2010) (court could intervene before debtors made payment and could allow debtors to build up security deposit over time).
\item \textsuperscript{72} See \textit{In re Darby}, 470 F.3d 573 (5\textsuperscript{th} Cir. 2006) (cable television service not a utility); \textit{In re New Rochelle Telephone Corp.}, 397 B.R. 633 (Bankr. E.D.N.Y. 2008) (provider of telecommunications services provided for resale was a utility).
\end{itemize}
been made.\textsuperscript{73} A trustee may have up to three years less a day from the petition date to assert preference claims.\textsuperscript{74}

In most instances, where a creditor has received a payment from a debtor within 90 days of the bankruptcy filing, the trustee will not have difficulty establishing that the payment qualifies as a “preference.” Thus litigation in preference actions typically revolves around one or more of the affirmative defenses to a preference claim found in § 547(c).

Of these defenses, one often litigated is the “ordinary course” defense of § 547(c)(2). In BAPCPA, Congress made it easier for preference defendants to argue this defense. Previously, to prevail on an ordinary course defense, the defendant had to prove three elements: (i) the debt was incurred in the ordinary course of the debtor’s business, (ii) the payment was made in the ordinary course of business between the debtor and the payee, and (iii) the payment was made according to “ordinary business terms” (i.e., according to the market). Now, a defendant need not show that a payment was both “ordinary” in regards to the course of dealing between the parties and in regards to the market. Rather, a defendant must only show that the payment was either within the ordinary course of dealing between the parties or in ordinary terms according to the market.\textsuperscript{75}

Though a small change in wording, this amendment seems to have made it easier for creditors to prove their payments were made in the ordinary course.\textsuperscript{76}

\textbf{7.2. Small Dollar Venue Provision}

BAPCPA amended the venue provision for proceedings to require suit on small matters in the defendant’s venue.\textsuperscript{77} Due to poor drafting, the limitation for actions “arising in or related to such case” does not include a reference to proceedings “arising under title 11.”\textsuperscript{78} Courts disagree whether the limitation applies to small preference actions, which arise under title 11.\textsuperscript{79}

\textsuperscript{73} 11 U.S.C. § 547(b).
\textsuperscript{74} 11 U.S.C. § 546(a).
\textsuperscript{75} 11 U.S.C. § 547(c)(2)(A) and (B).
\textsuperscript{77} 28 U.S.C. § 1409(a) and (b).
\textsuperscript{79} Compare \textit{Moyer v. Bank of America} (\textit{In re Rosenberger}), 400 B.R. 569 (Bankr. W.D. Mich. 2008) (restriction in applicable); \textit{Dynamerica Mfg. LLC v. Johnson Oil Co. LLC} (In
8.  CHAPTER 11

8.1.  § 1121 Plan Exclusivity

BAPCPA amended § 1121 to place an outside limit on a debtor’s plan filing and solicitation exclusivity. The change was presumably intended to speed up the chapter 11 process and reduce cost. Exclusivity disputes rarely reach reported decisions, except in the small business case context discussed below. One decision denied a debtor’s request to extend exclusivity without reference to the BAPCPA changes. A pre-BAPCPA decision found, among other things, that a debtor’s filing a plan with a non-debtor proponent did not waive the debtor’s exclusivity.

8.2.  § 1104(e) Appointment Of Trustees

One reported decision mentions the new ground for the appointment of a trustee on a motion brought by the United States Trustee ("UST"). BAPCPA added § 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.

Other than mentioning secondary authorities on what might constitute “reasonable suspicion”, and reciting the statute, the court in 1031 Tax Group simply did not find cause for appointment of a trustee.

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83 In re The 1031 Tax Group, LLC, 374 B.R. 78 (Bankr. S.D.N.Y. 2007).
84 11 U.S.C. § 1104(e).
85 Norton Annual Survey of Bankruptcy Law Part III § 34 (Sept. 2006); 7 Collier on Bankruptcy ¶ 1104.02.
8.3. § 1112 Expanded Grounds For Dismissal Or Conversion

BAPCPA amended § 1112(b) to increase the likelihood that chapter 11 cases would be converted or dismissed absent proof of unusual circumstances.\(^{86}\) Additional factors were added to the definition of cause for relief under § 1112(b) and dismissal or conversion is mandatory if the court finds cause.\(^{87}\) The factors are non-exclusive even though the list is conjoined with “and” before the last element, rather than “or.”\(^{88}\)

