

# THE EAGLE 9<sup>®</sup> NEWSLETTER



The First American Corporation  
UCC DIVISION

INSIDE THIS ISSUE:

<i>Introduction</i>	1
<i>Cases of Interest</i>	2
<i>Local Filing Issues</i>	3
<i>Bankruptcy Act</i>	5

UCC EAGLE 9<sup>®</sup> policies insure commercial loan transactions, including

- Mixed-collateral loans
- Asset-based loans
- Mezzanine lending
- Fixtures
- Loan workouts/bankruptcy
- Equipment leasing
- Existing loan portfolios
- Project finance

## INTRODUCTION

Welcome to the Third Issue of the UCC Division's Newsletter. Again, we hope that the review of recent cases of interest to commercial lawyers, UCC insurance product updates, and article of interest are proving useful to your legal practice or commercial lending business.

The UCC Division is the only provider of UCC related insurance products that offers:

- A full range of personal property priority lien perfection and priority insurance products including a Lender's Policy, a Buyer's Policy, a Vacation Ownership Interest Policy that insures the ownership of non-deeded vacation interests, Cooperative Interest Insurance Policy that insures the ownership of cooperative interests in New York, and a Vessel-under-Construction Policy that insures the buyer's lien in a vessel under construction, a policy that also integrates seamlessly to our EAGLE Protection<sup>®</sup> Vessel Owner's Policy or EAGLE Protection<sup>®</sup> Vessel Loan Policy, or both.
- A full range of UCC search and filing services nationwide, including the only Insured Search<sup>™</sup> and Insured Filing<sup>™</sup> insurance products at pricing competitive with non-insured searches and filing services. Our search and filing section also provides full corporate, litigation, tax, bankruptcy and similar search services.
- A full range of personal property priority lien perfection and priority insurance products for the common law provinces of Canada and now for Quebec, reducing the cost and facilitating the risk management of cross-boarder transactions.

The UCC Division does not limit itself to a single UCC insurance product, the Lender's Policy, nor does it limit itself to mezzanine real estate lending. Our policies are designed to work across all commercial finance market segments from the SBA community bank to the multi-million dollar mezzanine real estate transaction. Our unique Buyer's Policy provides equity ownership insurance coverage in real estate transactions where the equity ownership, rather than the underlying real property, is being transferred to avoid transfer and other taxes.

We are also the only UCC insurance company that is fully staffed internally, with nationally recognized commercial and real estate law expertise to help structure your financial transactions to fully utilize the risk management and outsourcing functionality of our UCC insurance products and related services. We alone are capable of assisting you through creative endorsements to resolve legal and factual issues that cannot be resolved through legal opinions.

We look forward to being of service; and if this web site doesn't answer your questions, please give us a call or send an email. We would also like to hear from you as to how you enjoy the Newsletter and whether there are any subject areas you would like added.

## CASES OF INTEREST<sup>1</sup>

### REAL PROPERTY SECURED TRANSACTIONS

**Melendrez v. D & I Investment, Inc.**, \_\_ Cal.App.4th \_\_ (2005) – A buyer at a deed of trust foreclosure sale was a BFP, even if the secured lender violated a repayment agreement with the borrower by prematurely conducting the sale. The fact that the buyer at the foreclosure sale was an experience buyer at these sales who purchased the property for significantly less than its fair market value did not disqualify the buyer from being a BFP. In the absence of procedural irregularity, the buyer was entitled to retain the property.

**Jones v. Union Bank of California**, \_\_ Cal.App.4th \_\_ (2005) – A lender conducted a non-judicial foreclosure sale under a deed of trust. The borrower then attacked the sale and the lender won that dispute. Code of Civil Procedure § 580d's anti-deficiency rule did not prevent the lender from obtaining its attorneys' fees under the terms of the agreements. The attorneys' fees were not part of an indebtedness satisfied at the sale.

### GUARANTIES

**Central Building, LLC v. Cooper**, \_\_ Cal.App.4th \_\_ (2005) – Guarantors of a lease agreed to pay all amounts due under the lease. The lease was later amended and the amendment was “made a part of” the guaranteed lease. There were further amendments and extensions. In all cases the amendments were treated as part of the lease. The court construed the contract language of the guaranty as a “continuing” guaranty that was irrevocable and applied to all of the amendments and extensions.

