

Creditors' Rights Quarterly

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Third-Party Releases in Chapter 11 Cases: Are They Enforceable?

Over the last few years, Chapter 11 cases have become increasingly large and complex. Forming a plan of reorganization that resolves all claims and addresses all issues involved in a reorganization can be difficult. In attempting to address complex issues that arise in Chapter 11 cases, many plans now include a provision which expands the bankruptcy discharge to include related non-debtor entities, such as insiders, partners, officers, and affiliates that have contributed to a debtor's reorganization. Although the United States Supreme Court has not yet addressed the issue, the Circuit Courts are split on whether these third-party releases are enforceable under the Bankruptcy Code.

Section 524 of the Bankruptcy Code provides for one of the most fundamental of the bankruptcy protections—the bankruptcy discharge. The discharge “operates as an injunction against the commencement or continuation of an action, the employment of process, or an act, to collect, recover or offset any such debt as a personal liability of the debtor.” Upon the confirmation of a plan, the permanent injunction of section 524 replaces the automatic stay that becomes effective on the date of the filing of the bankruptcy petition. The permanent injunction thus provides a debtor with a “fresh start” at the conclusion of the debtor's bankruptcy case, allowing it to move forward without the specter of preexisting debt. The language of the statute, however, clearly expresses a fresh start for a *debtor*, and a continuing injunction against collecting on discharged debts as a personal liability of a *debtor*.

Notwithstanding the language of section 524, debtors and other plan proponents have looked to the equitable powers of the Bankruptcy Courts to enforce these third-party releases. Section 105(a) has been used to confirm plans that provide for broad post-confirmation injunctions to third-party *non-debtors*. On the theory that a flexible approach is sometimes needed for a suc-

cessful reorganization, the majority of the Circuit Courts that have addressed the issue have held that Section 105(a) provides the authority to confirm third-party releases when appropriate under a case-by-case analysis.¹ However, while third-party releases may be permissible, the majority position concedes that they are justified only under “unusual circumstances.”²

Most courts in the majority cite to the factors set forth in the Dow Corning case to determine whether “unusual circumstances” exist to justify a third-party non-debtor release. The factors in Dow Corning are: (1) there is an identity of interests between the debtor and the third party; (2) the non-debtor contributed substantial assets to the reorganization; (3) the injunction is essential to reorganization; (4) the impacted class, or classes, have overwhelmingly voted to accept the plan; (5) the plan provides for a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) the plan provides for an opportunity for those claimants who choose not to settle to recover in full; and (7) the bankruptcy court made a record of specific factual findings that support its conclusions.

While the Dow Corning factors provide useful guidance to analyze the appropriateness of a non-debtor release on a case-by-case basis, those parties seeking the benefit of a third party release should be wary. In fact, in a recent decision from the Middle District of Florida, the Bankruptcy Court stated that “[a]llowing non-debtor releases is the exception, not the norm. Debtors should not automatically expect to release officers, directors, insurers or creditors from future liability, unless some extraordinary reason is proven.”³

In contrast, the minority position holds that the broad equitable powers of Section 105(a) do not trump the plain language of Section 524(e).⁴ While broad, the courts' equitable powers under Section 105(a) are nonetheless confined to “issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code].”⁵ In the case of Section 524(e), the Bankruptcy Code specifically prohibits the application of the discharge to non-debtor entities. The minority approach, which adheres to a narrow view of Section 105(a) and a strict interpretation of Section 524(e), does not per-

mit the discharge provisions of the Bankruptcy Code to have any effect on the liability of third-parties on discharged debts. This unresolved dispute among the Circuit Courts underscores the need for creditors and other interested parties to proceed cautiously, whether as beneficiaries of a release or as potential claimants enjoined by a release. Interested third parties, such as insiders, partners, affiliates, and subsidiaries that are the beneficiaries of third-party releases should be careful to consider whether those releases are appropriate under the particular circumstances of their case. Parties that have contributed substantial assets to a debtor's reorganization often want to receive the benefits of third-party releases for their efforts. In minority jurisdictions, third parties should anticipate that plans containing third-party releases will not be confirmed. Even in majority jurisdictions, these parties should take care to examine the Dow Corning factors to determine whether the third-party releases are appropriate under the circumstances.

