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Matters of First Impression—Business: The Death of Retail Chapter 11?—

BAPCPA in Practice in Retail Bankruptcy Cases

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I. Introduction

The revisions to the Bankruptcy Code implemented by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), which became effective in October 2005, have had wide-ranging effects on nearly all aspects of business and consumer bankruptcy. Highlighting provisions of interest in consumer cases as opposed to business cases is comparatively straightforward. However, any effort to narrowly identify a set of provisions of particular interest in retail cases is doomed to be incomplete—the changes wrought by BAPCPA are so numerous and far-reaching, and the details of any retail case so idiosyncratic, that nothing less than a complete survey of the revisions to the Title 11 of the United States Code (the "Bankruptcy Code") would suffice. Such a review is beyond the scope of this panel or these materials. The following pages review six significant amendments under BAPCPA that have had and will continue to have a significant impact on retail cases. The six could as easily be four or ten, and reasonable minds will differ on those changes of most import to retail cases. Suffice to say that these six substantial changes present significant challenges for retail cases.

II. Overview of Amendments Considered

The following bullet points identify the sections analyzed and the significance of the change to each section; for the full text of the revision for each section discussed, see the section below dedicated to that provision.

- 365(d)(4)—revised to cap at 210 days after the petition date the deadline to assume or reject leases of non-residential real property; further extension only upon prior written consent of the counter-party to the lease.
- 366(c)—strictly defines adequate assurance of payment to utilities.

- 503(b)(9)—creates administrative claim for value of goods received by the debtor in the ordinary course within the 20 days prior to the petition date.

- 503(c)—limits severance and retention payments to insiders.

- 1102(b)(3)—creates obligation for committee to provide information to creditors.

- 1121(d)(2)—revised to cap at 18 months after petition date the debtor's exclusive period to file a plan and at 20 months after petition date the debtor's exclusive period to solicit acceptance of such a plan.

III. Limitation of Time to Assume or Reject Non-Residential Real Property Leases

A. Redline of Revised Section

11 U.S.C. § 365(d)(4) ~~Notwithstanding paragraphs (1) and (2), in a case under any chapter of this title, if the trustee does not assume or reject an unexpired lease of nonresidential real property under which the debtor is the lessee within 60 days after the date of the order for relief, or within such additional time as the court, for cause, within such 60-day period, fixes, then such lease is deemed rejected, and the trustee shall immediately surrender such nonresidential real property to the lessor.~~

(A) Subject to subparagraph (B), an unexpired lease of nonresidential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that nonresidential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of—

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B) (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

B. Discussion

Prior to the BAPCPA amendments, an initial period of 60 days for assumption or rejection of non-residential real property leases was provided for, and a bankruptcy court could extend that time "for cause" without limitation any statutory limitation. In practice, such extensions were routinely granted through plan confirmation. Under the BAPCPA revisions to section 365(d)(4), the initial period to assume or reject is extended to 120 days. However, the

court may only extend that period (again, "for cause") for up to an additional 90 days, with such order to be entered prior to the expiration of the 120 day period.[1] Any additional extension may be granted by the court "only upon prior written consent of the lessor." 11 U.S.C. § 364(d)(4)(B).

The extension of the initial assumption/rejection period from 60 to 120 days provides some welcome breathing room for debtors that, under the old rule, were barely into bankruptcy before they had to begin considering a request for an extension of time to assume or reject. However, the creation of the rather arbitrary cap of 210 days for assumption/rejection absent agreement from the lessor imposes a real and significant burden on debtors, especially in retail cases where numerous leases of non-residential real property must be analyzed and where the consequences of improvident assumption or rejection of what are likely significant assets of the estate may be catastrophic.

As an initial matter, the burden of simply analyzing numerous leases to determine whether their retention or rejection is valuable is significant. Seven months in the life of a retail debtor is not long, and under this new limitation a debtor with numerous leases of non-residential real property will likely need to begin to assess and value its leases well in advance of its bankruptcy filing. Such analysis will occupy important resources also in the early days of the case and, depending upon the nature of the debtor and the leases in question, may require the quick retention of specialized advisors. Moreover, the analysis required has changed from the binary question of "assume or reject" to the fuzzy question of what can effectively be rejected now, what can be consensually extended to a later date, what should be assumed without doubt,

[1] This revision appears to eliminate the possibility of a bridge order, either automatic or affirmatively entered by the court, as it suggests that the extension itself must be granted prior to the expiration of the 120 day period.

and what should perhaps be assumed in order to avoid a potentially worse loss associated with rejection.