### FINANCIAL INSTITUTIONS

**Casey v. U.S. Bank**, \_\_ Cal.App.4th \_\_ (2005) – Banks that handled ordinary banking transactions were not liable for aiding and abetting a fraudulent scheme in the absence of actual knowledge of the underlying wrong of the primary actor and the giving of substantial assistance to the wrongdoer. Performing ordinary business transactions can satisfy the second element. Actual knowledge of the wrongdoing involves “intentional participation with knowledge of the object to be obtained.”

**In re OODC**, 2005 Westlaw 535238 (Bankr.D.Del. 2005) – A lender in an LBO could be liable for aiding and abetting a breach of fiduciary duty by the borrower's insiders. The court held that the lender could also be liable for improvident lending where it breached a duty of reasonable care not to lend when the borrower was not receiving adequate consideration.

### UCC— SALES AND PERSONAL PROPERTY LEASING

**Milicevic v. Fletcher Jones Imports, Ltd.**, \_\_ F.3d \_\_ (9th Cir. 20054) – Magnuson-Moss Warranty Act creates a private right of action for the seller's failure to comply with the terms of a written warranty. The cause of action does not arise until the seller fails to correct the defective product.

*“Actual knowledge required to aid and abet a fraudulent scheme.”*

<sup>1</sup> We want to thank Steven O. Weise of Heller Ehrman White & McAuliffe LLP, Los Angeles, for allowing us to use his case summaries developed for his bimonthly presentations to the Commercial Law Committee of the Commercial Law and Bankruptcy Section of the Los Angeles County Bar Association and his annual presentations to the Financial Lawyers Conference and the Commercial Financial Services Committee of the Business Law Section of the American Bar Association, of which Steve is the immediate past chairperson.

*Robinson Helicopter Co., Inc. v. Dana Corp.*, \_\_ Cal.4th \_\_ (Cal. Sup. Ct. 2005) - The economic loss rule operates to prevent a purchaser of goods from recovering in tort, unless the purchaser can demonstrate that it incurred damages beyond those economic damages obtainable for breach of contract (e.g. inadequate value, costs of repair and replacement, loss of profits). The courts have applied the economic loss rule to strict liability cases and to negligent breach of contract cases, but the Supreme Court refused to apply the limitation here, where a prima facie case of fraud had been made out by the buyer. The seller allegedly supplied a false certificate stating that the goods met the warranty requirements of the agreement between the parties. The severity and extent of the seller's alleged misrepresentations constituted a tortious act independent of the contractual breach. Here, the Court further noted, a public policy need was served by punishing the blameworthiness of an intentional fraud, and by deterring such egregious intentional misrepresentation in future contracts. The court argued that the public policy of encouraging predictability in commercial contracts does not outweigh the need to ensure honesty, good faith and fair dealing in such transactions. The seller could have avoided the imposition of punitive damages by refusing to supply a certificate certifying that the parts conformed to the specifications; in that case, it might still have been liable for breach of contract damages, but would not have taken its actions into the realm of intentional and knowingly tortious conduct.


*"In Robinson Helicopter, non-economic recovery in commercial transactions!!!"*

**Comment:** This is a significant decision, as it opens up the possibility for a buyer to recover non-economic damages in commercial transactions. The court emphasized that its holding was based on the delivery of the false certificate of compliance, which contained the misrepresentation that supported the claim of an intentional tort. Had the seller done no more than deliver non-complying goods, the economic loss rule would have precluded the recovery of non-economic damages (such as punitive damages) for breach of warranty. Once a recovery for tort damages based on an intentional misrepresentation are allowed, it seems unlikely that disclaimers and limitations on remedies and damages will be effective. See California Civil Code § 1668 ("All contracts which have for their object, directly or indirectly, to exempt any one from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.")

**LETTERS OF CREDIT,  
INVESTMENT SECURITIES,  
AND DOCUMENTS OF TITLE**

*Hendricks v. Bank of America*, \_\_ F.3d \_\_ (9th Cir. 2005) – Court could enjoin the issuer of a letter of credit from honoring a draw under the letter of credit if the applicant can show material fraud. UCC § 5-109. The court was entitled to enter the injunction even if the fraud involved the underlying transaction (creating a fictitious right to draw) instead of the draw itself. The court reserved the question of whether the person seeking the injunction under UCC § 5-109 had to show irreparable harm, as would ordinarily be necessary for an injunction.

*"A court enjoins a draw under a letter of credit."*



**We don't just detect.  
We protect.**

First American, UCC Direct Services, and iLienOnline have joined to bring you the strength of the nation's leading UCC service and insurance providers. The combined Web-based searching methodologies of iLienOnline, and the financial resources and innovative UCC insurance policies of First American, meet your UCC requirements effectively and with the highest level of protection ever offered.