In addition, parties holding claims against entities seeking third-party releases should make sure they do not waive their right to pursue these claims by failing to object to a plan that includes third-party releases. The standard for approving these releases is stringent and the analysis varies on a case-by-case basis. Thus, creditors of the entities who may receive a third-party release should be very careful to review each proposed third-party release and file an objection to the plan if necessary.



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Given the growing importance of third-party releases in plans of reorganization, and the conflicting jurisprudence on their enforceability among the Circuit Courts, the issue seems well-suited for Supreme Court review.

¹ The First, Second, Third, Fourth, Sixth, Seventh, Eleventh, and D.C. Circuits are considered "pro-release" circuits.

² In re Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002).

³ In re Transit Group, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002).

⁴ The Fifth, Ninth, and Tenth circuits comprise the minority position.

⁵ 11 U.S.C. § 105(a) (emphasis added).

Supreme Court Rules that IRAs Are Exempt From the Assets of a Debtor's Estate

In our last issue, we mentioned that United States Supreme Court decisions on bankruptcy issues are rare. However, on April 4, 2005, a *unanimous* United States Supreme Court held that individual retirement accounts ("IRAs") can be exempt from the assets of a debtor's estate pursuant to Bankruptcy Code Section 522(d)(10)(E)¹. While the decision is important since the Court unanimously overruled the prior decisions of the Eighth Circuit Court of Appeals, the Bankruptcy Appellate Panel for the Eighth Circuit, and the United States Bankruptcy Court for the District of Alabama, the timing of the decision is interesting. The new Bankruptcy Law signed by President Bush on April 20, 2005, which has been before Congress for more than eight years, clearly provides that IRAs are exempt from a debtor's estate. Thus, the decision in Rousey will only have an impact on cases filed after April 4, 2005 (the day the Rousey decision was issued) and before October 17, 2005 (the date the new Bankruptcy Law becomes effective).

One other note of interest in Rousey is that the Court refers to its prior decision in Patterson v. Schumate² which addressed the issue of whether a pension plan was an asset of a debtor's estate. There is a clear distinction between the holding in Patterson v. Schumate and the holding in Rousey. In Patterson v. Schumate, the Court held that the plan at issue was *not* an asset of the debtor's estate since it was an ERISA qualified plan. In Rousey, the Court held that the IRA at issue *was* an asset of the debtors' estate, but could be exempt from the debtors' estate under the federal exemption statute.

Although the Rousey decision will not have a large impact on bankruptcy cases, it is significant that the Supreme Court has issued opinions in two bankruptcy cases within the last year. Given the enactment of the new Bankruptcy Law, we may see more Supreme Court decisions on bankruptcy issues in the very near future.

¹ Rousey v. Jacoway, 544 U.S. ____ (2005).

² 504 U.S. 753 (1992).

Beware of the Omnibus Claims Objection

In large bankruptcy cases, a debtor will often file a pleading called an “Omnibus Claims Objection”. The purpose of the Omnibus Claims Objection is to help streamline the resolution of all of the proofs of claim filed in the debtor’s case. However, the Omnibus Claims Objection can be problematic to a creditor since it is likely to list objections to several hundred claims. Thus, a creditor must thoroughly and carefully review the Omnibus Claims Objections to determine if its claim has been objected to by the debtor. Because the list of claims is often voluminous, many creditors do not realize that the debtor has objected to their claim and fail to respond to the Omnibus Claims Objection. The failure to respond to the Omnibus Claims Objection can, and often does, result in a creditor’s claim being reduced, expunged or disallowed. If the creditor’s claim is reduced, expunged or disallowed, the creditor will receive a reduced payment, or in many cases, no payment on an otherwise legitimate claim.

Omnibus Claims Objections commonly object to a proof of claim based upon the assertion that the amount set forth on proof of claim does not match the amount of debt listed in the debtor’s books and records. Many courts have failed to sustain such objections. The majority of the courts that have addressed the issue have held that the failure of a debtor to do more than make conclusory statements denying liability is insufficient.¹ In order to be able to sustain the objection to the proof of claim, the debtor must produce some evidence to support the assertion that it has no liability to the claimant.

