October 17, 2005

SUMMARY OF THE HIGHLIGHTS OF "THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005"[1]

PUB. LAW 109-8
ENACTED APRIL 20, 2005

I. OVERVIEW

Congress passed major bankruptcy reform legislation at the beginning of 2005 that represents the most significant changes to the Bankruptcy Code (Code) since its enactment in 1978. The President signed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (Act) into law on April 20, 2005. Most of changes to the Code and other amendments made by the Act are effective for bankruptcy filings on or after **October 17, 2005.**

The Act revises many provisions of the Code including Chapters 7 (liquidation and discharge of debts), 11 (business reorganizations), 12 (family farmer reorganizations), and 13 (debt restructuring for individuals). The most publicized changes affect consumers who are seeking to discharge debts owed to banks and other creditors in bankruptcy. Other amendments to the Code, however, significantly affect commercial bankruptcies. In addition to changes to the Code, there are provisions in the Act that are intended to reduce risks to banks and other parties to financial contracts if a counterparty should become insolvent, and provisions are added to the law requiring banks to provide consumers with new and extensive disclosures with respect to certain extensions of credit.

The Act generally expands the rights of the creditors, particularly secured creditors. Many of the amendments to the Code have the potential to impact national banks either directly as unsecured and secured creditors of individuals or companies filing for bankruptcy protection, or indirectly as creditors to individuals, companies, or suppliers who are unsecured or secured creditors to individuals or companies filing for bankruptcy protection. The impact on a national bank will vary depending on the bank's creditor relationship to the bankruptcy estate. Because the Act generally did not become effective until **October 17, 2005**, the actual impact is still unknown and may remain so for several months to come. However, discussed below are some issues to be considered when assessing the potential impact on a particular bank creditor.

First, one of the primary purposes of the Act is to limit the ability of consumers with adequate income to immediately discharge unsecured debt, primarily credit card debt, in Chapter 7 bankruptcies. To do so, the Act imposes a needs-based means test to determine if an individual may discharge unsecured debts under Chapter 7 or is required to pay a certain amount toward such debts under a Chapter 13 five-year payment plan, which may or may not satisfy the total amount of the debt before it is discharged at the end of the plan. When considering the Act as a whole, however, it is not clear that the changes made by the Act will significantly increase the amount that unsecured creditors may receive from debtors to pay credit card debt.

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[1] The Legislative and Regulatory Activities Division in the OCC's Law Department prepared this summary.

On the one hand, the Act requires certain debtors who satisfy the means test to enter into five-year payment plans under Chapter 13, rather than three-year plans, and to make payments to secured and unsecured creditors over the term of the plan, thus enabling these creditors to recover a certain amount of their debt before a debt may be discharged under Chapter 13 (if the debt is eligible to be discharged, such as credit card debt). In addition, the Act provides new restrictions on the extent to which a debtor's home equity may be protected from creditors under a state's homestead exemption, and reduces the amount of credit card debt for luxury good and services that is incurred shortly before bankruptcy that may be discharged. On the other hand, several of the amendments made by the Act relating to Chapter 13 bankruptcies enhance the position of secured creditors, give priority to certain payments (*e.g.,* 401(k) loans, domestic support obligations, up to $1500 in private school tuitions, and charitable contributions up to 15% of the debtor's gross income), increase administration costs, such as legal fees, that must be borne by the debtor, and expand the universe of nondischargeable debts, as well as administrative expenses that must be paid in full before unsecured creditors are paid. The net result of these changes will be to reduce assets in the Chapter 13 bankruptcy estate that are available to unsecured creditors. In addition, some research on the expected impact of the means test on bankruptcy filers has concluded that only a modest decline in net charge-offs is likely.[2] The bottom line may be that the amount received by unsecured creditors to pay credit card debt under the Act may be only a modest increase from what was recovered under prior law, and the credit risk associated with such accounts may be unchanged.

Second, the Act imposes new requirements on banks and other creditors. The Board of Governors of the Federal Reserve System (Fed) must adopt implementing regulations requiring banks to make extensive new Truth-in-Lending Act disclosures to customers, including minimum payment warnings, disclosures concerning credit extensions secured by principal residences, and disclosures concerning credit card introductory rates, internet solicitations, and late payment penalties. In addition, creditors of debtors in bankruptcy are subject to new requirements. For example, if a creditor unreasonably refuses to enter into a reasonable repayment plan more than 60 days prior to a consumer's bankruptcy filing, the creditor's claim for unsecured debt may be reduced by up to 20% under certain circumstances. Moreover, creditors are required to provide new lengthy disclosures to debtors who reaffirm a debt, and creditors may be subject to sanctions for willfully failing to credit mortgage payments paid under a bankruptcy plan if such action causes material injury to the debtor.