In short, once a debtor has expended the resources timely to complete its analysis of the relative value of its non-residential real property leases, it no longer has the luxury of reserving its decision on such assumption or rejection until a 363 sale or plan confirmation when it can be certain of unloading assumed leases with an accompanying assignment or of need for continued use of those leases itself as a reorganized entity. In effect, notwithstanding 11 U.S.C. § 365(d)(2)'s broad assertion that a debtor in a case under chapter 11 may decide to assume or reject a lease "at any time before the confirmation of a plan," and notwithstanding section 1121(d)'s (now) eighteen-month exclusivity period, a debtor under the BAPCPA revisions is now faced with determining in less than half that time whether to lose a potentially valuable asset through rejection or to assume a lease and incur associated expenses (including cure costs and future expenses) without yet having a clear picture of how the case will terminate. In sum, while the code ostensibly provides an 18-month plan preparation period, the threat of 365(d)(4) in cases where non-residential real property leases are a significant asset compels such debtors to speed even more quickly to a 363 sale or plan or to accept the risks and burdens associated with early rejection or assumption.

From a practical point of view, section 365(d)(4)(B)(ii)'s allowance of further extension upon prior written consent of the lessor is, at best, of limited value for a debtor.[2] From a practical point of view, the agreement requirement imposes a significant administrative burden upon debtors with multiple non-residential real property leases, as soliciting and documenting

[2] The statute does not state whether a consensual extension must be entered and/or approved before the expiration of the period to assume or reject. While the necessary safe assumption must be that the lease will be deemed rejected, the ambiguity appears to create the possibility of a consensual unscrambling of the egg if the parties agreed, although for the reasons discussed in the context of the analysis of section 365(d)(4)(B)(ii), such agreement appears unlikely.

numerous such agreements and submitting them to the court if reached will be time consuming and costly. More important, it is difficult to imagine a circumstance in which a lessor would consent to such an extension except in circumstances that favor principally (if not exclusively) the lessor. Where a lease is priced under market, the lessor will have incentive to decline a further extension in the hope that rejection can be compelled by operation of 365(d)(4) or affirmatively from a debtor unready to determine whether it should keep the lease or not. Where a lease is priced over market, the lessor does have incentive to consent to a further extension (in the hope of continuing to collect rent at an over market rate), but in such a case the debtor will already be inclined to terminate the lease as quickly as circumstances permit. Where a lease is priced approximately at market, so long as a lessor has other potential tenants, the lessor's incentive will be to decline such an extension in the hopes of placing another—more solvent—tenant in the property at comparable or better rates.

If there are statutory bright sides to the new 210-day time-limit, they are 11 U.S.C. §§ 503(b)(7) and 365(f). Section 503(b)(7) provides for a limitation upon administrative claims arising from assumed and rejected nonresidential real property leases. It states:

> [After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including—] . . . with respect to a nonresidential real property lease previously assumed under section 365, and subsequently rejected, a sum equal to all monetary obligations due, excluding those arising from or relating to a failure to operate or a penalty provision, for the period of 2 years following the later of the rejection date or the date of actual turnover of the premises, without reduction or setoff for any reason whatsoever except for sums actually received or to be received from an entity other than the debtor, and the claim for remaining sums due for the balance of the term of the lease shall be a claim under section 502(b)(6).

Section 503(b)(7) thus caps at no more than two years the associated administrative claim created by virtue of a debtor's premature and unwise assumption that may be compelled by

operation of section 365(d)(4); also, its reference to reduction for "sums actually received or to be received" provides statutory support for the case and/or state-law driven duty of the landlord to mitigate. Thus, a debtor faced with the deadline under section 365(d)(4), and uncertain as to the future value of the lease in question, may decide to assume that lease with the understanding that it can still be rejected and the claim capped under section 503(b)(7).

What remains unclear is what the final words of this section mean—"shall be a claim under section 502(b)(6)." 11 U.S.C. § 502(b)(6) is not a claim-originating provision but provides for the limitation of a claim arising from the rejection of a lease of non-residential real property. The implication of section 503(b)(7) is that the balance of the rejection claim for an assumed non-residential real property lease then rejected is an unsecured claim, calculated and limited in accordance with 502(b)(6).

Finally, while simultaneous assumption and assignment has been the norm in most cases of assignment prior to the BAPCPA amendments, it appears that a lease assumed in accordance with the time limitation of section 365(d)(4) will still be amenable of assignment later, if a willing buyer of those rights can be found. 11 U.S.C. § 365(f)(2) provides simply that "The trustee may assign an executory contract or unexpired lease of the debtor only if—(A) the trustee assumes such contract or lease in accordance with the provisions of this section; and (B) adequate assurance of future performance by the assignee of such contract or lease is provided, whether or not there has been any default in such contract or lease." Thus, a debtor unable to speed its way to a 363 sale or a plan but who is nevertheless able to appropriately identify valuable leases may assume them in the hope that, should the debtor later wish to relieve itself of the associated obligation, the leases can be assigned at the appropriate time.