While Omnibus Claims Objections can help debtors process and eliminate thousands of claims, creditors must pay careful attention to the claims resolution process and thoroughly review all Omnibus Claims Objections filed by a debtor.

¹ See e.g., *In re Brown*, 221 B.R. 46 (Bankr. S.D.Ga. 1998); *In re Reilly*, 245 B.R. 768 (B.A.P. 2d Cir. 2000).

Pre-Judgment Remedies in Connecticut: Going for the First Round Knock-Out

Delay, expense and uncertainty are among the aspects of litigation dreaded most by creditors seeking recovery through the legal process. Plaintiffs looking to enforce their rights often face extended litigation with no guarantee of a return on their investment. While the uncertainty of litigation cannot be avoided, creditors may look to Connecticut’s prejudgment remedy statutes to alleviate concerns over delays in the litigation process and the possibility of a judgment-proof debtor at the end of that process.

Prejudgment remedies generally take the form of attachments, garnishments or replevin actions in civil cases and are aimed at preserving assets that can be used to satisfy an eventual civil judgment. In order to obtain a prejudgment remedy, the applicant must show that there is probable cause that a judgment, in an amount equal to or greater than the amount of the prejudgment remedy sought, taking into account any known defenses, counterclaims, or setoffs, will be rendered in favor of the applicant. (See Conn. Gen. Stat. § 52-278d(a)). A prejudgment remedy can be requested and granted prior to or during a pending action and preserves the subject property for later satisfaction of a final judgment in that action.

The procedures for obtaining a prejudgment remedy are spelled out in detail in Connecticut General Statutes §§ 52-278a through 52-278g. Because of their impact on a debtor’s property rights, however, the statutes describe procedures that are painstakingly precise and must be precisely followed. To be successful, the applicant must not only show grounds for the prejudgment remedy and meet the applicable standard of proof, but must at all times remain mindful of the statutory procedural requirements. The statutes include many traps for the unwary: the prerequisites include compliance with technical requirements relating to the application, notice and claim form, summons, order, verified complaint, affidavit, and more, which are too detailed to discuss here. At a minimum, it is highly advisable, if not mandatory, to use preprinted forms made available by the courts, and to adhere strictly to the timing, procedures and language set forth in the statute. The applicant also should anticipate and be prepared to defend a request by the opposing party to post a bond to protect that party from harm caused by the prejudgment remedy should the defendant ultimately prevail. If it is not clear already, any applicant should begin and end their efforts by reference to the applicable statutes.

Not only do prejudgment remedies provide an opportunity to preserve assets that might later be used to satisfy a judgment, the availability of these remedies serves another very practical purpose. They provide a plaintiff (or counter-claim defendant) with an early opportunity to get their matter before the court and force an immediate and substantive response from the debtor. The filing of an application for a prejudgment remedy gets the parties to the table in a matter of weeks rather than months or years, forces all parties to look seriously at the merits of their case, and often leads to resolution of the matter before the case ever begins.

As a practical matter, before applying for a prejudgment remedy, it is valuable to perform an asset search. Based on the findings of an asset search, the application should list specific property to be attached if at all possible, but can also cover a broad array of property as well. Other tools available in Connecticut may be appropriate and utilized as well. For instance, if there is reason to believe that the debtor is about to transfer property in an effort to evade a creditor’s reach, a temporary restraining order should be filed to prevent him or her from

doing so. In the most extreme cases, such as where assets are being hidden, you may obtain a prejudgment remedy on an *ex parte* basis, although such applications are not routinely granted.

It has become increasingly common in Connecticut commercial contracts to include a commercial waiver provision that permits a creditor to obtain a prejudgment remedy without first providing the opposing party notice and a hearing. This exceptional remedy is allowed under Connecticut General Statute § 52-278f, and eliminates many of the procedural hurdles associated with non-commercial waiver cases. Where a valid commercial waiver exists, a creditor can essentially pass go and proceed directly to the finish line by having the creditor's attorney issue the prejudgment remedy through a marshal without a court order. Be certain, however, that you strictly comply with the commercial waiver portion of the prejudgment remedy statute.

While the technical requirements may be daunting, the benefits of obtaining a prejudgment remedy can be well worth the effort. Creditors and their counsel should consider these options among the tools available when forming a strategy and proceeding to collect on their debts.