Third, the Act makes significant changes in the Code that may benefit commercial creditors. As discussed above, however, the impact on a particular bank will depend on the bank's relationship to the bankruptcy estate, *e.g.,* whether a bank is creditor to the debtor

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[2] *See* Moody's Investment Service's special comment "Bankruptcy Law Changes Unlikely to Have Significant Impact on U.S. Consumer Lenders" (April 2005) (In Moody's view, the impact of the changes made by the Act on the credit card industry and on other unsecured consumer lenders will be modest. When viewed over the longer-term, Moody's concluded that the amendments made by the Act will result in only a very modest improvement in net charge-offs for credit card lenders and auto lenders. Consequently, Moody's does not believe that there will be any significant changes in the profitability of U.S. consumer lenders and does not expect any ratings changes in this sector because of the Act.)

corporation, creditor to the supplier to the debtor corporation, creditor to the shopping center owner who rents space to the debtor corporation, etc. The changes limit the rights of debtor-tenants of commercial property, enhance the position of creditors with perfected security interests, strengthen the ability of suppliers to reclaim goods sold on credit to commercial debtors, and restrict key employee retention payments, or KERPs, by a business filing under the Code.

Fourth, significant provisions in the Act restructure Federal insolvency laws governing the financial markets to provide more legal certainty about how certain derivative and other financial contracts are settled and executed in the event of an insolvency of one of the parties. In the second quarter of 2005, the notional value of all types of derivatives held by U.S. commercial banks totaled approximately $96.2 trillion. Should counterparties to any of these derivative transactions file for bankruptcy, or become subject to other Federal insolvency laws, these rule changes will allow bank participants (and other counterparties) to these financial contracts to more effectively assess and manage contract risks.

The following are some significant highlights of this new complex law. These are highlights only, and the document is not a section-by-section summary of the Act. Thus, it may not answer the many questions that may be raised by OCC examiners and bank creditors with respect to implementation of these new provisions. Unless otherwise provided, the provisions summarized herein became effective on **October 17, 2005.**

TABLE OF CONTENTS

Consumer Bankruptcy……………………………………………………… 5

Means Test……………………………………………………………… 5
Limits on State Exemptions……………………………………….. 6
Enhancing the Position of Secured and Other Creditors………….. 7
Limits on “Overloading”…………………………………………… 8
Protection for Consumers from Creditor Abuses…………………. 9
Other Key Provisions……………………………………………… 10

Creditors Must Make New Disclosures…………………………………. 12

Truth-in-Lending Act Amendments………………………………. 12
Other Provisions…………………………………………………….. 14

Business Bankruptcy………………………………………………………. 15

New Limits on Executive and Employee Compensation………… 15
New Rules for Property Leases…………………………………… 15
New Time Limits on Filing a Chapter 11 Plan…………………… 16
New Rules for Suppliers and Service Providers’ Claims………… 17
Relief from Preference Actions…………………………………… 17
Other Key Provisions……………………………………………… 18

New Protections for Parties to Financial Market Contracts…………. 20

II. HIGHLIGHTS OF THE ACT

A. CONSUMER BANKRUPTCY

- **MEANS TEST**

In General. Under prior law, Chapter 7 relief was available to individuals of all income levels. Under the Act, an individual's access to Chapter 7 relief to discharge or liquidate debts immediately depends on the outcome of a means test projecting the debtor's current monthly income over a five-year period minus certain expenses.[3] Any individual seeking Chapter 7 protection whose income is above the state's median level is subject to the test. Such a filing under Chapter 7 must either be dismissed or converted to a Chapter 13 filing if (1) the individual has at least $166.67 in current monthly income *after* the allowed expense deductions (or at least $10,000 to repay unsecured creditors over five years), or (2) the individual has at least $100 in such income *after* deductions (or at least $6,000 to repay unsecured creditors over five years) and the amount of net income is sufficient to pay at least 25% of his/her nonpriority unsecured debt over three to five years. (Sec. 102)[4] If converted to a Chapter 13 filing, the Act increases the repayment time period from three to five years during which an individual debtor whose income is above the state median level must make payments to unsecured creditors, thereby increasing the time period over which payments are made to such creditors. Debtors below the state median income would still be subject to a three-year plan. (Sec. 318)

Computing Current Monthly Income. The amendments to the Code require a look back of six months from the filing date to include income from all sources (except social security and certain other payments made to the debtor, *e.g.,* payments to victims of war crimes). Income may be adjusted based on a showing of special circumstances, *e.g.,* called to military active duty. (Sec. 102)

Computing Deductions for Expenses. Under the means test, the Act provides that individual debtors may deduct reasonable monthly living expenses based on IRS standards and allowances for food, clothing, personal care, and entertainment based on family size in accordance with other national standards from current monthly income. Among other things, monthly expenses include health and disability insurance; health savings account expenses; expenses to maintain the safety of the debtor and family; expenses to care for and support elderly, ill, or disabled family members; actual expenses of up to $1500 per year per child for private school; charitable contributions up to 15% of the debtor's gross income in the year in which the contribution was

[3] However, a court cannot dismiss or convert a bankruptcy filing based on means testing if the debtor is a disabled veteran and the indebtedness occurred primarily during a period of active duty or performing a homeland defense activity. (Sec. 102)
[4] The section numbers refer to sections in the Act.

made; actual payments for secured debts (including any additional payments to secured creditors necessary for the debtor to maintain possession of a primary residence, car, or other property necessary to support the debtor and family) and nondischargeable debts; and expenses for administering the Chapter 13 plan, which may be up to 10% of the projected repayments. The total may be adjusted based on a showing of special circumstances, *e.g.,* serious medical condition. (Sec. 102)

