

SUMMARY OF PERTINENT PROVISIONS OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005

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I. INTRODUCTION

On April 20, 2005, President George W. Bush signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "Act") into law. The Act has an effective date of 180 days after enactment (October 17, 2005) and, with a few notable exceptions, its provisions will apply to all cases filed thereafter.

The Act makes substantive changes to the current Bankruptcy Code which has not seen such significant revisions since it was enacted in 1978. Most of the Act focuses on consumer debtors. However, the Act also makes numerous and substantial revisions to Chapter 11 business bankruptcy cases. This memorandum summarizes some of the significant provisions of the Act that will affect Chapter 11 business bankruptcies. This memorandum is not intended to be a comprehensive summary of the entire Act. Omitted from this memorandum is any discussion concerning the provisions of the Act relating to consumer bankruptcies, small business debtors, or healthcare provider cases. This memorandum is provided for informational purposes only and is not intended and should not be construed as legal advice.

II. SIGNIFICANT CHANGES AFFECTING CHAPTER 11 BUSINESS CASES

A. Reclamation and Administrative Expense Claims for Sellers of Goods

The Act grants a new priority administrative claim to those entities who sell goods on an unsecured basis that are received by the debtor within certain specified time frames immediately prior to the filing of Chapter 11. Specifically, any claim for goods received by a debtor in the ordinary course of its business within 20 days before the bankruptcy filing is entitled to administrative expense priority status for the "value of these goods". There is no requirement that the debtor be insolvent at the time it received the goods or for the creditor to serve a written notice upon the debtor to be entitled to this relief. As a Chapter 11 plan cannot be confirmed unless all administrative expense claims are paid in full or the administrative creditors voluntarily agree to some other treatment, this revision will enhance the return to vendors and make it more expensive for a debtor to confirm its plan of reorganization. Furthermore, under Section 503(a) of the Bankruptcy Code, a creditor can file a request for the payment of an administrative expense claim during the administration of a debtor's bankruptcy. If the request is granted, it would impose an immediate cash burden upon the debtor during the pendency of its case. This provision effectively elevates general unsecured claims for goods received by the debtor in the ordinary course of its business within 20 days of the commencement of the bankruptcy case to administrative claims.

Additionally, under the Act, a new and independent right of reclamation is created under the Bankruptcy Code. This is substantially different from the current law which merely preserves a nonbankruptcy right, i.e., reclamation claim under state law. The revisions also expand the existing 10 day reclamation period to 45 days. Specifically, the Act provides that vendors who sell goods which the debtor receives while insolvent and within 45 days of the bankruptcy filing may make a written reclamation demand to the debtor within 45 days after the debtor receives the goods or within 20 days after the bankruptcy filing if the 45 days expires after the commencement of the debtor's case. If a seller fails to give either timely or written notice, the seller's right to reclamation is lost. However, the seller retains its rights to assert an administrative claim, if applicable, under Section 503(b)(9) as described in the preceding paragraph.

Under the Act, these reclamation rights are now expressly and clearly "subject to the prior rights of a holder of a security interest in such goods or the proceeds thereof." However, there is no clarity on what is meant by this new language (e.g., what if the lender is oversecured - does the vendor have reclamation

right as to the goods in this situation?). Moreover, the option the Bankruptcy Court has under the current version of the Bankruptcy Code to substitute an administrative claim or lien in favor of the reclaiming creditor has been deleted. This suggests (possibly unrealistically), that the debtor is required to return the goods if it receives a timely and proper reclamation demand before it has sold the goods or incorporated them into its products, or if reclamation is unavailable, pay for them close to the outset of the Chapter 11 case. Assuming that debtors are capable of implementing a system to comply with the revised reclamation procedures, the financial burden imposed upon debtors to monitor reclamation demands, segregate, track and return properly reclaimed goods is significant. Further, if payment is made for the goods, it will represent a drain on the debtor's cash flow.

