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HRO Bankruptcy Alert

RADICAL CHANGES IN BANKRUPTCY LAW:

2005 REVISIONS TO THE UNITED STATES BANKRUPTCY CODE BRING GREATER PROTECTION TO CREDITORS IN COMMERCIAL BANKRUPTCY CASES

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "2005 Act"), which President Bush signed into law on April 20, 2005, heralded the most sweeping changes in bankruptcy law in over a quarter-century, since the enactment of the original Bankruptcy Code (the "Code") in 1978. Most of the media coverage surrounding the 2005 Act focused on the impact of the new law on individual debtors in consumer bankruptcy cases. Less publicized -- though vitally important to commercial creditors -- are numerous revisions to the Code that can significantly increase those creditors' protections and diminish their financial losses when they receive the fateful notice that a long-time business partner has filed for bankruptcy. Many of the new Code provisions that provide commercial creditors with a "leg up" in bankruptcy involve complicated bankruptcy procedures and proceedings, where expert assistance is necessary to navigate through the hidden obstacles and unexpected dangers of a bankruptcy case. We have prepared this bulletin to alert our clients and friends to some of the areas in which the 2005 Act might provide them with important benefits in commercial bankruptcy cases. The lawyers in HRO's Bankruptcy, Financial Restructuring, and Creditors' Rights group assist clients in bankruptcy and other debtor-creditor cases and transactions throughout the United States and around the world and would welcome the chance to work with you toward the shared goals of saving you money and increasing your returns.

Less Uncertainty for Commercial Real Estate Landlords

The 2005 Act has made a number of pro-landlord changes to the Bankruptcy Code. In the past, although the Code imposed an initial 60-day period for the assumption or rejection of a commercial lease, it was common for debtors to get endless extensions of this deadline. No more. Now, commercial leases will have to be assumed or rejected within 120 days of the filing, with a single 90-day extension if "cause" is established. After that, further extensions will require the landlord's written consent. Also, once a commercial lease is assumed, all future rent obligations under the lease are automatically entitled to priority payment, subject to a cap of two years of rent and other obligations.

Broader Preference Defenses for Ordinary Course Transactions

Several provisions of the 2005 Act will make it more difficult for debtors or trustees to avoid and recover preferential transfers from creditors. In the past, a preference defendant had to prove two things: (1) that the payment was made in the ordinary course of business of both the debtor and the defendant, *and* (2) that the transfer was made according to ordinary business terms. The 2005 Act allows the preference defendant to prevail if it can satisfy *either* of these two tests. Additional changes will preclude debtors or trustees in business bankruptcy cases from pursuing any preference

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actions involving an amount of \$5,000 or less. Further, any preference action relating to a non-consumer debt of less than \$10,000 must be commenced in the district where the defendant resides, thereby preventing a debtor or trustee from unduly leveraging a preference defendant by making it defend such a lawsuit in a remote court.

Modernizing the Treatment of Derivatives Transactions

The 2005 Act greatly expands the old Code's now-antiquated definitions of covered derivatives transactions to conform with the evolving variety and complexity of modern transactions. Plus the 2005 Act will automatically include within the Code's definition future types of derivatives transactions that may become generally accepted in commercial markets, and lend greater certainty to the treatment of existing and future derivatives transactions in bankruptcy. Now, the Code's general "hands off" policy, which generally allows non-debtor parties in derivatives transactions to exercise their rights freely to terminate, setoff, and foreclose despite a debtor's bankruptcy filing, will extend to, for example, all parties to a "master netting agreement" involving the debtor. Congress also added a precise standard for a counterparty's calculation of damages when a swap agreement is terminated due to the debtor's bankruptcy.

Greater Reclamation Rights for Trade Creditors

Under the Uniform Commercial Code vendors who sell goods on credit to an insolvent buyer have a right to reclaim any goods that are unsold to a third party if the reclamation claim is made within 10 days of the buyer's receipt of the goods. The 2005 Act broadens the reclamation "window" from 10 to 45 days, although any reclamation claim is still subject to the rights of a prior, perfected secured creditor. In addition, the 2005 Act provides that even if no reclamation demand is made and the goods were subsequently sold by the buyer/debtor, vendors whose goods were received within 20 days prior to the bankruptcy petition date will have an administrative priority claim for goods sold by the debtor in the ordinary course of its business.

Harmonizing Domestic and Foreign Bankruptcy Cases

New Chapter 15 replaces section 304 of the Bankruptcy Code and applies to domestic cases that are ancillary to foreign insolvency proceedings. Based upon the UNCITRAL Model Law on Cross-Border Insolvency completed by the United Nations Commission on International Trade Law in 1997, the new Chapter 15 encourages cooperation between the United States and foreign countries with respect to transnational insolvency cases. It will also dictate how and where a debtor with a proceeding pending in another country may avail itself of the protections of the Bankruptcy Code, and enhance consistency in dealing with property and creditors, both domestic and foreign, of multi-national debtors.

Limiting the Debtor's Exclusive Ability to Prepare a Reorganization Plan

The 2005 Act imposes an 18 month limit on the "exclusivity period" in which a debtor has the exclusive right to propose a plan of reorganization. Prior to the 2005 Act, bankruptcy courts routinely granted debtors multiple extensions of the exclusivity period, a practice that creditors often criticized as affording debtors permanent exclusivity and excessive control in negotiating plans of reorganization. The 2005 Act prohibits extensions of exclusivity beyond 18 months and will accelerate the negotiation of reorganization plans and restore creditors' leverage in bankruptcy cases, by allowing creditors to propose an alternative plan of reorganization if the debtor fails to propose its own plan within 18 months.

Increased Security for Utilities Providers

The 2005 Act offers added protection to utilities that provide service to debtors. No longer will the mere granting of an administrative expense priority constitute "adequate assurance" of payment, sufficient to require a utility to continue providing service to the debtor. Instead, the debtor will need to provide cash or cash equivalent (letter of credit, surety bond, etc) as security for continued service. Additionally, in determining whether a debtor's assurance of payment to a utility is adequate, the Court may not consider the absence of security before the petition date, the timeliness of the debtor's payments pre-petition, or the availability of an administrative priority claim.

If you need assistance or have further questions, please contact any of HRO's business bankruptcy attorneys.

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