Attorney Due Diligence. The Act requires an attorney's signature on any bankruptcy petition, pleading, or written motion. Among other things, by signing the document the attorney is certifying that he/she has performed a reasonable investigation into the circumstances giving rise to the filing, the filing is well grounded in fact and is warranted under existing law, and that the attorney has no knowledge, after an inquiry, that the information on the schedules is incorrect. An attorney faces sanctions, *e.g.,* civil penalties and payment of costs, for false certifications. While the accuracy and reliability of bankruptcy filings may be improved, these changes will increase attorney fees for bankruptcy cases with the result of reducing funds that may otherwise be available to unsecured creditors of the debtor. (Sec. 102)

- **LIMITS ON STATE EXEMPTIONS**

In General. The Act requires that an individual must live in a state for at least 2 years (prior law required 180 days) before filing for bankruptcy to claim any exemptions under that state's law that would allow a debtor to retain certain property in a bankruptcy proceeding (other than a homestead exemption as discussed below). (Sec. 307)

Homestead Exemption *(Effective April 20, 2005)*. Under prior law, debtors in homestead states (such as, Florida, Texas, Kansas, Iowa, and South Dakota) could protect all of their home equity from creditors as provided by state law. The Act limits that exemption. Under the Act, the debtor must own the residence for 40 months to be able to take advantage of that state's homestead exemption. If the debtor does not satisfy the residency requirement, the amount of the exemption is limited to the lesser of $125,000 or the maximum amount of the state's homestead exemption. The amount also may be limited to $125,000 if the debtor owes debts that arise from certain violations of the securities laws or criminal acts. (Sec. 322). A debtor's homestead exemption is further reduced to the extent the property subject to the exemption was obtained by disposing of other nonexempt property in the last ten years with the intent to hinder, delay, or defraud a creditor. (Sec. 308)

- **ENHANCING THE POSITION OF SECURED AND OTHER CREDITORS**

Relief from the Automatic Stay.[5] Under the Act, a secured creditor will not be required to file a motion requesting relief from the automatic stay under certain conditions.

- All creditors will be granted relief from the automatic stay 30 days after a debtor files if the debtor had prior bankruptcy cases pending during the last year that were dismissed, unless the debtor rebuts the presumption that the recent case was not filed in good faith. (Sec. 302)
- In addition, there is no automatic stay if a debtor files a case after two or more dismissed cases were pending in the previous year. (Sec. 302)
- Moreover, the court may lift the automatic stay for a creditor whose lien is secured by real property if the bankruptcy petition is part of a scheme to delay, hinder, and defraud the creditor with respect to the property. (Sec. 303)
- Further, if the debt is not timely assumed, the automatic stay is lifted as to any personal property securing a claim or subject to an unexpired lease, and such property is no longer property of the estate. (Secs. 305, 309(b))
- Also, an individual Chapter 7 debtor can no longer retain possession of personal property in which a creditor has a purchase-money security interest (the so-called "ride-through" of secured property) if the secured debt is not reassumed through agreement within 45 days after the meeting of creditors. If the debtor fails to take this action, the stay is automatically lifted and the secured creditor can continue collection efforts. However, the bankruptcy trustee also may file a motion to retain the secured property as part of the estate during this same time period. (Sec. 304).
- Moreover, the Act provides new exceptions to the automatic stay with respect to leased residential real estate to allow the continuation of eviction proceedings if a lessor obtained a judgment prior to the filing of the bankruptcy petition. (Sec. 311)
- Finally, the automatic stay does not apply to the withholding of deductions from a debtor's wages for contributions to qualifying IRAs or a thrift savings plan. (Sec. 224(b))

Debtor Has Continuing Payment Obligations. A new provision is added to require a Chapter 13 debtor, within 30 days after filing and unless otherwise ordered by the court, to continue to make payments directly to the lessor of personal property or directly to the secured creditor of a debt secured by a purchase-money security interest in personal property. Such payments will be credited against plan payments. If a Chapter 13 plan is not confirmed, the trustee will pay the creditors any court ordered payments that were made to the trustee and will pay any administrative expenses before returning the remaining funds to the debtor. (Sec. 309(c))

[5] Generally, the automatic stay prevents creditors from pursuing collection efforts against debtors during the duration of the bankruptcy. The changes made by the Act that provide certain creditors with relief from the automatic stay generally apply to bankruptcies filed under Chapter 13, as well as other chapters of the Code, unless otherwise noted.

Retention of Lien. A new provision is added to the Code that clarifies that a Chapter 13 plan must provide that a secured creditor retains its lien on the collateral until all payments are made or the debt is discharged thereby precluding a Chapter 13 plan that would provide for release of a lien upon payment of a stripped-down secured claim. (Sec. 306(a)) Moreover, if a case is converted from Chapter 13 to Chapter 7, the secured creditor's claim to the security is not affected. (Sec. 309(a)) In addition, any prebankruptcy default not cured by the date of conversion is given the effect it has under nonbankruptcy law thereby allowing a foreclosure action to proceed. (Sec. 309(a))

Valuation of Claims. A new provision ensures that a creditor's claim for personal property securing a claim is valued at its replacement value. With respect to property acquired for personal, family, or household purposes, the replacement value is the price a retail merchant would charge for the property considering its age and condition. (Sec. 327)