In sum, while section 365(d)(4) imposes significant new administrative burdens upon retail debtors, compelling rapid assessment of multiple non-residential real property leases, encouraging quicker determinations with respect to case status, and imposing associated costs, the revisions are not fatal to such cases. On the one hand, retail debtors may require additional pre-filing planning to analyze leases or to limit their time in bankruptcy in order to avoid the strictures of section 365(d)(4). However, even absent such planning, section 365(f) provides a possible complete escape with respect to leases prematurely and improvidently assumed and, in the worst case, section 503(b)(7) imposes a cap on the consequence of such assumption.

IV. Utility Deposits

A. Redline of Revised Section

11 U.S.C. § 366(a) Except as provided in subsection**s** (b) **and (c)** of this section, a utility may not alter, refuse, or discontinue service to, or discriminate against, the trustee or the debtor solely on the basis of the commencement of a case under this title or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due.

(b) Such utility may alter, refuse, or discontinue service if neither the trustee nor the debtor, within 20 days after the date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security, for service after such date. On request of a party in interest and after notice and a hearing, the court may order reasonable modification of the amount of the deposit or other security necessary to provide adequate assurance of payment.

(c)(1) (A) For purposes of this subsection, the term "assurance of payment" means—

(i) a cash deposit;

(ii) a letter of credit;

(iii) a certificate of deposit;

(iv) a surety bond;

(v) a prepayment of utility consumption; or

(vi) another form of security that is mutually agreed on between the utility and the debtor or the trustee.

(B) For purposes of this subsection an administrative expense priority shall not constitute an assurance of payment.

(2) Subject to paragraphs (3) and (4), with respect to a case filed under chapter 11, a utility referred to in subsection (a) may alter, refuse, or discontinue utility 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 the trustee adequate assurance of payment for utility service that is satisfactory to the utility.

(3) (A) On request of a party in interest and after notice and a hearing, the court may order modification of the amount of an assurance of payment under paragraph (2).

(B) In making a determination under this paragraph whether an assurance of payment is adequate, the court may not consider--

(i) the absence of security before the date of the filing of the petition;

(ii) the payment by the debtor of charges for utility service in a timely manner before the date of the filing of the petition; or

(iii) the availability of an administrative expense priority.

(4) Notwithstanding any other provision of law, with respect to a case subject to this subsection, a utility may recover or set off against a security deposit provided to the utility by the debtor before the date of the filing of the petition without notice or order of the court.

B. Discussion

Pursuant to 11 U.S.C. § 366(a) & (b), utilities are prohibited from altering or discontinuing service to a debtor unless the debtor fails to provide "adequate assurance" of further payment within 20 days after the petition date. The addition of 11 U.S.C. § 366(c), which incidentally increases the time for provision of adequate assurance in a chapter 11 case to 30 days,[3] provides new, statutory, parameters for determining what constitutes adequate assurance in the context of a chapter 11 case, imposes a significant burden on debtors by removing much of the court's discretion with respect to determination of what constitutes adequate assurance of future payment, removes the possibility of using administrative expense priority as adequate assurance, and effectively compels the placement of a cash deposit (or equivalent) with all utilities. The burden is particularly onerous in the context of retail debtors who, with numerous locations served by multiple utilities, face a large outlay of cash and the associated administrative burden of making and tracking such deposits. Moreover, section 366(c)(2)

[3] See In re Astle, 338 B.R. 855 (Bankr. D. Id. 2006) (limiting applicability to chapter 11 cases only based upon express limitation of section 366(c)(2)).

appears to give complete discretion to the utility in determination of whether the assurances provided to the utility are "satisfactory to the utility." Finally, section 366(c)(4) eliminates the effect of the automatic stay and permits a utility to effectuate a setoff of a prepetition deposit against prepetition amounts without notice or court order, thereby eliminating any bargaining power the debtor may have had in form of negotiating an agreed offset and relief from stay in the context of a global resolution of post-petition adequate assurance.

Prior to the enactment of BAPCPA, courts, commentators, and legislative history had all confirmed that section 366 did not require, in every case, that the debtor provide a deposit or other security to its utilities as adequate assurance of payment. In Virginia Electric & Power Co. v. Caldor, Inc., 117 F.3d 646, 648-49 (2d Cir. 1997), the United States Court of Appeals for the Second Circuit affirmed the bankruptcy court's ruling that the debtor's prepetition payment history, its postpetition liquidity, and the administrative expenses afforded postpetition invoices constituted adequate assurance of future performance. The Second Circuit rejected the argument that section 366(b) nevertheless requires a "deposit or other security":

> [A] bankruptcy court's authority to "modify" the level of the "deposit or other security," provided for under section 366(b), includes the power to require no "deposit or other security" where none is necessary to provide a utility with "adequate assurance of payment."