Yet the cases seem to reflect the continued balancing of factors by the courts in ways that are familiar from reading the pre-BAPCPA decisions. For example, the Third Circuit affirmed dismissal of a bankruptcy petition filed to stop pending litigation where the sole reorganization purpose offered was an orderly liquidation and there was no legitimate bankruptcy purpose.\(^{89}\)

One impact of BAPCPA is that the debtor may attempt to demonstrate the presence of “unusual circumstances” to avoid dismissal or conversion after the movant meets its burden to demonstrate cause.\(^{90}\) “Generally, unusual circumstances require a showing that there is a reasonable likelihood that a Chapter 11 plan will be confirmed within a reasonable period of time.”\(^{91}\) In contrast, there is a good argument that the element “substantial or continuing loss to or diminution of the estate and the absence of a reasonable likelihood of rehabilitation” means there is cause for conversion or dismiss in the context of every liquidating chapter 11 case. “In this context, rehabilitation means to put

\(^{86}\) See generally Clifford J. White III & Walter W. Theus, Jr., Chapter 11 Trustees and Examiners After BAPCPA, 80 Am. Bankr. L.J. 289, 300-01 (Summer 2006).


\(^{89}\) In re 15375 Memorial Corp. v. Bepco, L.P., 589 F.3d 605 (3d Cir. 2009). See also In re Bartle, 560 F.3d 724 (7th Cir. 2009) (where no prospect of plan confirmation, case properly dismissed); In re Owens, 552 F.3d 958 (6th Cir. 2009) (case filed in response to marital dissolution proceeding dismissed); In re Premier Automotive Services, Inc., 492 F.3d 274 (4th Cir. 2007) (case filed two days before expiration and non-renewal of tenancy properly dismissed); Squires Motel, LLC v. Gance, 426 B.R. 274 (N.D.N.Y. 2010) (two party dispute, case dismissed).


back in good condition and reestablish on a sound basis.” 92 A debtor’s intention to liquidate (rather than rehabilitate), arguably demonstrates that there is no likelihood of rehabilitation. 93 The burden then is to convince the court to exercise its discretion to neither dismiss nor convert upon proof of the possibility of confirming a plan.

8.4. Small Business Cases94

The small business case provision of § 1121(e) was amended to add an outside limit of 300 days to file a plan and disclosure statement.95 The plan must be confirmed within 45 days of filing.96 The small business provisions are mandatory, the debtor no longer opts in.97 The court has discretion for remedies where the debtor fails to provide documents or information required in a small business case.98

Failure to either obtain a timely extension for good cause99 before expiration of the deadline,100 or meet the deadlines is cause for conversion or dismissal.101 Seeking

93 In re BH S & B Holdings, LLC, 439 B.R. at 347-48 (citing Loop Corp. v. U.S. Trustee, 379 F.3d 511 (8th Cir. 2004)); see In re Quail Farm, LLC, 2010 WL 1849867 (Bankr. N.D.W.Va. 2010) (“rehabilitation requires, ‘at minimum, the prospect of re-establishing a business.’” (quoting In re Vallambrosa Holdings, L.L.C., 419 B.R. 81, 89 (Bankr. S.D. Ga. 2009)); In re ARS Analytical, LLC, 433 B.R. at 862 (“Rehabilitation is more than reorganization. It signifies something more, such as “to put back in good condition” or “to re-establish on a firm, sound basis.” It contemplates the successful maintenance or reestablishment of the debtor's business operations. Rehabilitation in Chapter 11 starts with a confirmable plan.”) (citations omitted); In re Westgate Properties, Ltd., 432 B.R. 720 (Bankr. N.D. Ohio 2010) (same); In re LG Motors, Inc., 422 B.R. 110 (Bankr. N.D. Ill. 2009) (“The issue of rehabilitation for purposes of Section 1112(b)(4)(A) ‘is not the technical one of whether the debtor can confirm a plan, but, rather, whether the debtor's business prospects justify continuance of the reorganization effort.’”) (citations omitted).
99 See In re Darby General Contracting, Inc., 410 B.R. 136, 143 (Bankr. E.D.N.Y. 2009) (“the plain language of Section 1121(e)(3) requires only that ‘the Court find by a preponderance of evidence that it is more likely than not that the court will confirm a plan within a reasonable amount of time, not necessarily the plan which is before the Court at the time of hearing on the extension motion.’”) (citation omitted); In re AMAP Sales & Collision, Inc., 403 B.R. 244 (Bankr. E.D.N.Y. 2009).
to amend the petition to undo the small business case designation is a poor alternative. A Florida court filled a gap in the statute and found that after expiration of the small business debtor’s exclusivity, creditors were free to file a plan.