- **The Search** is the most effective way to obtain information on the credit quality of and perfected security interests filed against your borrower or seller of assets.
- **The Assisted Search™** analyzes search results against your supplied criteria and eliminates the results that don't apply to your borrower or seller of assets.
- **The Insured Search™** lets you insure the results of your search and the editing provided by The Assisted Search, giving you the first effective insured search ever offered.

First American is the UCC Insurance company.

Call us today, and see how our UCC experts and EAGLE 9™ family of insurance products and services can benefit you.

**800.700.1191**

UCC Direct Services  
A WoltersKluwer Company

iLIEN  
ONLINE

THE FIRST AMERICAN CORPORATION  
UCC DIVISION

1 First American Way, Santa Ana, CA 92707  
800.854.3643 • www.eagle9.com

©2014 The First American Corporation • NYSE: FAF

## CONTRACTS

**Paul v. Schoellkopf**, \_\_ Cal.App.4th \_\_ (2005) – An escrow agreement provided for the payment of attorneys’ fees, in connection with litigation by the escrow company to collect its escrow fees. Because the right to attorneys’ fees is a matter of contract, the attorneys’ fees provision did not extend to disputes over the sufficiency of services by the escrow company or to disputes between the seller and the buyer. California Civil Code § 1717.

## OTHER LAWS AFFECTING COMMERCIAL TRANSACTION

**Bousey v. Jacoway**, U.S. (2005) -. Individual retirement accounts, or IRAs, from which funds cannot be withdrawn prior to a specified age without incurring substantial tax penalty, are "similar" to pensions and annuities, as the term is used in Bankruptcy Code and thus may be exempted from bankruptcy estate.

**Morris v. Redwood Empire Bancorp** - filed April 29, 2005, Fourth District, Div. Three, 2005 SOS 2160. Where agreement between merchant and bank issuing credit card expressly permitted merchant to terminate it at any time, termination fee for which agreement provided was not a liquidated damages provision since termination was not a breach of the agreement. Where merchant failed to allege he could not have obtained merchant credit card services from another source on different terms, that he was unaware of the fee when merchant agreement was executed, that its terms were misrepresented to him, or that fee was grossly out of line with fees charged by other banks, complaint did not allege facts sufficient to demonstrate termination fee was unconscionable under California Civil Code Sec. 1670.5.

## LOCAL FILING ISSUES

“Uniform” Commercial Code (...and I use the term loosely)

Finally! Revised Article 9 is in full bloom and we have uniformity with our searching and filing procedures... Right? WRONG! As was the case with former Article 9, almost every jurisdiction has adopted its own, non-uniform provisions. For example, do you know which state demands CAPITAL 12PT. FONT? (#1)? How about the state that requires the secured party mail the debtor a copy of the recorded financing statement? (#2) What about the state that will only accept 250 characters of collateral description per page? (#3) If you don’t know, don’t feel bad—you’re not alone. 75% of the UCCs that we review each day in our Search and Filing Section are not acceptable for filing. Though we see this as job security, lenders seem to feel differently. Be sure to use a reputable service company to assist you with your document preparation, such as our UCC Search and Filing Section, and stay tuned to this column for helpful hints. And don’t forget that First American alone insures the results of UCC searches and filings.

- #1: Illinois
- #2: Indiana
- #3: Utah

*‘Non-uniformity in the Uniform Commercial*

# SUMMARY OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005<sup>2</sup>

April 22, 2005

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Bankruptcy Reform Act"). While there has been much reporting on the effect of the Bankruptcy Reform Act on consumer bankruptcies, the Bankruptcy Reform Act will have a significant impact on business bankruptcy cases. Set forth below is a summary of the key provisions of the Bankruptcy Reform Act, paying particular attention to the business-related provisions. Most parts of the Bankruptcy Reform Act go into effect 180 days after the bill was signed (i.e., October 17, 2005), while some apply to all new cases. One provision also applies to pending cases. We have noted in the text below the significant provisions that take effect immediately; at the conclusion of this client advisory, we provide the effective dates for the other key provisions.

## PROVISIONS AFFECTING BUSINESS BANKRUPTCY CASES

### LEASE-RELATED PROVISIONS

**Deadline to Assume Commercial Realty Leases:** A debtor must assume or reject unexpired commercial realty leases within 120 days of a bankruptcy filing, or within 210 days of a bankruptcy filing, if the court permits that extension. No extension beyond 210 days is permitted, unless the lessor consents in writing. In addition, a debtor can no longer retain the ability to assume or reject a realty lease after a plan has been confirmed.