B. Commercial Leases

The Act modifies the timing limitations imposed on a debtor/lessee to assume or reject an unexpired nonresidential real property lease. Presently, a debtor has 60 days commencing on the date of the order for relief to assume or reject leases of nonresidential property. (In a voluntary case, the date of the order for relief is the date of the filing of the petition). The Bankruptcy Court can extend this 60-day period "for cause". Currently, there are no limits on the number of extensions the Bankruptcy Court may grant or the length of such extensions. Under the Act, the initial period for a debtor/lessee to assume or reject an unexpired lease of nonresidential real property is increased from 60 to 120 days. However, this period can be extended only once by the Bankruptcy Court, for up to an additional 90 days, without the consent of the lessor and upon a showing of cause. Any subsequent extension requires the lessor's prior written consent "in each instance". If the debtor does not assume or reject an unexpired nonresidential lease within the prescribed periods, the lease will be deemed rejected and the debtor will be required to surrender possession of the property to the lessor. These revisions appear, primarily, to be designed to remove a Bankruptcy Court's discretion to grant extensions of time to retail debtors in order to decide whether to assume or reject a lease beyond a maximum possible period of 210 days. Beyond this maximum period, the Bankruptcy Court has no authority to grant further time unless the lessor has agreed, in writing, to the extension. The Act shifts significant leverage to real property lessors, and forces debtors to accelerate their strategic decisions on the closing of leased locations. This will have a considerable impact on large retail debtors with numerous store leases.

Apparently In recognition that the 210 day provision may cause improvident assumptions of nonresidential real property leases, the Act adds a new Section 503(b)(7) to the Bankruptcy Code which "caps" the administrative claim for damages arising from a nonresidential real property lease which was assumed post-petition and is subsequently rejected. The administrative expense claim is limited to 2 years of the monetary obligations due under the lease (excluding all penalties and obligations arising from or relating to a failure to operate, such as going dark clauses which require a lessee to maintain continuous operations at the premises) from the later of the rejection date or actual turnover of the premises. If the landlord is able to recover from another source (e.g., a guarantor), its administrative claim will be reduced by such mitigating amount. Any damages above the 2 year "cap" are treated as general unsecured claims and are subject to the "caps" imposed under Section 502(b)(6) of the Bankruptcy Code.

C. Curing Nonmonetary Defaults Under Unexpired Real Property Leases

As currently drafted, the Bankruptcy Code requires the cure of all defaults in the event an unexpired lease is assumed. The Act amends Section 365(b)(1)(A) of the Bankruptcy Code to provide that a trustee (or debtor-in-possession) does not have to cure nonmonetary defaults under an unexpired lease that are impossible to cure. If the default arises from a failure to operate in accordance with the lease (e.g., going dark clauses which prohibit the lessee from ceasing operations at the premises), the default must be cured on and after the assumption of such lease (e.g., as of the assumption date, operations must commence on the premises). Under the Act, pecuniary losses resulting from such non-curable defaults must be compensated.

D. Executive Compensation

The Act imposes significant limitations on administrative priority claims for post-petition executive compensation, severance pay and certain other payments commonly referred to as Key Employee Retention Programs or "KERPs." The Act prohibits payments to and obligations incurred for the benefit of an insider (in this context insiders are generally defined under the Bankruptcy Code as officers and directors of the debtor) for the purpose of inducing the insider "to remain with the debtor's business" unless the debtor can show that the payment or obligation (1) is essential to the retention of the insider because the individual has a bona fide offer from another business at the same or greater rate of compensation; and (2) the services provided by the person are essential to the survival of the business; and (3) either (i) the amount of the transfer made to or the obligation incurred for the person does not exceed 10 times the "amount of the mean [average] transfer or obligation of a similar kind given to nonmanagement employees for any purpose" during the calendar year, or (ii) if no such payments were made or obligations incurred, the amount does not exceed "25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such Insider for any purpose" during the prior calendar year. Each of the three prongs must be proven in order for these key employee inducement payments or obligations to be approved. As a result of these revisions, a Bankruptcy Court has limited discretion to approve KERPs. Moreover, under the new restrictions on KERPs, debtors will have significantly less flexibility in attempting to retain key employees.

The Act also limits severance payments. Specifically, a debtor is prohibited from giving an insider a severance payment unless (1) the payment is part of a program generally applicable to all full-time employees, and (2) the amount is not greater than "10 times the amount of the mean [average] severance pay" given to nonmanagement employees in the same calendar year.