- **LIMITS ON "OVERLOADING"**

Luxury Goods. Certain debts are nondischargeable in bankruptcy and must be paid by a debtor. The Act provides that there is a presumption that a consumer debt is nondischargeable if a debtor incurs debts owed to a single creditor aggregating more than $500 in luxury goods and services (*i.e.,* excluding goods and services that are reasonably necessary for the support or maintenance of the debtor or the debtor's dependent) within 90 days of filing, or $750 in cash advances within 70 days of filing. Under the prior statute, a debtor could not discharge consumer debt over $1,000 in luxury goods and services or over $1,000 in cash advances if incurred within 60 days of filing. These changes are intended to further limit a debtor's ability to discharge debts for goods and cash advances above certain amounts that the debtor incurred shortly before bankruptcy. (Sec. 310)

Nondischargeable Debts Are Expanded. The Act adds the following additional debts to the list of debts that are nondischargeable in bankruptcy:

- Debts incurred to pay state or local tax (Federal tax debts are already nondischargeable) (Sec. 314(a));
- Debts for money, property, or services, or an extension, renewal, or refinancing of credit that was obtained by a Chapter 13 debtor under false pretenses or statements, or misrepresentation, or other types of fraud (this type of debt is already nondischargeable under other chapters of Code) (Sec. 314(b));
- Debts of a Chapter 13 debtor for fraud or defalcation when acting in a fiduciary capacity, embezzlement, or larceny (this type of debt is already nondischargeable under other chapters of the Code) (Sec. 314(b));
- Debts incurred from judgments or settlements arising from certain violations of the securities fraud laws that are committed pre- or post-petition (Sec. 1404) ***(effective July 30, 2002 upon enactment of the Sarbanes-Oxley Act)***;

- Any qualified education loan (not only those that are government guaranteed or made by a nonprofit institution) (Sec. 220);
- Domestic support obligations and marital property settlement obligations (Sec. 215); and
- Debts owed for loans from a qualifying pension, profit sharing, stock bonus, or other plan, such as a thrift savings plan. (Sec. 224(c))

Prior Bankruptcy Discharge. Under prior law, a debtor could have received a discharge in Chapter 7 or Chapter 11 only once every six years. The Act extends this time period to eight years. (Sec. 312)

Serial Filings. The Act requires a debtor to wait two years between Chapter 13 filings and three years before filing under Chapter 13 if the debtor received a discharge under Chapter 7, 11 (generally business reorganizations), or 12 (family farmers).[6] Under prior law, there was no time limit on serial Chapter 13 filings or limit on filing in Chapter 13 after receiving a Chapter 7 discharge. These types of serial filings are usually done for the purpose of frustrating foreclosures, evictions, or other creditor actions. These changes should be helpful to curb such bankruptcy abuses. (Sec. 312)

Avoidance of Transfers to Trusts. The Act adds a new provision permitting a bankruptcy trustee to avoid transfers made by a debtor to a self-settled trust that were made within 10 years of the bankruptcy filing if the debtor is the beneficiary of the trust and made the transfer with the intent to hinder, delay, or defraud any creditor at the time or after the transfer was made. (Sec. 1402)

- **PROTECTION FOR CONSUMERS FROM CREDITOR ABUSES**

Unreasonable Refusal to Enter Into A Reasonable Pre-petition Repayment Plan. The court may reduce a creditor's dischargeable unsecured consumer claim by up to 20% if the creditor unreasonably refused to accept a reasonable repayment plan with an approved credit counseling agency more than 60 days prior to bankruptcy and if the plan provided for the payment of at least 60% of the debt over a certain period of time. The burden of proof is on the debtor to show that the creditor's refusal to consider the debtor's proposal was unreasonable and that the proposed alternative repayment schedule was made at least 60 days before filing for bankruptcy. Moreover, any payments made to a creditor under such a plan are not voidable by the bankruptcy trustee. This provision is intended to encourage an alternative resolution to paying certain creditor claims rather than filing for bankruptcy. (Sec. 201)

[6] The language is ambiguous about whether the time period runs from prior discharge to current filing or from prior filing to current filing.

Failure to Credit Mortgage Payments. A creditor's willful failure to credit mortgage payments as provided in a confirmed bankruptcy plan will be subject to sanctions if the failure to credit the payments caused material injury to the debtor. (Sec. 202)

Additional Disclosures Required. Creditors are required to give new lengthy disclosures to any debtor who reaffirms a debt. However, notwithstanding the intention of a debtor to reaffirm a debt, a presumption arises that a debtor cannot afford an affirmation agreement if the debtor's income less expenses leaves insufficient funds to make the payments (unless the creditor is a credit union) and, on that basis, a court may disapprove the agreement. (Sec. 203)

Defenses to Sales of Consumer Credit Obligations. The Act clarifies that the sale of consumer credit obligations does not terminate any consumer claims or defenses that would otherwise be available outside of bankruptcy. (Sec. 204)

- **OTHER KEY PROVISIONS**

Priority of Domestic Support Obligations. Domestic support obligations are given the first priority among unsecured debts (other than administrative expenses of the bankruptcy trustee to the extent the expenses are incurred in administering assets of the estate to pay the domestic support obligations). (Sec. 212) Moreover, new standards will apply to ensure that domestic support obligations are protected under Chapter 13 plans. (Sec. 213) However, other changes in the Act elevate the priority of certain tax liens that may result in a tax lien being satisfied before outstanding domestic support obligations are paid from assets of the estate under certain circumstances. (Sec. 701)