**New Requirement to Cure Nonmonetary Lease Defaults:** A debtor must now cure nonmonetary defaults that result in actual pecuniary losses to the landlord. Penalties do not have to be paid as part of the cure, and, if cure is impossible, the cure may be waived or be prospective only, such as with a pre-petition violation of a "failure to operate" clause.

**Rejection of Assumed Leases:** If a debtor rejects an assumed real property lease, the landlord's administrative expense claim is limited to the monetary obligations that would have accrued over the two years following rejection; damages beyond the two year cap are entitled to unsecured claim status, capped by Section 502(b)(6). The landlord's administrative claim against the estate will be reduced if the landlord can recover from another source.

### PLAN EXCLUSIVITY

A debtor cannot obtain extensions of the period when it has the sole right to file a plan beyond 18 months after its bankruptcy filing, and a debtor cannot obtain the sole right to solicit acceptances of a plan beyond 20 months after bankruptcy filing.

**Expanded Reclamation Period:** Suppliers can now seek to reclaim goods delivered to the debtor during the 45 days before the bankruptcy filing. Prior law only allowed reclamation of goods delivered during the 10 days before bankruptcy. In addition, suppliers now have a longer time period to make a reclamation claim—within 45 days of the debtor's receipt of the goods, or within 20 days of the bankruptcy filing, if the 45 day period expires after the bankruptcy filing.

**New Administrative Expense Claim for Certain Suppliers:** All shipments of goods received by the debtor within 20 days of its bankruptcy filing are entitled to administrative expense priority for the value of the goods, if the sale was in the ordinary course of the debtor's business.



*"Which consumers are we protecting and from what?"*

<sup>2</sup>We wish to thank Lynn A. Soukup of the Washington D.C. office of Alston & Bird LLP, 601 Pennsylvania Avenue, N.W., North Building, 10th Floor Washington, D.C. 20004; 202-756-3492 (phone); 202-756-3333 (fax); [lsoukup@alston.com](mailto:lsoukup@alston.com), for providing us with this summary of the Bankruptcy Act Amendments.

## LIMITATIONS ON CORPORATE DISCHARGES

**Government Claims Relating to Fraud:** A corporate discharge does not extinguish debts owed to a governmental unit if those debts are based on certain fraudulent acts committed by the debtor. The language of this provision makes it unclear whether these nondischargeable debts to governmental units must arise from the debtor's own fraudulent dealings with the government, or if this extends to claims or fines the government could impose on account of the debtor's defrauding of investors or creditors. We expect substantial litigation over this, for rendering nondischargeable governmental claims and fines on account of defrauding investors or creditors would make reorganizations very difficult in cases such as World-Com and other large Chapter 11s. Another reading of the statute could even mean that the claims of creditors and investors that are defrauded by a corporate debtor are not dischargeable; this would also greatly change the dynamic of certain Chapter 11 cases. We expect the matter will remain uncertain until several courts can be heard on the issue.

**Claims of Individuals Under the False Claims Act:** If an individual holds a claim against a corporate debtor arising from the federal False Claims Act or similar state statute, such claim is not discharged.

## VOIDABLE TRANSFER PROVISIONS

**A More Lenient Ordinary Course of Business Defense:** A voidable preference defendant now only needs to prove that a payment was made **either** in the ordinary course of business of the debtor and the defendant **or** made according to ordinary business terms. Prior law required a defendant to prove both to assert a successful ordinary course of business defense.

**Extended Period to Perfect Security Interests:** A security interest perfected within **30 days** of the receipt of the property by the debtor is not a preferential transfer. Prior law required perfection within 10 days to eliminate preference risk.

**Longer Lookback Period for Fraudulent Transfers:** A debtor may now seek to avoid fraudulent transfers that occurred during the **two years** before bankruptcy. Prior law allowed for a one year lookback period. Note: state laws on fraudulent transfer lookback periods are unchanged by the Bankruptcy Reform Act.

**No More Small Preference Lawsuits:** Transfers totaling less than \$5,000 are not preferential.

**Forum Selection:** Preference actions to collect consumer debts of less than \$15,000, or any other noninsider debt totaling less than \$10,000, must be brought where the defendant resides.

