

BANKRUPTCY

Expert Analysis

BAPCPA's Five-Year Anniversary: Transformative Influence Or Negotiable Challenge?

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Since the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, it has been a challenging time for American businesses. As the most significant legislative amendment to the U.S. Bankruptcy Code since its inception in 1978, BAPCPA brought significant change and controversy.

However, in retrospect, it represented merely a contributing factor, rather than the sole cause, of the hurdles companies have faced in undergoing Chapter 11 bankruptcy in recent years.

As the U.S. economy sluggishly emerges from the deepest economic recession in decades, industry analysts debate whether BAPCPA alone has transformed the Chapter 11 process into a more challenging endeavor or whether the recent volatile economic conditions have magnified its impact, which otherwise might have been manageable.

To mark the five-year anniversary of this significant change in the Chapter 11 process, this article highlights some of BAPCPA's provisions, ranging from the most controversial to those that have been less impactful than previously expected. From this analysis, we can draw further conclusions about BAPCPA's impact and what it means for companies considering Chapter 11 within today's fragile economic landscape.

SECTION 365(D)(4)

Formidable challenges for the retail sector

BAPCPA's changes to Section 365(d)(4), limiting the time allowed for corporate debtors to assume or reject real property leases, have been among the law's most controversial provisions.

Prior to BAPCPA, debtors made the decision to reject or assume an unexpired lease of non-residential real property within 60 days after bankruptcy, and courts could extend that period "for cause" ad infinitum.

After the 2005 amendments, an unexpired lease of non-residential real property is deemed rejected by the earlier of 120 days after the bankruptcy petition or the date

of the entry of an order confirming a plan.¹ Furthermore, a court now may grant only a single 90-day extension at the debtor's or lessor's request for cause. Subsequent extensions can only be granted upon the lessor's written consent.

Debtors today have less time to assume or reject leases, which hits multi-site entities such as retailers the hardest. Seven months may be too short a time to determine which stores to keep and which stores to close. BAPCPA has empowered landlords and increased pressure on debtors to resolve all lease-related issues in what is often-times an unreasonably short amount of time.

In examining the impact of the revised Section 365(d)(4) on bankruptcies, one cannot overlook the impact of the financial crisis on retailers during the past two years. After all, issues such as decreased consumer spending, the changes in the consumer experience (in terms of continued increases in online shopping) and the overleveraged nature of many corporate balance sheets all played a role in retail challenges.

However, much of the attrition of the retail sector can be credited to BAPCPA for making it more difficult for certain retailers to reorganize during the crisis.

As a response to these changes, the Bankruptcy Reorganization and Job Protection Act, H.R. 1942, was introduced in the U.S. House of Representatives in April 2009. The proposal, among other things, revises the formula for the deadline to assume or reject unexpired leases before they are deemed rejected.² The act was referred to a subcommittee and is not expected to be enacted before Congress' current session expires.

However, it illustrates the significance of BAPCPA's impact on the ability for certain types of companies to successfully restructure under its new provisions.

SECTION 503(B)(9)

New obstacles bring emerging strategies

On another front, BAPCPA added a new type of administrative priority claim for the "value of any goods received by the debtor, within 20 days before the date of commencement of a case under this title in which the goods have been sold to the debtor in the ordinary course of such debtor's business."

In general, this can increase the cost of exiting bankruptcy because the debtor cannot consummate a reorganization plan without paying such claims in full. For debtors that receive goods from numerous vendors, the number and scope of Section 503(b)(9) claims can dramatically influence their reorganization strategy.

For many debtors, it is important to quickly determine the extent of these claims. Unfortunately, case law is still developing under this provision and the Bankruptcy Code offers debtors no guidelines as to:

- How and when such claims must be asserted.
- Whether such claims can be disallowed.
- Whether the claims can be set off.
- How to distinguish between "goods" and "services."

For example, the official proof-of-claim form states that the form should not be used for administrative claims, so it seems that asserting a Section 503(b)(9) claim simply

by writing it into a claim form would be insufficient to create an administrative priority claim.

In addition, since Section 503(b)(9) does not specify a procedure for filing such claims, creditors can assert Section 503(b)(9) claims by motion like other administrative claims. This can lead to numerous motions being filed, each seeking Section 503(b)(9) priority claims and adding significant costs for a debtor that is forced to respond to each creditor separately.