8.5. Creditors Committees

BAPCPA imposed a new obligation on creditors and equity security holders committees. Such committees must:

provide access to information for creditors who – hold claims of the kind represented by that committee; and are not appointed to the committee; solicit and receive comments from the creditors described in subparagraph (A); and be subject to a court order that compels any additional report or disclosure to be made to the creditors described in subparagraph (A).

Meeting statutory information-sharing obligations while complying with information protection obligations has spawned a standard practice of committee “protocol orders,” and a cottage industry in committee website production and maintenance. Not surprisingly, the concept started as a Delaware “first day order.” It prohibited the committee from disclosing any non-public information of the debtors or any information protected under state or federal privilege law.

The first reported opinion on committee protocols was a decision in the Refco case. Judge Drain analogized the committee’s new responsibilities under Section 1102(a)(3) to those of a trustee furnishing information to a party in interest under Section 704(7). Case law interpreting that provision holds that:

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104 This section is drawn from an earlier paper by my partner Susan M. Freeman presented to the American Bankruptcy Institute.
106 In re FLYi, Inc., U.S. Bankr. D. Del., No. 05-20011 [Dkt. 145] (Order Providing That Creditors’ Committees are not Authorized or Required to Provide access to Confidential Information of the Debtors or to Privileged Information).
(1)…a trustee’s duty under section 704(7) is fairly extensive, as [it] places the burden of providing requested information on the trustee, and reflects the overriding duty to keep parties in interest informed…

(2)…the duty to provide information under section 704(7) is not unlimited…a trustee may obtain a protective order against disclosure of information…if disclosure would result in a waiver of the attorney-client privilege…or of information that is propriety and confidential…

(3)…a trustee’s right to a protective order under section 704(7) is informed by the trustee’s fiduciary duties…to creditors and the estate.\textsuperscript{108}

Judge Drain also cited a Bankruptcy Act case holding that a committee was not required to forward to each creditor all of the raw data it receives and considers when meeting its duties under Section 339(1) of the Bankruptcy Act to report to creditors about the progress of a Chapter XI case.\textsuperscript{109} Finally, he considered the duties and functions of a committee, and pre-BAPCPA cases concerning confidentiality restrictions in the context of those duties and functions.\textsuperscript{110}

The order implementing the committee disclosure statute in light of these authorities and concerns is attached in full to the \textit{Refco} opinion. The order meets several concerns:

- First, it authorizes the committee to withhold from disclosure information:

  (a) that could reasonably be determined to be confidential and non-public or proprietary,

  (b) the disclosure of which could reasonably be determined to result in a general waiver of the attorney-client or other applicable privilege, or

  (c) whose disclosure could reasonably be determined to violate an agreement, order or law, including applicable securities laws.\textsuperscript{111}

- Second, the order provides that the committee is to take into account a requesting party’s agreement to be bound by confidentiality and/or trading

\begin{footnotes}
\footnote{108 Id.. at 193 (citations omitted).}
\footnote{109 Id. at 194, citing \textit{In re Gilchrist Co.}, 410 F. Supp. 1070 (E.D. Pa. 1976).}
\footnote{110 Id. at 195-97.}
\footnote{111 Id. at 198, 200-01.}
\end{footnotes}
restraints in determining whether to release protected information.112

- Third, it provides for a committee website providing creditor access to specified information, both public information and committee-generated reports. The website also provides a mechanism for creditors to submit questions, comments, and requests for access to information.113

- Fourth, and of particular concern to the professionals representing the committee, the order exculpates them liability in complying with their duties under Section 1102(b)(3), except to the extent the act or omission is determined by a final, non-appealable order to have constituted a breach of fiduciary duty, gross negligence or willful misconduct or breach of a confidentiality agreement or order.114 The Refco opinion cites cases recognizing qualified immunity from suit of a committee and its professionals, and says the exculpation is co-existent with such immunity.115 Exculpation of professionals in a reorganization plan is common,116 and bankruptcy courts certainly have authority to grant equitable relief, including an injunction against litigation, with respect to activities of a trustee or committee participating in administering the case.117