Please see our insert containing highlights of the new Bankruptcy Law, including provisions affecting the rights of creditors.



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Highlights of Business-Related Amendments to the Bankruptcy Code Enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005

Although the focus on consumer issues in the new bankruptcy legislation signed by President Bush on April 20, 2005, has been well-publicized, changes in the new legislation will affect businesses as well. This insert highlights those amendments and additions enacted by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (hereinafter, the "Act") that are likely to have an impact on both debtors and creditors in business bankruptcy cases. With a few exceptions, the provisions of the Act become effective 180 days after enactment, or October 17, 2005.

Unexpired Leases of Nonresidential Property

Under the current Bankruptcy Code provisions, the trustee or debtor in possession must assume or reject the debtor's unexpired leases of nonresidential real property within 60 days of the order of relief, or the leases are deemed rejected and the debtor is required to surrender the premises. Upon a showing of cause, a court may grant any number of extensions of time in which to assume or reject. In practice, bankruptcy courts routinely grant these extensions of time.

The Act amends the Bankruptcy Code to require the trustee or debtor in possession to assume or reject unexpired nonresidential real property leases within the earlier of 120 days from the petition date or the confirmation date. Upon a showing of cause, the court may extend the assumption/rejection period for 90 days. Any extensions thereafter require the prior written consent of the lessor. As the text of the Act makes clear, "[t]his provision is designed to remove the bankruptcy judge's discretion to grant extensions of time for a retail debtor to decide whether to assume or reject a lease after a maximum possible period of 210 days from the time of entry of the order of relief."

The amendments to the timeline for assuming or rejecting unexpired commercial leases must be read together with the amendments to the administrative expense provisions of the Bankruptcy Code. Under the new law, claims resulting from the rejection of a commercial lease previously assumed are accorded administrative expense priority. The amount allowable as an administrative expense is capped at two years from the later of the rejection of the lease or the turnover of the premises, and is subject to reduction for payments from non-debtor sources. Any remaining amounts under the claim that are in excess of the cap are treated as a general unsecured claim.

The amendments to these sections of the Bankruptcy Code will have a direct impact on retail debtors and lessors, particularly in

larger chapter 11 cases where the debtor has numerous unexpired commercial leases and may require a longer, unspecified amount of time to decide whether to assume or reject those leases. Additionally, the availability of post-petition financing, which would better assist the debtor with its decision to assume or reject leases, may not be known within the 210-day period. The firm deadline should provide commercial lessors with greater predictability regarding the assumption or rejection of their leases.

Reclamation Claims

The Act has a significant impact on the rights of sellers of goods to reclaim goods received by a debtor in the ordinary course while the debtor was insolvent. Under the current provisions of the Bankruptcy Code, the seller may reclaim goods that were received by the debtor within the 10-day period prior to the commencement of the case. The seller is required to provide written notice of the reclamation before 10 days after the debtor's receipt of the goods, or before 20 days after the debtor's receipt of the goods if the 10-day notice period expires after the commencement of the case. A court may deny a valid reclamation claim only if the court grants the reclamation claim an administrative expense priority or secures the claim with a lien.

Under the new law, a seller of goods, subject to the prior rights of secured creditors, may reclaim goods sold in the ordinary course to the debtor if the debtor received such goods while insolvent within 45 days prior to the commencement of the case, a substantial increase from the current 10-day reclamation period. A seller may exercise its right to reclaim goods only if it has given written notice of the reclamation either within 45 days of the debtor's receipt of the goods, or within 20 days after the commencement of the case if the 45-day period expires after the commencement of the case. Under the new law, even if the seller does not properly notice a reclamation claim, the seller may still assert an administrative claim for the value of any goods sold to the debtor in the ordinary course within 20 days of the commencement of the case.

As described in the preceding paragraph, the Act deletes the current provision requiring a court that denies a reclamation claim to replace it with an administrative priority claim or a lien. The deletion of this provision may cause some issues to arise in the context of properly noticed reclamation claims on goods that the reclaiming creditor cannot reclaim (for example, the debtor may no longer have the goods). Under the new law, it is not clear if properly noticed reclamation claims on goods

received by the debtor 45 days prior to the commencement of the case require that the goods *must* be returned. It is even less clear what the rights of the reclaiming creditor or the options of the court are in those cases where the goods cannot be reclaimed since the new law does not state whether an administrative priority or lien may be substituted for a denied reclamation claim.