Id. at 650. See also In re Pacific Gas & Elec. Co., 271 B.R. 626, 644-45 (N.D. Cal. 2002) (upholding the bankruptcy court's finding that the debtor's likelihood of performance and availability of resources provided adequate assurance); In re Shirley, 25 B.R. 247, 249 (Bankr. E.D. Pa. 1982) ("section 366(b) … does not permit a utility to request adequate assurance of payment for continued services unless there has been a default by the debtor on a prepetition debt owed for services rendered"). 11 U.S.C. § 366(c) affirmatively changes this prior rule.

Nonetheless, while the form of adequate assurance of payment may be limited under new section 366(c) to the types of security enumerated in subsection 366(c)(1)(A) and thereby, effectively, to a cash deposit or equivalent, the amount of the deposit or other form of security remains fully within the reasonable discretion of the court. In pre-BAPCPA decisions, it is well established that the requirement that a utility receive adequate assurance of payment does not require a guarantee of payment. Instead, the protection granted to a utility is intended to avoid exposing the utility to an unreasonable risk of nonpayment. In Adelphia Business Solutions, Inc., 280 B.R. 63, 80 (Bankr. S.D.N.Y. 2002), the Bankruptcy Court for the Southern District of New York stated that "[i]n determining adequate assurance, a bankruptcy court is not required to give a utility company the equivalent of a guaranty of payment, but must only determine that the utility is not subject to an unreasonable risk of nonpayment for postpetition services." The essence of the Court's inquiry is an examination of the totality of the circumstances in making an informed judgment as to whether utilities will be subject to an unreasonable risk of nonpayment. Id. at 82-83. See also In re Magnesium Corp. of America, 278 B.R. 698, 714 (Bankr. S.D.N.Y. 2002) ("In deciding what constitutes adequate assurance in a given case, a bankruptcy court must focus upon the need of the utility for assurance, and to require that the debtor supply no more that than that, since the debtor almost perforce has a conflicting need to conserve scarce financial resources.").

Confronted with the new 11 U.S.C. § 366(c) and the possibility of utility termination, debtors have been proactive, filing first-day motions and seeking orders authorizing and approving as adequate cash deposits to individual utilities, prepays, and/or deposits to escrow accounts, and seeking approval of procedures whereby utilities can make a request for further adequate assurances. Courts have been quick to approve such relief. See, e.g.:

- In re G+G Retail, Inc., Case No. 06-10152 (Bankr. S.D.N.Y. Mar. 13, 2006) (authorizing as adequate assurances creation of a pot deposit account estimated to cover utility usage through sale closing);

- In re Musicland Holding Corp., et al., Case No. 06-10064 (Bankr. S.D.N.Y. Feb. 2, 2006) (authorizing as adequate assurance deposit for two week's service upon request of deposit in writing provided that utility does not already hold a greater deposit and provided that the utility is not already paid in advance for services);

- In re Calpine Corp., Case No. 05-60200 (Bankr. S.D.N.Y. Jan 8, 2006) (authorizing as adequate assurance deposit for two week's service upon request of deposit in writing provided that utility does not already hold a greater deposit and provided that it is not already paid in advance for services);

- In re Pliant., Case No. 06-10001 (MFW) (Bankr. D. Del. Jan. 5, 2006) (two-week deposit for utilities constituted adequate assurances of future performance under Bankruptcy Code § 366);

- In re Nobex Corporation, Case No. 05-20050 (MFW) (Bankr. D. Del. Dec. 21, 2005) (authorizing adequate assurance in the form of one-month deposit with utility);

- In re Refco, Inc. et al., Case No. 05-60006 (Bankr. S.D.N.Y. Dec. 9, 2005) (authorizing adequate assurance in form of deposit in the amount of 50% of debtors' estimated cost of monthly utility costs, to be held in escrow);

- In re FLYi, Inc., Case No. 05-20011 (MFW) (Bankr. D. Del Dec. 2, 2005) (providing procedure whereby utilities were required to request adequate assurances and debtor was authorized to provide adequate assurance in a form consistent with section 366(c)(1)(A), in a amount equal to the lesser of one month's average usage and amount of prepetition deposit,

pending consensual resolution or determination hearing re: utility's request for additional assurances);

- In re Clean Earth Kentucky, LLC, Case No. 06-50052 (Bankr. E.D. Ken. Mar. 9, 2006) (authorizing adequate assurance of a prepay of average amount of prior monthly invoices within first days of month).

While section 366(c)(2) appears to give a utility absolute discretion in determining what is "satisfactory" assurance, at lease one court has interpolated a possible good faith requirement. See In re Lucre, Inc., Case No. 05-21732 (Bankr. W.D. Mich. 2005) (section 366(c) "could be read to require a utility to bargain in good faith with the trustee or debtor in possession before electing to discontinue service thereunder"; also found that section 366(c) applies only to traditional utility service consumed by debtor). Moreover, as the orders detailed above reflect, post-BAPCPA, courts have routinely put the onus back onto utilities to challenge adequate assurance where the debtor has made some provision for deposit, in some cases as little as two-week's worth, and in some cases without such deposit to be held by the utility. Thus, courts and debtors have fashioned remedies that minimize the adverse effect of the revisions to section 366.