## AVOIDANCE OF INSIDER COMPENSATION

Fraudulent transfers now also include transfers for which the debtor receives less than reasonably equivalent value, if such transfers were made to insiders under an employment contract and outside the ordinary course of business.

## LIMITS ON KEY EMPLOYEE RETENTION PROGRAMS (KERPS) AND SERVERANCE

**More Stringent Requirements for KERPs:** An employee may not receive a KERP payment unless he/she is essential to the survival of the debtor and he/she already has a bona fide job offer.

**Limits on the Size of KERP Payments:** Even if the debtor is able to satisfy the standard for a KERP for a given employee, a KERP payment may not exceed 10 times the mean transfer to non-management employees during the calendar year preceding the KERP, or if there were no such transfers to non-management employees, the payment cannot be greater than 25% of what the employee could have received during the calendar year preceding the bankruptcy.

**Limits on Severance Payments:** A debtor cannot make a severance payment to an insider unless the payment is pursuant to a program generally applicable to all full-time employees and the amount is not greater than 10 times the mean severance payment made to non-management employees during that calendar year.

## PLANS AND PAYMENTS IN SINGLE ASSET REAL ESTATE CASES

In order for the automatic stay to remain in place in a single asset real estate case, the debtor must, within 90 days of the bankruptcy filing, file a confirmable plan or commence making monthly payments (at the nondefault contract rate of interest) to secured creditors based on the value of the collateral.

## INCREASED UTILITY PROTECTIONS

**Utility Deposits Required:** A debtor can no longer provide a utility with “adequate assurance of payment” by simply granting the utility an administrative expense priority. Instead, a debtor must now provide a cash deposit, letter of credit, bond or the like for post-petition services.



**Debtor's Past History Not Relevant to Determining “Adequate Assurance of Payment”:** If a court must determine what constitutes adequate assurance of payment, it cannot consider the debtor's prior timely payment history, the absence of a pre-petition security deposit or the availability of a post-petition administrative priority for utility services.

## CREDITORS' COMMITTEES AND EQUITY COMMITTEES

**Increased Sharing of Information with Creditors:** Creditors' committees are now required to provide access to information to creditors of the kind represented by the committee but who are not on the committee. In addition, creditors' committees must solicit and receive comments from their creditor constituents, and the court may order additional reports or disclosures to the committee's creditor constituents.

**Changes in Composition:** The court may now order the U.S. Trustee to change the membership of a creditors' committee or an equity committee, if necessary to ensure adequate representation.

**Addition of Small Creditors to a Creditors' Committee:** In addition to the general power of the court to adjust committee membership, the court may also require a creditors' committee to include a small business concern that has a “large” claim as measured by that small business concern's revenues.

## APPOINTMENT OF A TRUSTEE; CONVERSION OR DISMISSAL

The U.S. Trustee is now required to move for appointment of a trustee if there are reasonable grounds to suspect that the debtor's current management or board participated in fraud, dishonesty, or criminal conduct in the management of the debtor or in public financial reporting.

The factors that constitute "cause" to convert a Chapter 11 case to Chapter 7, or to dismiss the case altogether, have been substantially expanded. In addition, the court is now required to convert or dismiss a case upon a showing of any of such factors, unless there are unusual circumstances showing the relief is not in the best interests of creditors and the estate and if a plan will soon be confirmed. However, if the debtor is facing a substantial or continuing loss or a diminution of the estate and there is no reasonable likelihood of rehabilitation, the court must dismiss or convert the case (or appoint a trustee or examiner, as discussed immediately below).

In all circumstances, the court may appoint a trustee or examiner instead of converting or dismissing the case if this is in the best interests of creditors and the estate.

## IMPROVED EMPLOYEE WAGE PRIORITIES

**Increased Wage Priorities:** Employees are now entitled to priority claims for up to \$10,000 for pre-petition wages, salaries, commissions, vacation, severance and the like. Prior law had limited their priority claim to \$4,925.

**Increased Lookback Period for Unpaid Wages:** Unpaid wages and the like that were earned during the 180 days before bankruptcy are now entitled to priority (up to \$10,000, as noted above). Prior law had limited the lookback period to 90 days.

## RETIREE BENEFITS MODIFICATIONS

If a debtor modified its retiree benefits while it was insolvent and within 180 days of its bankruptcy filing, the court must reinstate the old benefits unless the balance of the equities favor the modified benefits.