Prohibiting the "Cramdown" of Debts Secured by Automobiles or Other Property. Under prior law in a Chapter 13 bankruptcy, a debtor could have kept a car by paying only the "Blue Book" value (*i.e,* "cramdown" the debt to the value of the collateral) and the remainder of the debt was considered an unsecured loan. Under the Act, the debtor must complete the full term of the loan or allow the car to be repossessed if the creditor has a purchase money security interest and the debt was incurred within approximately 2-1/2 years before filing. Debts secured by other types of property also cannot be crammed down if secured within one year before filing. (Sec. 306(b))

Funds in Retirement and Education Plans Excluded from Bankruptcy Estate. As in prior law, the full amount in a 401(k) will continue to be excluded from assets of the bankruptcy estate. However, under the Act, generally only the first $1 million in an IRA is protected from creditors (but any funds rolled over to the IRA from a non-IRA account would continue to be excluded). Education IRA funds for certain designated beneficiaries are also excluded if

contributed more than a year before filing. (Sec. 224)

Credit Counseling Required. An individual must obtain credit counseling within 180 days prior to filing unless granted an exemption. (Sec. 106)

Additional Documentation Required. The Act requires debtors to file additional documentation showing income and expenses, including Federal tax returns. Failure to file all of the required documents may result in the suit being dismissed. (Secs. 315(b), 316)

Privacy Protections. The Act puts into place new provisions intended to protect a debtor's personally identifiable information. A court may enter an order protecting an individual from the disclosure of information that would create an undue risk of identity theft. Information that may be protected includes, among other things, the debtor's name, social security number, date of birth, and driver's license number. (Sec. 234).

Debt Relief Agency Abuses. New restrictions and requirements are imposed on debt relief agencies to curb abuses. (Secs. 227-229)

Revoking a Discharge for Material Misstatements. New provisions are added to the Code requiring independent certified public accountants to conduct audits of randomly selected individual Chapter 7 and 13 cases. The audit reports will disclose any identified material misstatements of income, expenditures, or assets that were made by an individual debtor. Notice of such information will be given to creditors in the case and may result in revoking a debtor's discharge. A debtor's discharge also may be revoked if the debtor fails to cooperate with the auditor. (Sec. 603)

B. CREDITORS MUST MAKE NEW DISCLOSURES

- **TRUTH-IN-LENDING ACT (TILA) AMENDMENTS**

Minimum Payment Warnings ***(Effective the later of Oct. 20, 2006, or twelve months after the Fed issues final implementing regulations).***[7] The Act requires creditors extending credit under open end credit plans, *e.g.,* credit cards, to provide consumers with minimum payment warnings in their billing statements.

Unless a creditor subject to the Fed's regulations maintains a toll free telephone number for the purpose of telling a consumer the *actual* number of months it will take to pay off the consumer's balance making only the minimum monthly payment and provides such information on each billing statement (together with a general statement that making only minimum payments will increase interest and extend the repayment time), the creditor must make certain other disclosures on the front of each billing statement in accordance with the Fed's regulations. First, the creditor must give a warning stating that paying only the minimum payment will increase the consumer's interest payments and the time it will take to pay off the balance. Second, using an interest rate of 17% or higher, the creditor must give an example of how such payoffs are affected (a) by making a 2% minimum monthly payment on a balance of $1,000 if the consumer's required minimum monthly payment is not more than 4% of the balance, or (b) by making a 5% minimum monthly payment on a balance of $300 if the consumer's required minimum monthly payment is more than 4% of the balance. Third, the creditor must provide consumers with a toll free number to obtain an *estimate* of the minimum repayment time. Fed regulations also must include instructional guidance on using a detailed table developed by the Fed illustrating the number of months it would take to pay off various outstanding balances at various interest rates making only minimum monthly payments. This table is to be used to provide information to consumers over creditors' toll free numbers.[8]

The Fed, *in consultation with the other Federal banking agencies* **(including the OCC)**, *may* conduct a study of the type of information that is made available to potential borrowers concerning credit arrangements, including whether the consumer is aware that making only minimum payments on an account will increase the costs and repayment period. (Sec. 1301)

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[7] Contemporaneous with the effective date of the Act, the Fed published an Advance Notice of Proposed Rulemaking (ANPR) soliciting public comments on how the Fed should implement the Act's amendments to TILA. *See* 70 Fed. Reg. 60,235 (Oct. 17, 2005). Because the Fed only recently published the ANPR, as a practical matter, the new requirements will not take effect until 12 months after the Fed finalizes its rules adopting the changes.

[8] For a period not to exceed Oct. 17, 2007, the Fed will provide a toll free number (or will provide a toll free number established and maintained by a third party) to be used by depository institutions and credit unions that have total assets of less than $250 million. The Fed then must submit a report to Congress on this program. After Oct. 17, 2007, presumably, the creditor will be required to establish and maintain a toll-free number either directly or through a third-party in accordance with the statute and the Fed's regulations.