The Act also prohibits the payment or other transfers or obligations that are outside the ordinary course of business and "not justified by the facts and circumstances of the case", including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the commencement of the bankruptcy case. This revision appears to be aimed at limiting compensation to firms that specialize in restructurings and often install employees at the management level of the debtor after the bankruptcy petition date.

E. Utility Service

Under the current law, a utility may cease providing services to a debtor unless it is provided with "adequate assurance of payment" within 20 days after the bankruptcy filing. In connection with the determination of adequate assurance, Bankruptcy Courts have generally found that projected strong post-bankruptcy cash flow, a history of timely pre-petition payments and assurance of an administrative expense priority claim for post-petition utility services constitute "adequate protection" without the need for a cash or similar deposit. The Act will significantly change this practice because it defines "adequate assurance of payment" as a cash deposit, letter of credit, surety bond, certificate of deposit, prepayment or another form of security as agreed to by the parties. The Act explicitly provides that when determining the adequacy of assurance of payment, a Bankruptcy Court is precluded from considering the absence of security pre-petition, the timeliness of the debtor's pre-petition payments and the availability of providing the utility with an administrative expense priority claim. Finally, the Act provides that the utility must receive assurance, in a form and amount adequate to the utility, within 30 days following the bankruptcy filing. These changes are significant in that they appear to be designed to give utilities collateral for their services. This is likely to increase the debtor's financing needs particularly in the case of debtors with numerous locations, such as retailers.

F. Appointment of Trustee

Apparently in response to various recent bankruptcy cases involving substantial allegations of fraud, including Enron, Tyco, WorldCom and Adelphia, the Act revises Section 1104 of the Bankruptcy Code to impose a requirement that the United States Trustee shall move for the appointment of a Chapter 11

trustee if there are "reasonable grounds to suspect" that the debtor's current board members, chief executive officer, chief financial officer, or members of the board who selected the chief executive officer 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." No such requirement exists under the current law. The standard for the appointment of a Chapter 11 trustee, however, remains unchanged. The Bankruptcy Court will order the appointment of a Chapter 11 trustee only "for cause", which includes, without limitation, fraud, dishonesty, incompetence or gross mismanagement, or if the Bankruptcy Court determines that appointment is in the best interest of creditors and the estate. This revision may cause debtors to lose control of their business and the plan process due to the acts of pre-petition board members or officers who may have already been discharged. This provision applies to all chapter 11 cases commenced after April 20, 2005, the date of the enactment of the Act.

G. Plan Exclusivity

The Act limits the Bankruptcy Court's ability to extend a debtor's exclusive right to file a plan of reorganization under Section 1121 of the Bankruptcy Code beyond the 120-day period commencing on the date of the order for relief. Currently, the Bankruptcy Code allows the Bankruptcy Court to extend the exclusivity period indefinitely "for cause". The Act, however, explicitly and absolutely provides that a Bankruptcy Court may not extend the exclusive period (1) for filing a plan by more than 18 months after the date of the order for relief, or (2) for solicitation of a plan by more than 20 months after the date of the order for relief.

H. Preferences

Under the current law, a creditor receiving payment from an insolvent debtor within 90 days before bankruptcy can defend against the debtor's recovery of the payment as a preference by showing that (1) the payment (payment as used in this section includes other types of transfers) was of a debt incurred by the debtor in the ordinary course of business or financial affairs of both parties (e.g., the debt was incurred in the ordinary course), (2) the payment was in the ordinary course of business or financial affairs of both parties (e.g., the payment was made in the ordinary course), and (3) the payment was made according to ordinary business terms (e.g., the payment was ordinary in the particular industry). This "ordinary course" defense affords some protections to creditors, however, it requires creditors to establish that the challenged payment was both in the ordinary course of business of both parties and according to ordinary business terms. The Act relaxes the requirements of this preference defense, thereby making it easier for a creditor to successfully invoke the "ordinary course" defense. The Act eliminates the requirement that the creditor establish that the disputed payment was both in the ordinary course of business of both parties and according to ordinary business terms, by allowing the creditor to establish either condition. Stated another way, if a creditor establishes that the debt was incurred in the ordinary course of business or financial affairs of the parties, it only has to prove that the payment was made in the "ordinary course" of both parties, or according to ordinary business terms (i.e., prove it was ordinary as between them or in the industry). This revision substantially "lightens" the creditor's burden as to this defense.