Small Business Cases

The Act amends the Bankruptcy Code to add a new definition of a “small business debtor,” which is more complex than the prior definition of a “small business.” A small business debtor is defined as a person engaged in commercial or business activities, other than owning or operating real estate, having not more than \$2 million in aggregate noncontingent, liquidated secured and unsecured debts, not including debts to affiliates or insiders. Such a small business debtor cannot be a “member or group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts” greater than \$2 million.

The new law also imposes a variety of reporting requirements on the small business debtor. It requires the debtor to file periodic financial reports and other information relating to the debtor’s business operations. It is important to note that the small business reporting requirements do not become effective until *60 days after rules are prescribed to establish the forms for use in reporting the data*. The new law directs the Judicial Conference to propose official rules and forms with respect to these new reporting requirements.

The Act limits the availability of the automatic stay to serial small business filers. The automatic stay will not apply in a small business case (1) if the debtor has another case pending simultaneously, (2) if the debtor was a debtor in a small business case that was dismissed within 2 years of the order for relief in the second case, or (3) if the debtor had a plan confirmed in a small business case within 2 years of the new case. This new provision also applies if an entity acquired all or substantially all of the assets of a small business debtor in a case described in (1), (2) or (3) of this paragraph.

In the case of a small business debtor, the Act extends the exclusivity period to file a chapter 11 plan from 100 days to 180 days (unless the debtor is granted an extension or the court orders otherwise). The plan and disclosure statement must in any event be filed within 300 days of the order for relief. Extensions may be granted only if the debtor demonstrates that it is more likely than not that a plan will be confirmed within a reasonable time period, a new deadline is imposed at the time the extension is granted, and the extension order is signed before the existing deadline expired. The previous provision allowing for a shortening of the exclusivity period has been eliminated.

The plan disclosure and solicitation process in a small business case is streamlined under the Act. The court may determine that the plan provides sufficient disclosure, and thus a separate disclosure statement is not required. A disclosure state-

ment may be submitted (and approved by the court) on standard forms approved by the court. The court may grant conditional approval to a disclosure statement, subject to final approval after notice and a hearing, and the plan may be solicited based on a conditionally approved disclosure statement, so long as such disclosure statement is mailed not later than 25 days before the confirmation hearing.

Fraudulent Transfers

The Act amends the fraudulent transfer provisions of the Bankruptcy Code to (i) extend the reach-back period from one year to two years, and (ii) to explicitly include pre-petition transfers to or for the benefit of an insider under an employment contract and not in the ordinary course of business. The provision extending the one-year reach-back period will apply to cases commenced one year after the effective date of the Act, while all other fraudulent transfer provisions take effect on the effective date of the Act.

The Act also adds a new subsection that allows the recovery of an interest in the debtor of property that was made on or within the ten-year period preceding the debtor’s petition date to a self-settled trust or similar device with intent to hinder, delay, or defraud creditors.

Although the stated intention of the amendments is “to enhance the recovery of avoidable transfers and excessive pre-petition compensation, such as bonuses, paid to insiders of a debtor,” the effects of the amendments will largely be felt by individuals. While increasing the reach-back period certainly allows the trustee to potentially seek avoidance of a greater number of fraudulent transfers under the Bankruptcy Code, the impact of this amendment is somewhat tempered by the trustee’s ability under the current Bankruptcy Code provisions to sue under state fraudulent transfer statutes that often already provide for a reach-back period of greater than two years. Furthermore, the inclusion of transfers under an employment contract and transfers to self-settled trusts under the umbrella of fraudulent transfers will not likely affect business creditors. Business creditors will not likely be the targets of fraudulent transfer actions under these new amendments, because the beneficiaries of these transfers are generally individuals.