Enhanced Disclosures if Credit Extension is Secured by a Dwelling ***(Effective the later of April 20, 2006, or twelve months after the Fed issues final implementing regulations).***[9] In accordance with the Fed's implementing regulations, if an extension of credit exceeds the fair market value (FMV) of a dwelling, a creditor offering credit under an open-end consumer credit plan or a non-open end credit extension that will be secured by a consumer's principal dwelling is required to disclose that the interest on any portion of the credit extension that exceeds the dwelling's FMV is not tax deductible for Federal tax purposes. (Sec. 1302)

Enhanced Disclosures Relating to Introductory Rates ***(Effective the later of April 20, 2006, or twelve months after the Fed issues final implementing regulations).***[10] In accordance with the Fed's implementing regulations, if a creditor is offering an introductory or temporary interest rate (*i.e.,* a rate that will be in effect for less than one year) in an application or a solicitation to open a credit card account, the creditor must make certain additional disclosures highlighting that the rate is temporary, another rate will apply at the end of the temporary rate period, and, under what circumstances, the temporary rate may be revoked and, if revoked, what new rate that will apply. (Sec. 1303)

Enhanced Disclosures Concerning Internet Credit Card Solicitations ***(Effective the later of April 20, 2006, or twelve months after the Fed issues final implementing regulations).***[11] In accordance with the Fed's implementing regulations, if a creditor is using the Internet to solicit the opening of a credit card account under an open-end consumer credit plan, the creditor must make the same clear and conspicuous disclosures that would be required if making the solicitation by direct mail and must also make the disclosures described above if an introductory rate is being offered. Such disclosures must be "readily accessible to consumers" and in "close proximity to the solicitation." (Sec. 1304)

Enhanced Disclosures Relating to Late Payment Deadlines and Penalties ***(Effective the later of April 20, 2006, or twelve months after the Fed issues final implementing regulations).***[12] In accordance with the Fed's implementing regulations, for each billing cycle for an account under an open end consumer credit plan for which there is an outstanding balance, a creditor that charges late payment fees must disclose to the obligor the earliest date that a late payment fee will be charged (if different from the due date), and the amount of the late payment fee. (Sec. 1305)

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[9] *See supra* note 7.
[10] *Id.*
[11] *Id.*
[12] *Id.*

Prohibition on Canceling Accounts for Failure to Incur Finance Charges ***(Effective the later of April 20, 2006, or twelve months after the Fed issues final implementing regulations).***[13] In accordance with the Fed's implementing regulations, a creditor of an account under an open-end consumer credit plan may not terminate an account prior to the expiration date solely because the consumer has not incurred finance charges on the account. This restriction, however, does not prohibit a creditor from terminating an account that has been inactive for three or more consecutive months. (Sec. 1306)

- **OTHER PROVISIONS**

Regulations Clarifying the Meaning of "Clear and Conspicuous" ***(Statutory Deadline of Oct. 20, 2005)***. The Fed, *in consultation with the other Federal banking agencies* ***(including the OCC)****, NCUA, and FTC, must* issue regulations providing guidance on the meaning of the "clear and conspicuous" standard for certain consumer disclosures and include examples of model disclosures in the regulation.[14] (Sec. 1309)

[13] *Id.*

[14] *See supra* note 7 at 60,236-37 (The Fed will not meet the statutory deadline. The ANPR provides that issuing clear and conspicuous standards and model forms by Oct. 20, 2005 would have no effect until the substantive TILA rules required by the Act are issued and effective. Thus, the clear and conspicuous standard currently in Regulation Z will continue to apply to all TILA disclosures until a new standard is adopted after notice and comment is sought in connection with the Fed's review of Regulation Z).

C. BUSINESS BANKRUPTCY

- **NEW LIMITS ON EXECUTIVE AND EMPLOYEE COMPENSATION**

Limiting Executive Compensation and Key Employee Retention Programs (KERPs). The Act limits the circumstances under which insiders in a Chapter 11 business bankruptcy may be compensated to remain with the business and the amount of such compensation. The Act also limits severance payments to such insiders. (Sec. 331)

Increased Amount of Wage Claims Allowed. ***Effective April 20, 2005,*** the Act increases the amount of an employee's wage claim that is entitled to administrative priority and, thus, must be paid in full. Employees are now entitled to up to $10,000 (formerly $4,000 under the Code) for wages and benefits earned within 180 days (formerly 90 days for wages) prior to the bankruptcy filing. (Sec. 1401) In addition, *effective Oct. 17, 2005,* post-petition back pay awarded as a result of a violation of law by the debtor may be included as an administration expense regardless of when the conduct occurred, unless to do so would cause certain other payments not to be made. (Sec. 329)

Fraudulent Transfers to Insiders or for Their Benefit. The Act provides new provisions for avoiding certain transfers of property under the fraudulent transfer rules that were made within two years before the petition was filed (rather than one year) and that were made to or for the benefit of an insider under an employment contract and not in the ordinary course of business. (Sec. 1402)

Modifying Retiree Benefits. The Act gives the court the power to modify changes to retiree benefits that were made within 180 days prior to commencement of the case and to restore the benefits as they existed prior to the modification. (Sec. 1403)

- **NEW RULES FOR PROPERTY LEASES**

New Limits on Time to Assume a Commercial Lease. The Act benefits lessors of commercial property by imposing new limits on the deadline by which a debtor must assume or reject a commercial real property lease thereby requiring the debtor to make that decision more quickly. Under prior law, there was no limit on the number of extensions that a court may grant to a debtor-tenant to decide whether to assume or reject a commercial lease. Under the Act, the debtor must assume or reject the lease within 120 days of filing, and the court may grant only one extension for 90 days unless the landlord consents to an additional extension. (Sec. 404)