The Act also overrules certain Bankruptcy Court decisions (including the DePrizio case) which allowed a trustee (or debtor-in-possession) to recover preferential payments (again payment as used in this section includes other types of transfers) to non-insiders made during the applicable extended 1 year preference time period for insiders, if the payment was made for the benefit of an insider. These decisions generally discouraged lenders from obtaining loan guarantees because they were concerned that the transfers could be avoided as preferential based upon a debtor's insider relationship with the loan guarantor. The Act amends the Bankruptcy Code to provide that under such circumstances, the transfer can only be avoided with respect to the insider. This provision applies to any case (or adversary proceeding) that is pending or commenced on or after April 20, 2005, the date of the enactment of the Act.

In the case of business bankruptcies, the Act provides that a transfer may not be avoided as preferential if the aggregate value of all property constituting or affected by the transfer is less than \$5,000.

Accordingly, under the Act, preference actions will start at payments (or other preferential transfers) involving at least \$5,000.00.

In connection with purchase money loans, if a creditor extends credit to enable a debtor to acquire assets on which the creditor will take a lien (e.g., a UCC security interest or a real property mortgage), the Act extends the period within which the creditor may perfect the lien from 20 (the current law) to 30 days after the debtor's receipt of the asset. For all other collateral, a secured creditor will be insulated from a preference attack if such creditor perfects its lien within 30 days (rather than 10 days as provided under the current law) after the granting of the lien takes effect between the debtor and the creditor.

I. Fraudulent Transfers

The Act amends Section 548 of the Bankruptcy Code regarding fraudulent transfers and obligations to make it easier for a debtor to avoid certain pre-petition transfers. First, the Act extends the "reach back" period under Section 548 of the Bankruptcy Code from 1 year to 2 years before the bankruptcy petition date. Under the Act, a debtor is able to attack any transfers it made during the 2 year period before the petition date. This provision applies only to cases commenced more than 1 year after the date of the enactment of the Act, i.e., April 21, 2006.

The Act also adds language to Section 548 of the Bankruptcy Code to make it clear that a pre-petition transfer to an insider under an employment contract and not in the ordinary course of business may be subject to fraudulent transfer attack. The current law does not expressly provide for this fact pattern. This amendment as to insiders will apply to all cases commenced on or after the effective date of the Act.

J. Dismissal or Conversion of a Debtor's Case

Existing law provides that a Bankruptcy Court may convert a case to chapter 7 or dismiss the case "for cause" which includes a non-exclusive list of 10 items that constitute "cause". Currently, conversion to Chapter 7 or dismissal of a case is the exception, and a debtor that continues to sustain operating losses can remain in Chapter 11 as long as it can demonstrate a reasonable likelihood of rehabilitation. The Act amends Section 1112(b) of the Bankruptcy Code and directs the Bankruptcy Court, subject to limited circumstances, to convert or dismiss a chapter 11 case if the movant establishes any 1 of the 16 enumerated acts or omissions that constitutes "cause". The Act includes an exception to the mandatory dismissal or conversion if: (1) the debtor or another party-in-interest objects and establishes that (a) there is a reasonable likelihood that a plan will be confirmed within the timeframes established for small business cases, or a reasonable time for "non-small" business cases (i.e., greater than \$2 million in aggregate noncontingent, liquidated secured and unsecured debts excluding debts owed to affiliates and insiders), and (b) the grounds for granting dismissal/conversion include an act or omission of the debtor (i) for which there is reasonable justification, and (ii) that will be cured within a reasonable period of time fixed by the Bankruptcy Court; and (2) the Bankruptcy Court finds that no unusual circumstances exist establishing that conversion/dismissal is in the best interest of the estate and creditors.