V. Administrative Claim for Goods Delivered Within Twenty Days

A. Redline of Revised Section

11 U.S.C. § 503(b)(9) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including-- . . . **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.**

B. Discussion

The addition of section 503(b)(9) to the Bankruptcy Code creates an administrative claim for goods actually received by the debtor within the 20 days prior to the petition date provided

that such goods are sold to the debtor in the ordinary course. For a retail debtor receiving a high volume of inventory on a constant basis—often a significant portion of such a debtor's trade debt arises in the 30 days prior to bankruptcy—this new provision creates a large administrative claim that gives immediate rise to liquidity concerns. The debtor going into bankruptcy must be able to account in any eventual plan for the payment of administrative claims—including the new section 503(b)(9) claim—in full, and may need to immediately budget for some or all of these claims depending upon courts' willingness to compel pre-plan payment. On the positive side, the creation of this administrative claim meshes well with many debtors' desire to pay certain "critical" vendors upon their prepetition claims, creating a statutory equivalent of the doctrine of necessity, at least with respect to claims that fall within section 503(b)(9).

As a practical matter, nothing in section 503(b)(9) requires immediate payment, and many courts have already determined in other contexts that payment on administrative claims not otherwise required to be paid in the ordinary course may be deferred until plan confirmation to insure that such creditors do not receive an inequitable distribution in the event that the case becomes administratively insolvent. See, e.g., In re Photo Promotion Associates, Inc., 881 F.2d 6 (2d Cir. 1989) (timing of payment of administrative claim in discretion of court); In re HQ Global Holdings, Inc., 282 B.R. 169, 173 (Bankr. D. Del. 2002) (stressing that it is within the court's discretion to determine when an administrative claim will be paid, and noting that distribution prior to confirmation "are usually disallowed when the estate may not be able to pay all administrative expenses in full."). Consequently, the practical result of section 503(b)(9) may be simply to create another category of administrative claims required to be addressed in the context of restructuring exit planning.

Earlier payment may, of course, be permissible. Such earlier payment may disrupt operation of creditors' committees by reducing or eliminating the claims of certain members, as has been seen previously in the case of critical vendor payments. In addition, debtors have made efforts to turn the lemons of section 503(b)(9) into lemonade by combining them with requests to satisfy other critical vendor claims and winning court authority to extract similar concessions from section 503(b)(9) claimants. Debtors thereby control affirmatively both the timing of the payment to maintain liquidity and/or further condition such payment upon agreed terms for continued provision of goods or services. See, e.g.:

- In re Dana Corp., Case No. 06-10354 (Bankr. S.D.N.Y. Mar. 29, 2006) (in context of general critical trade motion, authorizing but not requiring payment of section 503(b)(9) claims);
- In re Oneida Ltd., Case No. 06-10489 (Bankr. S.D.N.Y. Apr. 5, 2006) (expressly requiring continued provision of goods and services on customary trade terms by creditors paid claims under section 503(b)(9));
- In re J.L. French Automotive Castings, Inc., Case No. 06-10119 (Bankr. D. Del. Mar. 6, 2006) (section 503(b)(9) claims treated along with other "critical" vendor claims);
- In re Romacorp, Inc., Case No. 05-86818-11 (Bankr. N.D. Tex. Nov. 8, 2005) (conditioning payment of 503(b)(9) claims on release of trade liens).

It is as yet unclear as a result of any decisional caselaw what meaning may be given to the words "the value of any such goods" in a contested situation and whether "the value" is equivalent with the contract or invoice price or is instead to be analyzed in the context of benefit to the estate akin to the analysis made under section 503(b)(1). It is also as yet unclear what meaning will be given to "ordinary course" in a contested demand for a section 503(b)(9) claim

and whether the caselaw treating ordinary course under section 547 will inform analyses of ordinary course under section 503(b)(9). In addition, it should be noted that the provision creates the claim for the value of "goods" received, thereby suggesting that there is no claim created for costs associated with delivery of the goods (e.g., shipping) and no claim for service, interest, etc.

Relatedly, the interaction between section 503(b)(9) and 11 U.S.C. § 546(c), which creates a reclamation claim with respect to goods received within 45 days prior to the petition date,[4] is of interest. The revisions to section 546(c) deleted the court's authority to deny a reclamation right in exchange for granting an administrative claim or security interest. It remains unclear what consequence will be of the overlapping section 503(b)(9) and section 546(c) rights with respect to goods received within the 20 days prior to the petition date.