Facilitating Assumption of Real Estate Leases. Under prior law, a debtor had to cure all defects under a lease prior to assumption. Some nonmonetary defaults in a lease cannot be cured, however, such as a store closing its doors for a period of time when the lease required it to be in operation during those business hours. In such cases, some courts have found that the lease cannot be assumed thereby possibly forcing the debtor to go into Chapter 7. The Act provides that breaches of such nonmonetary obligations can be cured by subsequent performance and, thus, do not bar the debtor from assuming the lease and continuing operations. (Sec. 328)

New Limits on a Landlord's Claim if an Assumed Contract is Subsequently Rejected. The new abbreviated time period in which a debtor must decide whether to assume or reject a commercial lease (described above) could force a debtor to assume a lease too quickly and then be forced to subsequently reject the lease, thereby creating considerable administrative claims. Under prior law, the landlord's administrative claim for a subsequently rejected lease had to be paid in full for the term of the lease. The Act, however, limits the amount of such a landlord's administrative claim to the monetary obligations that would have accrued over the two years following the rejection. Moreover, if the landlord can recover from another source, *e.g.,* renting the property to another tenant, its administrative claim will be reduced by that amount. Any damages above the two-year cap will be considered general unsecured claims. (Sec. 445)

Special Rules for Shopping Center Leases. The Act clarifies that shopping center leases may be assigned by the debtor only if permissible under the terms of the lease. Under prior law, some courts had interpreted the Code to permit the assignment notwithstanding the terms of the lease. While beneficial to the shopping center owners, the change may limit a debtor's ability to monetize its interest in the lease and increase the assets in the bankruptcy estate. (Sec. 328)

- **NEW TIME LIMITS ON FILING A CHAPTER 11 PLAN**

Expediting Chapter 11 Cases. Under prior law, a debtor in Chapter 11 had the exclusive right to file a plan and there was no limit on that right. Other parties in interest (including a trustee or any creditor) could file a plan if the debtor failed to file or have a plan approved within certain time limits. However, courts routinely granted the debtor multiple extensions of the debtor's exclusivity that, in some cases, extended this period for years beyond the date of the Chapter 11 filing. Restrictions on the exclusivity rights for filing plans by small business debtors are also imposed.[15] The Act restricts these time periods so as to expedite Chapter 11 cases. (Secs. 411, 437)

[15] A "small business" for Chapter 11 purposes is defined as a business with debts under $2 million. (Sec. 432)

- **NEW RULES FOR SUPPLIERS' AND SERVICE PROVIDERS' CLAIMS**

Full Payment of Certain Goods. The Act adds a new provision to the Code that enhances the rights of suppliers of goods. It provides that the value of any goods sold to a debtor in the ordinary course of business within 20 days prior to the filing for bankruptcy may be treated as an administrative expenses and paid in full under a Chapter 11 plan. Under prior law, such claims of the seller would have been treated as general unsecured claims unless subject to reclamation. (Sec. 1227)

Increasing Time Limits for Reclamation. The Act also increases the time periods during which a supplier may bring a reclamation claim for the return of goods delivered on credit to a debtor in Chapter 11. The new time period is the later of 45 days after the debtor received the goods or 20 days after the filing date. Under prior law, the claim had to be brought within 10-20 days after the debtor received the goods. This provision and the change described above have the effect of preferring trade creditors over other unsecured creditors. In addition, return of such goods under the expanded authority could negatively affect the prospects of a debtor to successfully reorganize under Chapter 11. (Sec. 1227)

Utility Service Payments Assured. Under prior law, a utility service could not discontinue service to a debtor if the debtor promptly gave adequate assurance of payment. A debtor could satisfy this requirement and avoid the need for a cash deposit by, among other things, arguing that a service provider's fees would be paid as administrative expenses of the bankruptcy estate if the debtor failed to make payments. The Act substantially tightens the criteria and defines "assurance of payment" to mean only such things as cash deposits, letters of credit, CDs, and prepayments. While beneficial to utility service providers, the new criteria may reduce the assets in the bankruptcy estate available to other creditors. (Sec. 417)

- **RELIEF FROM PREFERENCE ACTIONS**

Better Protection for Perfected Security Interests. The general rule is that any transfer of property within 90 days prior to filing bankruptcy is a voidable preference and may be brought back into the bankruptcy estate (transfers to insiders are voidable if made within one year of filing). For purposes of determining the transfer date for property subject to a security interest, the property is "transferred" at the time the security interest is perfected. The Code provides some limited exceptions to this general rule. In the case of a security interest (other than a purchase money security interest as described below), if the security interest is perfected within a certain time period after the initial transaction, the "transfer" of property occurs at the time of the initial transaction and not at the time of the perfection. The Act increases from 10 to 30 days the time period after the initial transaction during which a creditor must perfect a security interest to avoid preference attack if perfection takes place during the preference period. (Sec. 403)

Perfection of Purchase Money Security Interest. The Code assigns a high order of priority to purchase money security interests. Such an interest cannot be avoided by a bankruptcy trustee if perfected within a certain time period notwithstanding when the initial transaction took place. The Act strengthens the treatment of these interests and gives a creditor 30 days, rather than 20 days, after the debtor's receipt of the property in which to perfect the interest and avoid a preference attack. (Sec. 1222)