Moreover, the Act expands the grounds upon which a party-in-interest can request conversion or dismissal of a Chapter 11 case. The additional grounds which constitute cause for dismissal or conversion under the Act include: (1) failure to maintain appropriate insurance that poses a risk to the estate or the public; (2) unauthorized use of cash collateral substantially harmful to a creditor(s); (3) failure to comply with a Bankruptcy Court order; (4) unexcused failure to satisfy timely filing or reporting requirements established under the Bankruptcy Code; (5) failure to pay post-petition taxes in a timely manner; (6) failure to timely provide information to the United States Trustee; (7) failure to attend the meeting of creditors or an examination ordered under Bankruptcy Rule 2004 without good cause; and (8) failure to file a disclosure statement or file and confirm a plan within the time fixed by the Bankruptcy Court or the Bankruptcy Code.

The Act also expedites the procedures for conversion or dismissal of a case. Under the Act, the Bankruptcy Court must commence a hearing on a motion to dismiss or convert no later than 30 days after the filing of a motion and must render a decision no later than 15 days after the commencement of the

hearing on such motion, unless the movant consents to a continuance or compelling circumstances prevent the Bankruptcy Court from meeting the time limits.

Finally, the Act gives the Bankruptcy Court the option of appointing an examiner, in lieu of converting or dismissing the case, if the appointment is deemed to be in the best interests of creditors and the estate.

K. Prepackaged Chapter 11 Cases

The Act makes two significant changes that primarily affect "prepackaged" bankruptcies, i.e., those where a debtor solicits and obtains consents to a plan before its bankruptcy filing. Under current bankruptcy law, if a debtor commences solicitation of acceptances of a prepackaged plan, but a bankruptcy petition is filed (either voluntarily or involuntarily) before the end of the solicitation period, absent a Bankruptcy Court order approving the disclosure statement and continued solicitation, the solicitation must cease. Under the Act, if solicitation commences before the debtor's bankruptcy filing and the solicitation complies with applicable nonbankruptcy law, the solicitation is permitted to continue after the debtor's bankruptcy filing. Therefore, as revised under the Act, creditors who oppose and want to derail a prepackaged bankruptcy process will need to file an involuntary petition before solicitation begins.

The Act also provides that if a debtor has filed a prepackaged plan of reorganization and solicits votes before the bankruptcy filing, the Bankruptcy Court may dispense with the meeting of creditors as provided under Section 341 of the Bankruptcy Code. This revision appears to be intended to expedite the processing of prepackaged bankruptcies.

L. Creditors' Committees

The Act grants the Bankruptcy Court express authority to order the United States Trustee to change the membership of an official committee if the Bankruptcy Court determines that the change is necessary to ensure adequate representation. The Act also specifies that the Bankruptcy Court may direct the United States Trustee to increase the membership of a committee for the purpose of including a small business concern (as defined under §3(a)(1) of the Small Business Act) if the Bankruptcy Court determines that such creditor's claim is of the kind represented on the committee and that, in the aggregate, the claim is disproportionately large when compared to the creditor's annual gross revenue. Therefore, under the Act, disputes regarding membership on an official committee are now clearly within the powers of the Bankruptcy Court to adjudicate.

Furthermore, the Act imposes certain obligations on official committees that do not currently exist. Under the Act, an official committee (1) is required to provide access to information to, and solicit comments from, creditors holding claims of the kind represented by the committee, and (2) may be required by the Bankruptcy Court to make additional reports or disclosures to such creditors. This provision may impact the information that a debtor provides to a committee.

M. Automatic Stay

The Act modifies the automatic stay provisions of Section 362 of the Bankruptcy Code to, among other things, except from the automatic stay the commencement or continuation of investigations or actions by "security self regulatory organizations" (which is defined to include security associations registered with the SEC or a national securities exchange), to enforce such organizations' regulatory power or any act to delist, delete or refuse to permit quotation of any stock which does not meet applicable regulatory standards. The Act also limits the applicability of the automatic stay to clarify that the commencement or continuation of proceedings before the United States Tax Court against a debtor shall only be stayed with regard to taxable periods relating to such proceedings ending before the petition date. Moreover, under the Act a taxing agency that owes a debtor a refund will no longer be restricted by the automatic stay from offsetting the refund against any tax liability that the debtor may owe. If applicable nonbankruptcy law does not permit a setoff due to a pending tax determination action, the government may refuse to pay the refund pending the outcome of the action unless a Bankruptcy Court provides adequate protection of the government's setoff rights.