## RESTRICTIONS ON SALES OF ASSETS BY NONPROFITS

The debtor must now comply with applicable nonbankruptcy law when it uses, sells or leases property of a non-moneyed corporation or trust, i.e., a nonprofit entity. In other words, state law restrictions or limitations on sales of nonprofit assets, such as nonprofit hospitals, nonprofit educational facilities and the like, must now be respected in bankruptcy. Note: this provision now applies to pending cases. In addition, transfers made under a plan by a non-moneyed corporation or trust must comply with applicable nonbankruptcy law.

## RESTRICTIONS ON SALES OF PRIVATE DATA

The debtor may not sell or lease personal data unless (i) the sale or lease is consistent with the debtor's policy on the privacy of such data as of the commencement of the case, or (ii) a consumer privacy ombudsman is appointed (see below, under "New Professionals") and the court approves the sale or lease after giving due consideration to the facts and circumstances and finding that the sale does not violate applicable nonbankruptcy law.

## RESTRICTIONS ON SALES FREE AND CLEAR OF CLAIMS

Purchases of interests in consumer transactions or consumer contracts will not be free and clear of claims or defenses (such as those arising under the Truth in Lending Act) relating to that transaction or contract.

## SPECIAL TREATMENT IF THE GOVERNMENT IS INVOLVED

Wages and benefits awarded in a proceeding of the National Labor Relations Board attributable to any post-petition period are entitled to administrative expense treatment.

The Bankruptcy Reform Act includes an express exception from the automatic stay for a securities self-regulatory organization to enforce its regulatory power (except for imposing monetary sanctions), conduct investigations, delist a company's securities, or refuse to permit the quotation of any stock.

Suspension from the Medicare Program is not enjoined by the automatic stay.

## TAX-RELATED CONTENTS OF DISCLOSURE STATEMENTS

For a disclosure statement to contain "adequate information," it now must also include a discussion of the potential material federal tax consequences of the plan to the debtor, any successor to the debtor, and a hypothetical investor typical of the holders of claims or interests in the case.

## TREATMENT OF TAX CLAIMS UNDER A PLAN

**Payments Must Take Place Over a Shorter Period:** Payments on account of secured and priority tax claims under a plan cannot take place over a period longer than five years after the commencement of the case. Prior law permitted payments over time for six year after the plan was confirmed.

**Unsecured Creditors Cannot Receive Better Treatment than Tax Claimants:** Payment on account of secured and priority tax claims must be made in a manner at least as favorable as payments to the most favored nonpriority, unsecured creditor class.

**Interest Rate Determined by Nonbankruptcy Law:** Applicable nonbankruptcy law will determine the appropriate rate of interest for tax claims paid over time. To the extent such claims are paid under a confirmed plan, the interest rate shall be determined as of the calendar month the plan is confirmed.

## FAILURE TO FILE TAX RETURNS

The court may dismiss the case if the debtor fails to file a tax return or obtain an extension for a tax return that is due postpetition

EAGLE 9 UCC INSURANCE

a higher level of  
**PROTECTION**  
for the commercial lender

THE FIRST AMERICAN  
The First American Corporation  
UCC DIVISION

**ADMINISTRATIVE PRIORITY  
FOR CLAIMS ARISING  
FROM CLOSURE OF  
HEALTH CARE BUSINESS**

If a debtor or a governmental agency incurs costs or expenses to transfer patients from closed facilities or to dispose of patient records in accordance with new Bankruptcy Code Section 351, such costs and expenses are entitled to administrative priority.

**INTERNATIONAL  
BANKRUPTCY MATTERS**

Section 304 of the Bankruptcy Code, relating to ancillary proceedings, was repealed, and a new Chapter 15 relating to cross-border bankruptcy cases will now control.

**DERIVATIVE/COMMODITY  
CONTRACTS**

Various sections of the Bankruptcy Code are modified to allow termination or netting of various financial contracts upon a bankruptcy filing.

**STATUS CONFERENCES  
ARE REQUIRED**

The court is now required to hold status conferences to further the expeditious and economical resolution of the case.

**SECTION 341 MEETINGS IN  
PREPACKAGED CASES**

If the debtor files a prepackaged plan of reorganization and has solicited votes pre-petition, the court may dispense with a meeting of creditors.

**INCREASED NOTICE  
REQUIREMENTS**

Section 342 of the Bankruptcy Code is substantially modified to require a debtor to serve notices to each creditor at the address specified by the creditor. Notices that are not sent to the address specified by a creditor in accordance with Section 342 will not be effective, and a creditor will not be liable for monetary damages for a stay violation if it has not been served at the address it specifies under Section 342.