Preferential Transfers

Perhaps the most significant change to the preference sections of the Bankruptcy Code is the addition of a new section that provides that if a trustee avoids a transfer from a debtor to a non-insider for the benefit of an insider creditor between 90 days and one year before the filing of a bankruptcy petition, that avoidance is valid only with respect to the insider creditor. Previously, a trustee could avoid a transfer made to an arms-length creditor (such as a lender), if the payment to the creditor benefited an insider. Thus, for example, under the current law if an insider guaranteed a bank loan to the debtor corporation, the trustee

could avoid payments by the debtor to the bank made within a year of the filing of the petition, since such payments benefited the insider by reducing the insider's obligation on the guarantee. Under the new law, a trustee cannot avoid payments made to the non-insider bank during the 90-day to one year look back period.

Another significant change to the preference provisions of the Bankruptcy Code addresses the "ordinary course of business defense" in preference actions. Under the new law, a trustee may not avoid a transfer to the extent it was in payment of a debt incurred by the debtor in the ordinary course of the business or financial affairs of the debtor and the transferee, and such transfer was made either: (1) in the ordinary course of the debtor's and the transferee's financial affairs or business; or (2) in accordance with ordinary business terms. Previously, the recipient of a preferential transfer had to satisfy both of these grounds in order to prevail in defending the transfer.

The Act creates additional limitations on preference avoidance actions. The Act prohibits a trustee from avoiding as a preferential transfer any payment made by a debtor to a creditor pursuant to an alternative repayment plan created by an approved credit counseling agency. Furthermore, if the debtor's debts are primarily commercial in nature, a transfer may not be avoided if the aggregate amount of the property constituting or affected by the transfer is less than \$5,000. This section effectively places a \$5,001 floor on preference actions for commercial debts.

The new legislation also assists secured creditors by extending such creditors' time to perfect their security interests. Under the new law, if a creditor extends credit to enable a debtor to acquire assets as to which the creditor will have a security interest—i.e., a purchase money security interest—a trustee may not avoid a transfer that creates such a security interest if the interest is perfected within 30 days of when the debtor receives possession of the property. Previously, a purchase money security interest had to be perfected within 20 days in order to avoid attack by a trustee. Similarly, the Act allows creditors to perfect other types of security interests within 30 days of when the transfer takes place; previously such security interests had to be perfected within 10 days in order to avoid the risk of a preference action.

Employee Benefits

The new law significantly expands the exemption for assets of tax qualified plans. Under the Act, there is a virtually unlimited exemption for assets that are part of a 401(a) plan (these are employer pension and profit-sharing plans, including 401(k) programs), a 403(b) annuity or custodial account (these are tax deferral and retirement programs for teachers and employees of certain tax-exempt employers), a 457 program (these are deferral programs for governmental and tax exempt employees), or are contained in an IRA or Roth IRA. There is no dollar limitation on the exemption except a \$1 million cap for amounts in IRAs and

Roth IRAs, but since this cap does not apply to amounts attributable to rollover contributions it will rarely be applicable.

The new law replaces a confusing and inequitable set of rules that apply under existing law. Under existing law, if one of the tax advantaged programs listed above happened to be an ERISA plan (a plan governed by the provisions of Title I of the Employee Retirement Income Security Act of 1974), then the debtor assets in the program are not part of the debtor's estate, and therefore does not need an exemption. Otherwise, the debtor has one or two choices. He or she always can choose the state exemptions, and get whatever protection the state of residence happens to provide. Connecticut, for example, has a broad and sweeping exemption, but other states are much stingier. In the alternative, if he or she lives in a state that permits the choice of the federal exemptions (only 16 states, including Connecticut, permit this choice), then he or she can exempt the amount to the extent reasonably necessary for his or her support, or the support of a dependent.

The new law makes the complicated scheme described above irrelevant, even though it does not repeal the provisions that previously existed. Beginning on October 17, 2005, every debtor will be able to protect tax advantaged retirement assets regardless of their form or the debtor's circumstances. The new law does not apply to non-qualified plan assets (generally deferred compensation for executives), which will continue to be governed by current law and generally will be included in the debtor's estate.

Another set of provisions in the new law clarify the nature of a "plan loan", that is a loan that a debtor has taken from the account balance of his or her tax advantaged retirement program. First, the Act clarifies that a plan loan is not dischargeable under the Bankruptcy Code. Second, actions to continue to collect a plan loan by payroll deduction are not a violation of the automatic stay. Third, a chapter 13 plan cannot modify the terms of a plan loan, and the assets used to pay a plan loan according to its terms does not constitute "disposable income" that can be subject to use for other creditors.