N. Retiree Benefits

Under the current Bankruptcy Code, a Chapter 11 debtor is prohibited from modifying benefits under a post-retirement benefit plan such as health coverage without complying with a potentially lengthy negotiation process and showing the Bankruptcy Court that such modifications are necessary to permit the reorganization to succeed and that it treats retirees equitably as compared to all other parties-in-interest in the case. There is currently a split of authority on whether Section 1114 prevents a debtor from modifying a retiree health plan where the health plan permits unilateral modifications by the debtor/employer. Some Bankruptcy Courts hold that this section of the Bankruptcy Code supersedes any

unilateral modification provisions of a health plan such that they are nullified. Under the Act, Section 1114 of the Bankruptcy Code is amended to prevent debtors from terminating retiree benefit plans on the eve of bankruptcy. Specifically, under the Act, if a debtor modifies retiree benefits within 180 days of the

bankruptcy filing while it is insolvent, the Bankruptcy Court is required to reinstate the old benefits unless equities favor the new plan. Therefore, the Act requires retroactive reinstatement of retiree benefits that were modified within 180 days of the petition date, unless the Bankruptcy Court finds that "the balance of equities clearly favors such modification." This provision applies to all cases commenced after April 20, 2005, the date of the enactment of the Act.

O. Taxes

The Act makes various revisions to the treatment of tax claims. For example, the Act clarifies that the rate of interest payable on tax claims is to be determined by applicable nonbankruptcy law (e.g., state rate of interest on secured property taxes). Currently, the Bankruptcy Code is silent on the applicable rate of interest when such interest is allowed. In addition, the Act requires that certain priority taxes paid under a plan of reorganization must be paid in regular cash installments over a period not to exceed 5 years from the bankruptcy filing "in a manner not less favorable than the most favored nonpriority unsecured claim provided for in the plan (other than [administrative convenience claims])". Under the current Bankruptcy Code, the period is 6 years (not 5) from the date of the assessment of the tax (not from the date of the bankruptcy filing), provided that the taxing authority receives payments having a value of not less than the allowed amount of the claim. The effect of these revisions is that tax claims will be paid earlier, perhaps in cash at confirmation if there is sufficient cash and the required interest rate on delayed payments is high.

Finally, the Act places strict requirements on the debtor to timely file its tax returns. Under the Act, if a debtor fails to file a tax return (or obtain an extension) which is due after the commencement of the case, the taxing authority may request the conversion or dismissal of the case. If a debtor does not file the return or obtain an extension within 90 days of a taxing authority filing such a motion, the Bankruptcy Court must convert or dismiss the case, whichever is in the best interest of creditors and the estate.

P. Investment Bankers

Under the current Bankruptcy Code, all professionals retained by the debtor, such as attorneys and financial advisors, must be "disinterested persons". Currently, a firm that acted as an investment banker with respect to any outstanding security of the debtors or any securities issued within 3 years of the bankruptcy filing is automatically disqualified from being "disinterested". Additionally, a law firm that represented the investment bank in such transactions is not "disinterested" and thus such firm will be precluded from being retained by the debtor. The Act deletes all references to investment bankers in the definition of "disinterested person." Accordingly, under the Act, the automatic disqualification of a debtor's pre-petition investment banker (and its counsel) is repealed. But, "disinterestedness" still requires that an entity "not have an interest materially adverse to the interest of the estate or any class of creditors or equity security holders, by reason of any direct or indirect relationship to, connection with or interest in, the debtor, or for any other reason." Accordingly, a former underwriter of the debtor's securities and its counsel may still not qualify as being "disinterested" if they fail to satisfy such requirements.