To get around this, debtors have utilized procedures that streamline and standardize the process of asserting claims, such as setting a Section 503(b)(9) deadline and creating a specialized claim form that captures such claims. Debtors such as Visteon, Neff Corp. and SemGroup have recently used such procedures.

Section 503(b)(9) claims under BAPCPA have created confusion in other ways.

While most administrative claims are granted priority because they arise post-petition and the creditor adds value by providing a good or service for the benefit of the post-petition estate, Section 503(b)(9) administrative claims arise pre-petition, which has caused some courts to come to contradictory rulings.

For example, in *In re Plastech Engineered Products*, a court found that Section 502(d), which provides for disallowance of a claim if the creditor received an avoidable transfer, did not apply to Section 503(b)(9) claims because Section 502(d) does not apply to administrative claims.³

The opposite result was reached in *In re Circuit City*, where that court held that Section 502(d) could be used to disallow Section 503(b)(9) claims.⁴

Similarly uncertain, in *In re Associated Grocers*, the Bankruptcy Court concluded that the setoff provisions of Section 553(a) do not apply to claims asserted under Section 503(b)(9). This finding was reversed by the U.S. Bankruptcy Appellate Panel for the 9th Circuit, which held that Section 503(b)(9) claims are pre-petition claims properly susceptible to setoff, notwithstanding that Section 553 is not ordinarily applied to administrative claims.⁵

Courts have also reached contradictory results when defining goods and services, mostly with respect to the delivery of energy products.

In *In re Plastech*, the court held natural gas constituted "goods" that can form the basis for a Section 503(b)(9) claim.⁶ Meanwhile, the court in *In re Pilgrim's Pride* concluded that natural gas is a "good" but that electricity is a "service."⁷ Similarly, the court in *In re Samaritan Alliance LLC*⁸ reasoned that electricity was a "service" because it could not be reclaimed, but the court in *In re Erving Industries* disagreed.⁹

These changes and the subsequent lack of clarity regarding their execution have made some waves within the Chapter 11 process. However, many debtors have been able to find new strategies to navigate them without completely getting off the course to a successful restructuring.

SECTION 366

New procedures, practices

The rewriting of Section 366 also has received notable attention, yet professionals have found new ways to address the issues it presents. Under this revised section,

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utility providers are given greater leverage over the adequate assurance of future payment that debtors need to provide them to continue service.

Before BAPCPA, debtors-in-possession, or DIPs, would often file first-day motions to establish procedures to determine adequate assurances of payment to utilities. It was common for DIPs who remained current on their pre-petition utility bills to argue that their past timely payments already adequately assured the utility providers of future payment and, therefore, no new deposit or other security was required.

Also, DIPs could argue that the utility providers were entitled to an administrative expense claim in case of nonpayment and, therefore, they were adequately protected without the debtor providing out-of-pocket security.

However, the new BAPCPA section authorizes utility providers to “alter, refuse or discontinue service if during the 30-day period beginning on the date of the filing of the petition, the utility does not receive from the debtor or trustee adequate assurance of payment for utility service *that is satisfactory to the utility.*”¹⁰

Not only does BAPCPA require that the adequate assurance of payment be satisfactory to the utility, the Bankruptcy Code defines “assurance of payment” to mean a cash deposit, letter of credit, certificate of deposit, surety bond, prepayment of utility consumption or another form of security that is mutually agreed upon between the utility and the debtor or the trustee, and it explicitly excludes an administrative claim as a form of assurance of payment.¹¹

This new section also allows a court to modify the amount of the assurance payment, and case law is developing on when a court may intervene.

In *In re Lucre Inc.*, three utility providers failed to respond to the debtor-in-possession’s offers of adequate assurance, and the court was asked to continue the Section 366(a) injunction.¹²

The *Lucre* court held that the “trustee or debtor in possession has no recourse to modify the adequate assurance payment the utility is demanding until the trustee or debtor-in-possession actually accepts what the utility proposes.”¹³

A number of courts have since rejected that ruling and have held that a court can determine the form and amount of adequate assurance if the parties cannot reach agreement.¹⁴

Despite these issues, the new section has not kept DIPs from filing first-day motions. Rather, several courts have allowed procedures whereby the DIP’s proposed assurance payments are deemed accepted unless utility providers make a request for additional adequate assurance and provide sufficient evidence for the increased security.¹⁵ These procedures challenge the burden-shifting goals behind the revised Section 366.

Therefore, in this instance, while BAPCPA’s changes were anticipated with much concern, corporate debtors and their professionals have developed workable solutions and procedures to manage them.