Finally, the new law clarifies that amounts withheld from a debtor's paycheck, or contributed by the debtor to the employer, prior to the filing of a petition for the purpose of contributing the amount to a tax advantaged program or to an employee welfare benefit program (such as a cafeteria plan) does not constitute part of the debtor's estate. In other words, those amounts will not be subject to the claims of creditors and will not have to be listed on a debtor's petition.

Miscellaneous Provisions

The Automatic Stay. The amendments to the automatic stay provisions are designed in part to benefit secured creditors. A creditor can seek relief from stay under this section where (1) a debtor has transferred real property collateral without the consent of the secured creditor or court approval, or (2) multiple

filings have occurred affecting the real property. If an order for relief is granted, it is binding on all owners of the property for 2 years. In addition, the Act has addressed uncertainties with the automatic stay limitations in single asset real estate cases. Currently, the automatic stay terminates 90 days from the order for relief in single asset real estate cases if the debtor has not filed a confirmable plan and has not commenced making monthly payments to the secured creditor. The Act addresses situations where it is unclear whether the case is a single asset real estate case, and provides that the stay will terminate on the later of such 90 day period or 30 days from when the court determines it is a single asset real estate case.


Official Committees. The Bankruptcy Code generally provides for the appointment by the United States Trustee of an official committee of unsecured creditors and any other committees of creditors or equity security holders that the U.S. Trustee deems appropriate. As amended by the Act, the Bankruptcy Code will give the bankruptcy court the authority, upon the request of an interested party and following a hearing, to order the U.S. Trustee to alter committee membership in order to ensure the adequate representation of creditor constituencies. The Act also permits the court to order the U.S. Trustee to increase the size of a committee to include a small business concern, irrespective of the size of its claim in comparison to other creditors, so long as such claim is disproportionately large when viewed in relation to the creditor's gross annual revenue. Moreover, the Act requires official committees to provide access to information to, and to solicit and receive comment from, non-committee creditors. This latter aspect of the Act may prove a useful tool for creditors not participating in a committee to nonetheless remain educated regarding, and involved in, the development of a chapter 11 case. It may also, however, impact the information a chapter 11 debtor is willing to share with the official committees.

Appointment of trustee. Apparently in response to the accounting scandals that precipitated the bankruptcy filings of corporations such as Enron and Worldcom, a new subsection has been added to the Bankruptcy Code mandating that the United States Trustee move for the appointment of a trustee in a chapter 11 case if there are reasonable grounds to suspect that the governing body of the debtor, its CEO or CFO participated in actual fraud, dishonesty or criminal conduct in the management of the debtor's affairs or its public financial reporting.

Conversion. Prior to the Act, the bankruptcy court could, but was not required to, convert a case to chapter 7 or dismiss the case outright for cause. The Act amends the Bankruptcy Code to make conversion or dismissal mandatory. The court is now required to convert a case to chapter 7 or to dismiss a case for cause, unless (i) it finds unusual circumstances exist such that conversion or dismissal is not in the best interests of creditors or the estate, and (ii) the debtor or other party in interest objects to conversion or dismissal and establishes (A) the reasonable likelihood that a plan of reorganization will be confirmed

within the timeframe specified by the Bankruptcy Code, as amended by the Act, and (B) the "cause" for dismissal or conversion involves an act or omission by the debtor which is justified and capable of cure within a timeframe specified by the court.

Disclosure Statement. Under the current Bankruptcy Code, the debtor cannot solicit votes with respect to a plan of reorganization until it has provided its creditors and claim holders with a summary of the plan and a disclosure statement that has been approved by the bankruptcy court as containing "adequate information." Adequate information has traditionally been defined to encompass any information a creditor or claim holder would reasonably require in order to make an informed decision regarding the acceptance or rejection of a proposed plan of reorganization. As amended by the Act, this definition now instructs the court to consider the following factors in determining whether a disclosure statement contains "adequate information": (i) the complexity of the case, (ii) the benefit to creditors and other parties in interest of additional information, and (iii) the expense of providing such additional information.



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