- Finally, the order sets forth procedures for bringing disputes over information sharing to the court by motion.118

Most bankruptcy cases involve estates with considerably less resources than Refco, with fewer creditors and with professionals having smaller numbers of people to devote to writing website updates and the like. Bankruptcy courts have repeatedly recognized that committee counsel must meet their responsibilities in a manner that will not waste estate assets through excessive and inefficient work.119

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112 Id. at 198, 201-02.
113 Id. at 198, 200.
114 Id. at 198, 202-03.
115 Id. at 198, 203, citing In re PWS Holding Corp., 228 F.3d 224, 246 (3d Cir. 2000); Pan Am Corp. v. Delta Air Lines, Inc., 175 B.R. 438, 514 (S.D.N.Y. 1994).
116 In re PWS Holding Corp., 228 F.3d at 245 (such releases of professionals are “a commonplace provision in Chapter 11 plans”).
117 Barton v. Barbour, 104 U.S. 126, 26 L.Ed. 672 (1881) (trustee); In re Crown Vantage, Inc., 421 F.3d 970 (9th Cir. 2005) (and cases from other circuits cited therein) (trustee); In re Burstein-Applebee Co., 63 B.R. 1011, 1020 (Bankr. W.D. Mo. 1986) (committee); Diners Club, Inc. v. Bumb, 421 F.2d 396, 401 (9th Cir. 1970) (jurisdiction extends to the “protection and achievement of the goals for which the receivership or reorganization proceeding was instituted.”)
118 336 B.R. at 201-02.
119 E.g. In re Channel Master Holdings, Inc., 309 B.R. 855, 861 (Bankr. D. Del. 2004) (“we do not think that chapter 11 is a license to perform services and generate fees in a
Some courts have entered scaled-down protocol orders in smaller cases. In a California case, the committee’s request to be excused from operating a website for unsecured creditors was denied.120 In a Pennsylvania case, the committee expressly sought to avoid “the kind of disclosures warranted by a large case” in order to reduce administrative expenses, and to efficiently streamline compliance with the statutory requirement for the benefit of all the estate’s creditors.121 The protocol order in that case did provide for the committee to establish a website providing information of the sort listed in the Refco opinion, but it required quarterly instead of monthly reports, no non-public registration form for e-mailed case updates or non-public form for creditor questions and comments, and no e-mail address of committee counsel for creditor inquiries.122 In an Indiana case, the protocol order simply provided for limited sharing of non-confidential or public information in response to telephonic or written requests, along with express authority not to share non-public, confidential or privileged information.123 A Delaware order in another case included similar provisions and also expressly permitted, but did not direct, the committee to utilize a website to provide creditor access to materials the committee deemed relevant information.124

If a protocol order is sought, it may be helpful in dealing with creditors if the order expressly provides that access to confidential information cannot be given without a confidentiality agreement. The order should provide that the committee has no responsibility for the creditor’s compliance with the agreement, though, and no liability for the creditor’s breach of the agreement or violation of securities or other laws. Also, the protocol order should not limit the rights of parties, including committees and their constituents, to conduct Rule 2004 examinations or take other discovery.

Committee counsel in smaller cases may choose to forego a protocol order unless and until needed to respond to creditor demands. The authorities underlying such
protocols are cited and described in the *Refco* opinion, which recognizes the protocol order as in effect a “comfort” order for the committee professionals. 125 Committees generally include confidentiality and claims and stock trading restrictions in committee by-laws. Similar restrictions can be requested of committee constituents seeking information, a practice used before the BAPCPA amendments to the Code. 126 Committee counsel can send a form letter from time to time to the creditors, advising them of significant developments in the case, and advising that the committee will consider whatever comments and suggestions they may offer through a response to committee counsel.