LOOKING BACK AT BAPCPA AND FORWARD TO THE FUTURE OF CHAPTER 11

While BAPCPA has made its mark on the corporate restructuring process, not all of its provisions have produced the challenges that many expected. For many distressed

businesses, BAPCPA's impact was magnified by the deepest economic recession in decades.

The overall weakening of the economy and the contraction of the credit markets certainly contributed to greater challenges within Chapter 11, including limited DIP and exit financing, which in turn led to increased liquidations and accelerated bankruptcies.

With more time and money, many distressed companies might have been able to undergo the traditional Chapter 11 process to resolve their financial and operational challenges. This is evident from the numerous industry-wide recessions in recent years, including automotive, retail, manufacturing, real estate and media companies, just to name a few.

While a significant number of these companies did not survive the Chapter 11 process during the financial crisis, many with good business models did and continue to thrive today.

It is clear that the economic recession and BAPCPA both have influenced the Chapter 11 process, yet the challenges that American businesses have experienced over the past five years cannot be pinned solely upon one or the other; rather, it is a culmination of both.

Looking ahead to the future for Chapter 11, new challenges and changes likely will arise on both the economic and legislative fronts.

New financial regulation that emerged from the fallout of the financial crisis may have an indirect influence on the Chapter 11 process. At-risk systemically important financial institutions will be subject to the New Orderly Liquidation Authority, in lieu of traditional bankruptcy proceedings, under the Dodd-Frank Wall Street Reform and Consumer Protection Act signed into law July 21. Mandated studies under this new legislation will examine the traditional approach of Chapter 11, which ultimately may have an effect on the strategic approach that companies will take in resolving their financial and operational issues.

Despite the past, present or future challenges that companies face, the Chapter 11 process was created to adapt to these challenges and give corporate debtors alternative paths to corporate renewal and rejuvenation.

While BAPCPA, the economy and other influences may have a material impact on Chapter 11, their influence will always be tempered by the flexibility of the U.S. Bankruptcy Code and the creativity of corporate debtors and their professionals in finding new solutions.

NOTES

- ¹ 11 U.S.C. § 365(d)(4). Specifically, courts have held that the 120-day period permitting assumption or rejection of leases is a limitation on the filing of motions to reject or assume, and not on entry of the court orders approving or denying those motions. *See, e.g., In re Amerilink Ltd.*, 2009 WL 2497776 (Bankr. E.D.N.C. Aug. 12, 2009), *citing In re R. Ring Enters.*, 2009 WL 779800 (Bankr. N.D. Cal. Feb. 18, 2009).
- ² The proposal also would reduce the deadline by which a seller must demand reclamation of goods in writing from 45 days to 10 days after an insolvent debtor receives the goods at issue.
- ³ *In re Plastech Engineered Prods.*, 394 B.R. 147, 150 (Bankr. E.D. Mich. 2008).
- ⁴ *In re Circuit City Stores Inc.*, 426 B.R. 560 (Bankr. E.D. Va. 2010).
- ⁵ *In re Associated Grocers*, 375 B.R. 873 (B.A.P. 9th Cir. 2007).

⁶ *In re Plastech Engineered Prods.*, 397 B.R. 828 (Bankr. E.D. Mich. 2008).

⁷ *In re Pilgrim's Pride*, 421 B.R. 231 (Bankr. N.D. Tex. 2009).

⁸ *In re Samaritan Alliance LLC*, 2008 WL 2520107 (Bankr. E.D. Ky. June 20, 2008).

⁹ *In re Erving Indus.*, 432 B.R. 354 (Bankr. D. Mass. 2010).

¹⁰ 11 U.S.C. § 366(c)(2) (emphasis added).

¹¹ 11 U.S.C. §§ 366(c)(1)(A) and 366(c)(1)(B), respectively.

¹² *In re Lucre*, 333 B.R. 151 (W.D. Mich. 2005).

¹³ *Id.* at 154.

¹⁴ See, e.g., *In re Circuit City Stores Inc.*, 2009 WL 484553 (Bankr. E.D. Va. Jan. 14, 2009), at *10-11; *In re Beach House Prop. LLC*, 2008 WL 961498 (Bankr. S.D. Fla. Apr. 8, 2008), at *2; *In re Syroco Inc.*, 374 B.R. 60, 61 (Bankr. D.P.R. 2007).

¹⁵ *In re Circuit City Stores Inc.*, 2009 WL 484553 at *21 (citing cases).



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