Q. Employee Wage and Benefit Priority Increases

The Act increases the priority wage and benefit claim to \$10,000 earned in the 180 days before the bankruptcy filing or cessation of the debtor's business. The current priority wage and benefit claim is up to \$4,925 earned in the 90 days before the bankruptcy filing or the cessation of the debtor's business. This provision applies to all cases commenced after April 20, 2005, the date of the enactment of the Act.

R. Cross-Border Cases

The Act adds a new Chapter 15 to the Bankruptcy Code that addresses transnational bankruptcy cases. Chapter 15 replaces Section 304 of the current Bankruptcy Code and incorporates the Model Law on Cross-Border Insolvencies as promulgated by the United Nations Commission on International Trade Law with some necessary modifications in order to conform to the Bankruptcy Code. Under Chapter 15 of the Act, a foreign representative (defined as "a person or body, including a person or body appointed on an interim basis, authorized in a foreign proceeding to administer the reorganization or liquidation of the debtor's assets or affairs or to act as a representative of such foreign proceeding") may commence an ancillary proceeding by filing a petition for recognition in a U.S. Bankruptcy Court. The petition must be accompanied by one of the following: (1) a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative; (2) a certification of the foreign court affirming the existence of the foreign proceeding and the appointment of the foreign representative; or (3) other evidence satisfactory to the U.S. Bankruptcy Court of the existence of the foreign proceeding and the appointment of the foreign representative.

Under Section 1519 of the Act, pending a hearing on the petition and at the request of the foreign representative, the U.S. Bankruptcy Court is authorized to grant provisional relief with regard to the foreign debtor's assets located in the United States. In order to obtain provisional relief, it must be established that the "relief is urgently needed to protect the assets of the [foreign] debtor or the interests of the creditors" and the applicable standards for a U.S. court to grant injunctive relief (e.g., a temporary restraining order or preliminary injunction) must be satisfied. Provisional relief includes, without limitation, a stay against a creditor's execution on the foreign debtor's assets, authorizing the foreign representative or an examiner to administer the foreign debtor's assets, and other relief available to a trustee (or a debtor-in-possession) under the Bankruptcy Code, with the exception of the commencement of avoidance actions.

After notice and a hearing, the U.S. Bankruptcy Court may grant the petition recognizing the foreign proceeding and the authority of the foreign representative. The decision to grant recognition is not dependent upon any findings regarding the nature of the foreign proceeding as are currently required under Section 304 of the Bankruptcy Code which section currently requires findings such as (1) the just treatment of holders of claims against the foreign debtor; (2) the protection of claim holders in the United States against prejudice and inconvenience in the processing of their claims in the foreign proceeding; (3) the prevention of preferential or fraudulent transfers; (4) distributions substantially in accordance with the Bankruptcy Code; and (5) comity. Instead, a petition for recognition will be granted upon the presentation of satisfactory evidence of the foreign proceeding and the foreign representative's authority. The granting of the petition (or any other relief under Chapter 15) can be denied if the "action would be manifestly contrary to the public policy of the United States." The U.S. Bankruptcy Court can modify or terminate the order granting recognition upon a showing that the grounds for granting the relief have changed or no longer exist. The foreign representative is required to advise the U.S. Bankruptcy Court of any substantial change in the foreign proceeding or the appointment of the foreign representative.

Upon the recognition of a foreign proceeding and at the request of the foreign representative, the U.S. Bankruptcy Court may grant relief with regard to the foreign debtor's assets located in the United States such as staying actions concerning the foreign debtor's property, staying execution against the foreign debtor's assets, suspending the transfer or disposition of assets, authorizing the examination of witnesses, entrusting the foreign debtor's property to the foreign representative and any other relief available under the Bankruptcy Code to a bankruptcy trustee (or debtor-in-possession) except for the commencement of avoidance actions. The standards for granting such relief, as is the case with