Since 546(c) appears to provide only for the actual reclamation of goods (which may or may not still be of any value to the seller), will a seller who reclaims goods received within the 20 days still be entitled to an administrative claim for the "value" of those goods (or the value not recovered by reclamation) and/or will such a claim need to be reduced by the value to seller of any returned goods? Presumably, payment of an administrative claim under section 503(b)(9) will extinguish a right to reclaim those goods because the debtor has ostensibly paid for the value received. See, e.g., In re Pliant Corp., Case No. 06-10001 (Bankr. D. Del. Feb. 8, 2006) (authorizing, but not requiring, debtor to satisfy section 503(b)(9) "non-critical" claims provided that claims are undisputed and claimant withdraws any reclamation claim with respect to goods the subject of the payment). Even more interestingly, if the "value" the debtor were to determine was required to be paid under section 503(b)(9) was less than the value the creditor assigned to reclaimed goods, would the creditor's right to reclamation survive as to goods paid for under

[4] See In re Tucker, 329 B.R. 291 (Bankr. D. Ariz. 2005) (discussing whether revised section 546(c) creates a new, federal, right of reclamation or incorporates and expands state-law rights implemented under UCC § 2-702).

section 503(b)(9)? These questions remain to be litigated as debtors work to reduce their exposure under 503(b)(9) and creditors work to maximize their recovery between reclamation rights and section 503(b)(9) claims.

VI. Limits on Severance and Retention to Insiders

A. Redline of Revised Section

11 U.S.C. § 503**(c) Notwithstanding subsection (b), there shall neither be allowed, nor paid—**

(1) a transfer made to, or an obligation incurred for the benefit of, an insider of the debtor for the purpose of inducing such person to remain with the debtor's business, absent a finding by the court based on evidence in the record that--

(A) the transfer or obligation is essential to retention of the person because the individual has a bona fide job offer from another business at the same or greater rate of compensation;

(B) the services provided by the person are essential to the survival of the business; and

(C) either--

(i) the amount of the transfer made to, or obligation incurred for the benefit of, the person is not greater than an amount equal to 10 times the amount of the mean transfer or obligation of a similar kind given to nonmanagement employees for any purpose during the calendar year in which the transfer is made or the obligation is incurred; or

(ii) if no such similar transfers were made to, or obligations were incurred for the benefit of, such nonmanagement employees during such calendar year, the amount of the transfer or obligation is not greater than an amount equal to 25 percent of the amount of any similar transfer or obligation made to or incurred for the benefit of such insider for any purpose during the calendar year before the year in which such transfer is made or obligation is incurred;

(2) a severance payment to an insider of the debtor, unless—

(A) the payment is part of a program that is generally applicable to all full-time employees; and

(B) the amount of the payment is not greater than 10 times the amount of the mean severance pay given to nonmanagement employees during the calendar year in which the payment is made; or

(3) other transfers or obligations that are outside the ordinary course of business and not justified by the facts and circumstances of the case, including transfers made to, or obligations incurred for the benefit of, officers, managers, or consultants hired after the date of the filing of the petition.

B. Discussion

Prior to the implementation of section 503(c), debtors' efforts to structure retention and incentive programs were broadly permissible under section 363(b) and the "business judgment" rule. Ostensibly, retention of qualified management is important for any company's bankruptcy effort. Retail cases pose the elevated concern that management may possess information or expertise with respect to the particular retail industry that is not easily replicable and that, given turnover in merchandise and seasonal shifts in sales, even a brief falter in management could bring catastrophic effects.

The addition of section 503(c) places a significant—perhaps insurmountable—barrier to the implementation of key employee retention programs ("KERP"s) for insiders. Section 503(c) requires, in order for a payment to be authorized to an insider for the purposes of inducing that person to remain in the employment of the debtor, that evidence in the record support (a) that the transfer is essential for retention because the individual has a bona fide offer from another employer for an equal or greater amount, (b) that the individual's services are "essential to the survival of the business," and (c) that the retention compensation is no more than 10 times the mean compensation provided to non-management employees on similar programs or, if no such plan exists, 25% of the similar transfer made to the individual in the preceding year. In addition, section 503(c)(2) prohibits a severance payment to an insider unless it is (a) part of a program generally applicable to all full time employees and (b) not greater than ten times the mean severance given to non-management employees. Section 503(c)(3), strictly read, apparently imposes a limit on all administrative claims not arising in the ordinary course, except to the extent that they are "justified by the facts and circumstances of the case."

Section 503(c)(1) effectively eliminates retention plans for insiders, since it seems unlikely that, even if the other criteria could be satisfied, an insider with a bona fide offer from another employer at the same or greater compensation could be induced to remain with an insolvent company in any event. Moreover, section 503(c)(2) cabins severance payments to programs of general applicability, which will be impractical in many circumstances, and, where such general programs are practical, the limits on the ratio of severance may make such severance inadequate inducement for such insiders.