**8.6. § 1114 Retirees’ Committees And Retiree Benefits**

Although the result was not driven by BAPCPA, the Third Circuit decided that § 1114 limits a debtor’s ability during bankruptcy to terminate “those retiree benefits that it could, consistent with plan documents, collective bargaining obligations, and the prescriptions of the Employee Retirement Income Security Act of 1974 (‘ERISA’), 29 U.S.C. §§ 1001-461, terminate unilaterally outside of bankruptcy.” 127

**8.7. § 1125 Adequate Information**

Section 1125 was revised to require discussion of tax consequences in the disclosure statement as well as a balancing of competing interests in determining the required information. 128 Additional flexibility was provided for disclosure in small business cases. 129 Prepetition solicitation of acceptances and rejections of a plan was authorized. 130 There are few reported decisions on disclosure statement issues after BAPCPA, but the bankruptcy court’s *Adelphia* decision is an interesting discussion of disclosure statement issues in a remarkably complex case including supplementary material to accompany the disclosure statement. 131

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125 *Refco*, 336 B.R. at 190.
126 *In re Handy Andy Home Imp. Centers, Inc.*, 199 B.R. 376 (Bankr. N.D. Ill. 1996) (power under Code § 107(b) and Bankruptcy Rule 9018 to enter confidentiality order without showing of good cause required by Fed. R. Civ. P. 26(c)); *see In re Texaco, Inc.*, 79 B.R. 560 (Bankr. S.D.N.Y. 1987) (furnishing confidential information can be handled judiciously by debtor and committee, and if not, by the court).
127 *In re Visteon Corp.*, 612 F.3d 210 (3d Cir. 2010).
130 11 U.S.C. § 1125(g).
8.8. § 1129 Tax Claims

The requirement of treatment of § 507(a)(8) allowed unsecured claims of governmental units primarily tax claims, in a chapter 11 plan, is governed by § 1129(a)(9)(C). Prior to BAPCPA, the claims could be paid in full (present value) over six years from the date of assessment.\(^{132}\) After the change, the claims may be paid in full (present value) over five years from the order for relief, but on terms no less favorable than the most favored nonpriority unsecured creditor under the plan.\(^{133}\) In response to cases that did not follow § 1129(a)(9)(C) as to secured § 507(a)(8) claims, such claims must receive the same treatment.

One reported decision addressed language that was not changed in BAPCPA, and found that the requirement of “regular” payments did not mean “equal”, so that a final balloon payment after other regular payments could satisfy the statute.\(^{134}\)

8.9. § 1141 Discharge Of Individual Debtors

Section 1141(d)(5) delays entry of an individual debtor’s discharge until completion of all payments under the plan; or the court grants the discharge after finding that unsecured creditors have been distributed not less than they would have recovered in chapter 7 and the plan can not be modified.\(^{135}\) The tension of the delayed discharge and ordinary chapter 11 practice was evidenced in an Eighth Circuit Bankruptcy Appellate Panel (BAP) case where the bankruptcy court’s decision to refrain from closing the case until entry of the discharge was affirmed as not being an abuse of discretion.\(^{136}\) The bankruptcy court also has discretion over whether to grant the individual debtor an early discharge.\(^{137}\) One court explained that the debtor must demonstrate, in addition to substantial consummation of the plan, that via collateral or otherwise, there is a high degree of certainty that the debtor will complete the plan payments.\(^{138}\) Another court

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\(^{137}\) In re Beyer, 433 B.R. 884 (Bankr. M.D. Fla. 2009) (early discharge denied where debtor would have had substantial tax benefits).

\(^{138}\) Id.
entered the discharge upon plan confirmation with a similar showing.\textsuperscript{139} A desire to avoid quarterly UST fees is not cause for the early discharge.\textsuperscript{140}

8.10. § 1141 Discharge Of Fraud And Tax Claims Against Corporate Debtors

Section 1141(d)(6) excludes certain government obligations from the discharge of a corporation.\textsuperscript{141} There are no reported decisions applying the statute.

9. ETHICS

As an aside by this author, few ethical areas seem more confused than the obligations of an individual debtor’s counsel to the debtor with respect to reaffirmation. For example, courts have held that post-BAPCPA, debtor’s counsel ethically cannot exclude advising and negotiating reaffirmation agreements from the scope of core services required for representing a consumer debtor.\textsuperscript{142} Yet the roles of counsel in advising the client, making an independent investigation and certification are inherently in conflict.\textsuperscript{143}

\textsuperscript{139} \textit{In re Sheridan}, 391 B.R. 287 (Bankr. E.D.N.C. 2008).
\textsuperscript{143} See G. Duhl, Divided Loyalties: The Attorney’s Role In Bankruptcy Reaffirmations, 84 Am. Bankr. Inst. J. 361 (Fall. 2010).