**DISCLOSURE OF AFFILIATE  
INTERESTS**

The Bankruptcy Reform Act proposes (but does not require) that the Bankruptcy Rules require debtors to disclose the “value, operations, and profitability” of entities in which the debtor holds a controlling or substantial interest.

**FURTHER INFORMATION  
REQUIRED WITH THE  
SCHEDULES, 341 MEETING  
AND FINAL REPORTS**

The debtor's schedules and statements must now also include a statement of the debtor's monthly net income, itemized to show how that amount is calculated, as well as a statement disclosing any reasonably anticipated increases in income or expenses during the 12 months after the bankruptcy filing.

At least seven days before the Section 341 meeting of creditors, the debtor must supply its most recent tax return to the trustee and to any creditors that requests it. If the debtor fails to do so, the court must dismiss the case unless the debtor can show its failure was due to circumstances beyond its control.

The data requirements of interim reports have been expanded somewhat from current practice to include number of full-time employees, information about the debtor's industry classification, and with respect to any plan filed or confirmed, data regarding the recovery by each class of creditors, both in absolute terms and as a percentage of total allowed claims in the class.

Final reports must contain data regarding the receipts and disbursements of the estate, claims asserted against the estate, claims allowed, and distributions to creditors.

**NEW PROFESSIONALS**

Health Care Ombudsman: The court must appoint an ombudsman to monitor the level of patient care and represent the interests of patients unless the court finds that the appointment is not necessary.

Consumer Privacy Ombudsman: If the debtor seeks to sell personally identifiable information, covered by a privacy policy, the court must order the appointment of a consumer privacy ombudsman to assist the court in considering the sale.

**COMPENSATING  
PROFESSIONALS**

In awarding compensation, the court shall take into account whether a professional is board certified or has otherwise demonstrated skill and experience in the bankruptcy field .

**REVISED  
DISINTERESTEDNESS  
STANDARD ARISING FROM  
SECURITIES SALES**

Parties are no longer prevented per se from being "disinterested" due to their serving as investment banker for a security of a debtor or as attorney for an investment banker in connection with the offer, sale or issuance of a security of a debtor.

**EXCLUSIVE JURISDICTION  
OVER CLAIMS RELATING  
TO SECTION 327**

The District Court now has exclusive jurisdiction over claims or causes of action that involve construction of Section 327 of the Bankruptcy Code (relating to retention of professionals) or the disclosure requirements under Section 327.

## PROVISIONS LIMITED TO “SMALL BUSINESS”<sup>3</sup> BANKRUPTCIES

### INITIAL FINANCIAL REPORTING AND PERIODIC REPORTS

**Expanded Initial Financial Reporting:** Small business debtors must file their most recent balance sheets, statement of operations, cash-flow statement, and federal income tax return, or certify they have not prepared these financial records, within 7 days of their bankruptcy filing.

**Expanded Periodic Reports:** Small business debtors must file periodic reports containing profitability information, projections of receipts and disbursements, comparisons of projections to actual results, and setting forth whether the debtor is in compliance with the requirements of the Bankruptcy Code and Bankruptcy Rules.



### INCREASED ROLE OF THE U.S. TRUSTEE

The Bankruptcy Reform Act adds a new 28 U.S.C. § 586(a)(7) requiring the U.S. Trustee to investigate a small business' viability, inquire about its business plan, attempt to develop an agreed scheduling order, visit the debtor's business premises if appropriate and advisable, and review and monitor diligently the debtor's activities, in order to determine as promptly as possible if the debtor will be unable to confirm a plan.

### DISCLOSURE STATEMENT AND PLAN EFFICIENCIES

*Small business debtors have 180 days of exclusivity, and must file a plan within 300 days of the commencement of the case, unless those periods are extended by the court upon a showing that it is more likely than not that the court will confirm a plan within a reasonable period of time.*

No disclosure statement is required if the court determines that the plan provides adequate information to creditors. The court may also conditionally approve a disclosure statement subject to final approval later, presumably at the confirmation hearing.

The court is required to confirm the plan within 45 days after it is filed, unless that period is extended, once again upon a showing that it is more likely than not that the court will confirm a plan within a reasonable period of time.

## PROVISIONS AFFECTING CONSUMER CASES

### THE MEANS TEST

If an individual's income for the 6 months preceding his bankruptcy filing exceeds the median income of his state, he will be forced to file a Chapter 13 case if the debtor can "afford" (see below) to repay his creditors \$10,000 over 5 years. If debtor can only "afford" to repay between \$6,000 and \$10,000 over 5 years, conversion is required only if his repayment would represent more than 25% of the nonpriority unsecured claims.