Protection of Transfers to Non-insiders *(Effective April 20, 2005).* The Act clarifies that the look-back preference period applicable to the transfer of property to a *non*-insider (including the perfection of a security interest), if the transfer is for the benefit of an *insider* of the debtor, is the normal 90 days and not the extended one-year look-back preference period that applies to transfers to insiders.[16] This provision complements other changes that were made to the Code several years ago to overrule the so-called *DePrizio* doctrine[17] that extended the preference period to one year with respect to non-insiders who receive transfers of property for the benefit of an insider. (Sec. 1213)

"Ordinary Course" Defense Expanded. The Code provides an "ordinary course" of business defense to preference actions for payments made by a debtor within 90 days prior to bankruptcy if such payments satisfy certain criteria. The Act expands that criteria and also provides a *de minimis* exception for pre-petition payments of under $5,000 if the debtor's debts are not primarily consumer debts. (Sec. 409)

- **OTHER KEY PROVISIONS**

Improving the Administration of International Bankruptcies. New provisions are added to the Code to provide more efficient procedures for administering cross-border bankruptcies and improving the predictability of these cases. (Secs. 801-802)

Use of Current Investment Bankers. Under prior law, investment bankers used by a debtor pre-bankruptcy could not provide services to the debtor in bankruptcy. The Act will permit such continuing service. (Sec. 414)

Protection of Patients of Bankrupt Health Care Businesses. The Act provides for the appointment of a patient care ombudsman within 30 days of a bankruptcy filing by a health care business to monitor and report to the court at 60-day intervals on the quality of continuing patient care. The Act also requires that certain procedures must be followed when disposing of patient

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[16] For example, a bank (the non-insider) received payments on a loan that was guaranteed by an insider of the debtor more than 90 days prior to the bankruptcy filing but less than a year before the filing. The Act clarifies that the bankruptcy trustee cannot avoid such payments made to the bank in the ordinary course of business.

[17] *See* Levit v. Ingersoll Rand Financial Corporation (In re DePrizio), 874 F.2d 1186 (7th Cir. 1989).

records and provides administrative expense priority for the costs of disposing of patient records and transferring patients out of a healthcare business that is closing its doors. (Secs. 1101-1106)

Protections Against the Transfer of Personally Identifiable Information. The Act adds new requirements to protect the transfer of personally identifiable information. It requires that, if a debtor in connection with offering a product or service has disclosed a policy of not transferring personally identifiable information about individuals to nonaffiliates, and the policy is in effect at the time of filing, the debtor's transfer of such information must be consistent with the policy or a consumer privacy ombudsman is appointed and a court finds that the transfer does not violate non-bankruptcy law. (Secs. 231-232)

Bankruptcy Filings by Family Farmers and Family Fisherman. ***Effective July 1, 2005,*** the Act reenacts the special treatment of family farmers under Chapter 12 of the Code without a sunset date (without an extension, Chapter 12 would have expired June 30, 2005). ***Effective Oct. 17, 2005,*** the debt limit for a family farmer is increased from $1,500,000 to $3,237,000. Moreover, the law is changed to provide that a debtor may qualify for Chapter 12 if either 50% (rather than 80%) of the debtor's income was received from a farming operation in the tax year prior to the petition. An alternative test is added that would allow a debtor to qualify if 50% of the debtor's income was received from a farming operation in each of the second and third years before the petition. New provisions are added to cover family fishermen under Chapter 12. (Secs. 1001-1007)

Disclosure of Subsidiaries. New provisions are added to the Code to provide for the disclosure of information about entities in which a debtor holds a substantial or controlling interest to ensure that such assets may be used to pay creditor claims. (Sec. 419)

D. NEW PROTECTIONS FOR PARTIES TO FINANCIAL MARKET CONTRACTS

Harmonizing the Laws Governing the Insolvency of Parties to Financial Contracts. One purpose of the amendments in the Act is to reduce the risk associated with certain defined derivatives contracts,[18] known as "qualified financial contracts" (QFC) under the Federal Deposit Insurance Act. The Act puts into place uniform definitions and rights to ensure that parties to these contracts are treated the same in the event of an insolvency whether the insolvent party is a bank subject to the banking laws, a corporation subject to the Code, or a credit union subject to the credit union laws. To achieve this objective, the Act amends the various insolvency laws to provide uniform definitions of the protected financial contracts so that the same contracts are covered and similar rights are provided under the respective laws. (Title IX)

Uninsured National Banks and Uninsured Federal Branches and Agencies Are Included. The Act amends applicable banking laws to provide that uninsured national banks, as well as uninsured state member banks, are included in the definitions of "depository institution" and "financial institution" for purposes of preserving netting entitlements if an institution party should fail. Moreover, the Act would amend applicable banking law to ensure that similar rules to those that apply to the resolution of insured banks would apply to uninsured national banks and Federal branches or agencies if such an entity were a party to a QFC and should become insolvent. (Sec. 906)

Enhanced Protection for Netting. The Act enhances the protection of parties' netting rights to liquidate positions in financial contracts, including expanding the protections to cover cross-product netting under master netting agreements. (Secs. 905 – 907)

Relief from SIPC Stay. Amendments to the Securities Investor Protection Act provide that creditors' rights to take certain actions with respect to financial contracts are not stayed in a SIPC proceeding. (Sec. 911)

[18] Such contracts derive their value from the value of the underlying asset, such as a rate, index, or cash instrument.