Faced with section 503(c), debtors' counsel have as a practical matter faced the end of KERPs, notwithstanding the fact that, given the definition of "insider" under 11 U.S.C. § 101(31), KERPS remain valid alternatives for non-management employees and management personnel other than officers and directors. See, e.g., In re Refco Inc., et al., Case No. 05-60006 (Bankr. S.D.N.Y. Jan. 17, 2006) (approving under section 503(c)(3) severance payments and performance bonuses for non-insider employees).

With respect to directors and officers, debtors have made a number of efforts to work around the apparent limitations of section 503(c), including (a) focusing on the fact that the restrictions of 503(c)(1) apply to programs designed to retain insiders and not to programs designed to reward performance and success or to share profits—they propose, instead, management incentive programs ("MIP"s) tied to performance, (b) attempting to design termination payments not encompassed in section 503(c)(2)'s limitation on severance, and (c) relying upon the catch-all language of section 503(c)(3), which appears to suggest other transfers in the ordinary course would be acceptable.

In In re Dana Corp., et al., Case No. 06-10354 (Bankr. S.D.N.Y. Sept. 5, 2006), for example, the debtors proposed employment agreements with the president/CEO and certain

executives designed to side-step section 503(c). The proposed plan included base salary, annual incentive plan bonuses (conditioned on the debtor's financial performance), target completion bonuses (including a fixed component payable on plan effective date and a variable component based upon the debtors' total enterprise value six months after the plan effective date), and a senior executive retirement plan offered in exchange for a non-compete agreement. The court framed its analysis as whether the proposed plan was a "'Pay to Stay' plan," requiring analysis under section 503(c), or whether the plan was an "incentivizing 'Produce Value for Pay' plan" that could be scrutinized under 11 U.S.C. § 363 and the business judgment rule. Importantly, the court determined that the "plain language" of section 503(c)(3) "does not prohibit the Court from analyzing transfers to prepetition hires expansively under this section." The court did not expressly address the salary component; however, it appears that negotiating a new, higher salary with a prepetition employee could be a means of inducing the employee to stay and could thus run directly afoul of section 503(c)(1). The court did not analyze the financial performance bonus other than to note that the standards had been objected to as too easy to satisfy. With respect to the target completion bonus, the court determined that insofar as the completion bonus was tied only to the plan effective date rather than performance, it was not an incentive plan but a retention plan.[5] The Court also determined that the severance in exchange for a non-compete agreement still fell within the confines of section 503(c)(2), was a severance plan rather than a contractual payment. Ultimately, the Court concluded that the debtors had not carried their burden and denied the proposed plan, finding:

> While it may be possible to formulate a compensation package that passes muster under the section 363 business judgment rule or section 503(c) limitations, or both, this set of

[5] This conclusion begs the question of whether simply getting a case to confirmation could, in some cases, be a performance goal. While the Dana Corp. decision seems to contemplate that all debtors naturally take their cases to confirmation, there are certainly some cases that at the outset have such slim chances of reaching a confirmable liquidating or reorganizing plan that getting a company to confirmation is extraordinary performance.

> packages does neither. In so holding, I do not find that incentivizing plans which may have some components that arguably have a retentive effect, necessarily violate section 503(c)'s requirements.

(emphasis in original). In re Dana thereby suggests both that section 503(c)(3) can be used to sidestep section 503(c)(1) & (2), including in circumstances where there is some "retentive effect." It leaves open the curious question of whether "salary" is an impermissible inducement to remain with the debtor's business and highlights the potential problem associated with a too-broad definition of such inducement, clearly finding that some categories of compensation—even if they act as an inducement to remain—are potentially permissible, since inducement to stay threatens to include in its broadness any monetary or non-monetary compensation.

Several other orders have also been entered dealing with section 503(c). See, e.g.:

- In re Nellson Nutraceutical, Inc., Case No. 06-10072 (Bankr. D. Del. Jul. 18, 2006) (approving management incentive plan upon satisfaction of certain performance).
- In re Riverstone Networks, Inc., Case No. 06-10110 (Bankr. D. Del. Apr. 3, 2006) (approving plan with respect to non-insiders authorizing payments to management as determined by compensation committee, although reserving right to object to actual payment once authorized by compensation committee);
- In re Pliant Corp., Case No. 06-10001 (Bankr. D. Del. Mar. 14, 2006) (debtors sought approval of payments under a prepetition management incentive plan, covering insider and non-insider employees; court determined that proposed payments were not retention or severance, and thus did not run afoul of section 503(c)(1) or (2), approved the payment to non-insiders, and approved the payment to insiders until the package equaled 50% of the payment to non-insiders, reserving issue of payment on the balance until plan confirmation);

- In re FLYi, Inc., Case No. 05-20011 (Bankr. D. Del. Feb. 3, 2006) (approving severance payments as within scope of section 503(c)(2));
- In re Nobex Corp., Case No. 05-20050 (MFW) (Bankr. D. Del. Jan. 20, 2006) (approving under section 503(c)(3) "incentive" pay to senior management where such payments were linked to sale proceeds in excess of stalking horse bid; court determined that such compensation was "incentive" payment and thus neither a retention bonus nor a severance payment within the purview of section 503(c)(1) or (2); court also found section 503(c)(3) was a reiteration of the business judgment rule under section 363 and was not limited to post-petition professionals).