To determine whether a debtor can "afford" a Chapter 13 plan, the trustee will compare the debtor's actual income against an IRS based budget of what the consumer should be spending. If there is extra income, the trustee will apply the Means Test.

<sup>3</sup>A small business bankruptcy case is one in which total debt for the debtor and affiliate debtors is less than \$2 million exclusive of insider debt, and no creditors' committee is appointed or is determined to be inactive.

## CREDIT COUNSELING

An individual must receive credit counseling during the 180 days preceding the bankruptcy unless the individual can establish that there are exigent circumstances that prevented him from obtaining the required credit counseling. The automatic stay does not apply until the debtor actually files for bankruptcy.

## LIMITED EFFECT OF THE AUTOMATIC STAY FOR REPEAT FILERS

The automatic stay will terminate after 30 days if an individual re-files within one year of his prior bankruptcy unless the court extends the stay.

The automatic stay does not apply if an individual has filed two or more cases within the prior year unless the court orders otherwise.

## EXEMPTIONS

A debtor must live within a state for 730 days to claim that state's exemptions.

Homestead Exemption: A debtor may not exempt an interest acquired within 1215 days of the bankruptcy filing that exceeds the aggregate amount of \$125,000 in real or personal property that the debtor uses as a residence. Note: this and other provisions limiting the homestead exemption apply to all cases filed on or after April 20, 2005.

## PENSION LIABILITIES

Debts owed to a pension, profit-sharing, stock bonus, or other plan are not dischargeable.

## VALUATION OF PERSONAL PROPERTY

The value of personal property securing an allowed claim shall be determined based on the replacement value as of the bankruptcy filing.

## RETIREMENT FUNDS

Retirement funds that are exempt from taxation under section 401, 403, 408, 408A, 414, or 501(a) of the Internal Revenue Code are exempt assets to the extent their value does not exceed \$1 million.

## NONDISCHARGEABLE DEBTS

Consumer debts owed to a single creditor aggregating more than \$500 for luxury goods/services purchased within 90 days of the bankruptcy filing are presumptively non-dischargeable.

Cash advances to consumers under an open end credit plan (such as credit cards) aggregating more than \$750 within 70 days of the bankruptcy filing are presumptively non-dischargeable.



**RESIDENTIAL LEASES**

If a landlord has a judgment of possession against a debtor involving residential property, the automatic stay does not prevent the commencement or the continuation of an eviction or ejection proceeding. However, if nonbankruptcy law would permit the tenant to cure the default, the debtor may stop the landlord's eviction/ejection proceeding by curing the default within 30 days of the bankruptcy filing.

**REAFFIRMATION AGREEMENTS**

If the debtor does not file and perform a reaffirmation agreement with regards to personal property within 45 days of his bankruptcy filing, the automatic stay is lifted.

**EFFECTIVE DATES OF THE BANKRUPTCY REFORM ACT**

Generally, the provisions of the Bankruptcy Reform Act take effect 180 days from the date of enactment, i.e., October 17, 2005, and the provisions to not apply to pending cases. With respect to the provisions discussed in this client advisory, there are several exceptions to effective date, as set forth below.

**PROVISIONS THAT APPLY TO CASES THAT ARE NOW PENDING**

The requirement that a debtor must comply with applicable nonbankruptcy law when it uses, sells, or leases property of a non-moneyed corporation or trust, i.e., a nonprofit entity.

**PROVISIONS THAT APPLY TO ALL CASES FILED AFTER APRIL 20, 2005**

The new fraudulent transfer provisions relating to payments to insiders outside the ordinary course of business.

The provision mandating that the U.S. Trustee seek appointment of a trustee in certain management fraud cases.

The provision relating to potential reinstatement of pre-petition retiree benefits modifications.

The increased priority wage claims for employees, and the lengthened lookback period for such wages.

The limitations on the use of the homestead exemption for recently-acquired realty.

**OTHER UNIQUE EFFECTIVE DATES**

The increased small business reporting requirements go into effect 60 days after the rules are prescribed.

The two year lookback period for fraudulent transfers does not go into effect for a year.

*First American  
IS the  
UCC Insurance  
Company.*

Call us today, and see how our UCC experts and EAGLE 9® family of insurance products and services can benefit you.

800.700.1191

[www.eagle9.com](http://www.eagle9.com)