provisional relief, are the same as required to obtain Injunctive relief, except that the turnover of property to the foreign representative is only permitted if the U.S. Bankruptcy Court is satisfied that the interests of creditors in the United States are sufficiently protected. After the entry of an order granting recognition, and subject to any limitations imposed in such order, the foreign representative can sue or be sued in courts located in the United States and the foreign representative can seek appropriate relief from U.S. courts including a request for comity or cooperation. Upon recognition of a "foreign main proceeding" (defined as "a foreign proceeding pending in a country where the debtor has the center of its main interests"), certain sections of the Bankruptcy Code will apply including: Sections 362 (automatic stay), 361 (adequate protection), 363 (use, sale, or lease of property), 549 (post-petition transactions), and 552 (post-petition effect of security interest) to the foreign debtor and any assets of the foreign debtor located in the United States. Additionally, unless otherwise ordered, upon recognition of a foreign main proceeding, the foreign representative may operate the foreign debtor's business located in the United States and may exercise the rights and powers of a trustee (or debtor-in-possession) under and to the extent provided by Sections 363 and 552 of the Bankruptcy Code.

If recognition is granted, Chapter 15 also includes provisions for a U.S. Bankruptcy Court to provide "additional assistance to a foreign representative". The Act does not define the term "additional assistance", however, it provides that such "additional assistance" can only be provided after the court considers the factors currently required under Section 304 of the Bankruptcy Code which are identified above.

S. Financial Contracts

The Act includes certain provisions which amend the Bankruptcy Code and certain other federal statutes (e.g., the Federal Deposit Insurance Act (the "FDIC") and the Federal Credit Union Act (the "FCUA")) to clarify and expand the rights of non-debtor parties to certain types of financial contracts. Specifically, the Act amends the definitions of terms such as "qualified financial contract", "securities contract", "commodity contract", "forward contract", "repurchase agreement" and "swap agreement" under the FDIC, FCUA, and/or the Bankruptcy Code to expand such definitions and make them consistent. The Act also adds to the Bankruptcy Code new definitions for the terms "master netting agreement" and "master netting agreement participant". Master netting agreement is defined as "an agreement providing for the exercise of rights, including rights of netting, setoff, liquidation, termination, acceleration, or closeout, under or in connection" with a securities contract, forward contract, commodity contract, repurchase agreement or swap agreement. A master netting agreement participant is defined as "an entity that, at any time before the date of the filing of the petition, is a party to an outstanding master netting agreement with the debtor".

The Act amends the automatic stay provisions under Section 362 of the Bankruptcy Code to clarify that the automatic stay does not prohibit setoff or netting provisions in swap agreements and master netting agreements and security agreements or arrangements related to one or more swap agreements or master netting agreements. Additionally, under the Act, Sections 546 and 548(d) of the current Bankruptcy Code are amended to explicitly provide that the transfers made under or in connection with a master netting agreement may not be avoided by a trustee except when the transfer is made with the actual intent to hinder, delay or defraud and was not made in good faith. This provision grants the same protections for a transfer made under, or in connection with, a master netting agreement as currently provided under the Bankruptcy Code for margin payments, settlement payments and other transfers received by commodity brokers, forward contract merchants, stockbrokers, financial institutions, security clearing agencies, repo participants and swap participants, except to the extent that a bankruptcy trustee (or debtor-in-possession) could otherwise avoid such a transfer made under an individual contract covered by such a master netting agreement.

Currently, the Bankruptcy Code provides a "safe harbor" which permits non-debtor parties to exercise contractual rights to "cause the liquidation" of financial contracts, notwithstanding the automatic stay, trustee avoidance powers and other Bankruptcy Code provisions that generally restrict such actions by creditors. There is an issue as to whether the term "liquidation" includes termination. The Act clarifies this issue by explicitly allowing, under Section 555 of the Bankruptcy Code, the exercise of a contractual right

to cause the "liquidation, termination, or acceleration" of a securities contract. The Act also adds a new Section 562 to the Bankruptcy Code which specifies the damage claims of a non-debtor party when a bankruptcy trustee (or debtor-in-possession) rejects a swap agreement, security contract, forward contract, commodity contract, repurchase agreement or master netting agreement. Finally, the Act explicitly provides that the new provisions relating to securities contracts, forward contracts, commodity contracts, repurchase agreements, swap agreements or master netting agreements apply to any cases commenced under Chapter 15 of the Bankruptcy Code which, as discussed above, relate to foreign bankruptcy proceedings.