See also:

- In re Calpine Corp., Case No. 06-60200 (Bankr. S.D. N.Y. 2006) (approving management incentive plan);
- In re L.G. Phillips Displays USA, Inc., Case No. 06-10245 (Bankr. D. Del. 2006) (approving severance and key employee retention plan as to non-insiders and retention payment to insider where section 503(c)(1) was satisfied and committee and secured lender did not object);
- In re Orius Corp., Case No. 05-63876 (Bankr. N.D. Ill. 2005) (approving performance based incentive bonuses).

Finally, an interesting and—as yet—unaddressed question is whether the broad language of section 503(c)(3), which affirms generally that "Notwithstanding subsection (b), there shall neither be allowed, nor paid— **. . .** other transfers or obligations that are outside the ordinary course of business" should be interpolated to apply to all section 503(b) administrative claims adding a new administrative burden to the analysis of such claims.

VII. Obligation of Committee to Provide Information to Creditors

A. Redline of Revised Section

11 U.S.C. § 1102(b)**(3) A committee appointed under subsection (a) shall—**

(A) provide access to information for creditors who—

(i) hold claims of the kind represented by that committee; and

(ii) are not appointed to the committee;

(B) solicit and receive comments from the creditors described in subparagraph (A); and

(C) be subject to a court order that compels any additional report or disclosure to be made to the creditors described in subparagraph (A).

B. Discussion

The addition of section 1102(b)(3) for the first time imposes on creditors' committees an affirmative obligation to "provide access to information" to creditors with like claims and to solicit and receive comments from such creditors. The broadness and ambiguity of the sections provided occasion for some early panic as counsel puzzled over what information was to be provided and in what form, whether confidentiality concerns would chill the delivery of information to the committee from the debtor, and how comments were to be solicited and what was to be done with them. A particular concern from a debtor's point of view is protection of confidential proprietary and/or financial information provided to committees in their capacity as representatives of all creditors but not appropriate for sharing with all creditors. Debtors are also concerned about the cost of compliance, which is ultimately borne by the estate in the form of additional fees and expenses demand by the committee and its counsel. Committees, of course, are concerned with the continued flow of otherwise confidential information from debtors, ensuring that such information does not need to be provided to creditors, ensuring that the attorney-client privilege was not waived by information required to be disclosed under section 1102(b)(3), and implementing an effective mechanism for sharing information and soliciting

comments. Such concerns would be significant in any case, but in a retail case, where the number of creditors tends to be large, the looming administrative burdens appeared onerous, and there is an abundance of confidential proprietary information involved.

In point of fact, debtors and committees have made quick work of section 1102(b)(3), seeking—and receiving—orders that provide confidential information and privilege protections and that supply protocols for the permissive (and sometimes mandatory) delivery of information by committees to creditors. In many cases, the debtor has proactively, in a first-day filing or soon thereafter, sought protection for confidential information and accompanying approval for committee protocols, thereby insuring that there is no lapse in the debtor's confidentiality protections. Courts, debtors, and committees have generally found that the most simple and cost-effective means of providing information is by establishing a website with certain information and an email address for solicitation of comments.

For example, committees have been deemed in compliance with section 1102(b)(3) by adopting programs that may include the following (a) establishing a website to make certain information available to creditors, (b) making available on the website information regarding the debtor's case, including: (i) the petition date, (ii) the case number, (iii) the contact information for the debtor (and any information hotlines that they establish), the debtor's counsel, and the committee's counsel, (iv) the voting deadline with respect to any plan filed in this case, (v) access to the claims docket as and when established by the debtor or any claims and noticing agent retained in theses cases, (vi) a general overview of the chapter 11 process, (vi) press releases (if any) issued by the committee or by the debtor, (vii) links to other relevant websites (e.g. the debtor's corporate website, the bankruptcy court website, and the website of the Office of the United States Trustee), and (viii) any other information that the committee or its counsel

deems appropriate; (c) establishing an email address to allow unsecured creditors to send questions and comments in connection with this case; and (d) authorizing the committee and its counsel, in their reasonable discretion, to review and/or respond to the email correspondence.

In In re Refco, Inc., 336 B.R. 187 (Bankr. S.D.N.Y. 2006), the first reported decision on section 1102(b)(3), the court found the section ambiguous, considered the need for protection of confidential information, the need for the committee itself to preserve attorney-client privilege, and securities law requirements. The court held that the committee need not provide confidential or privileged information but required it to consider the willingness of the creditor requesting such information to enter a confidentiality agreement. The court established an information-sharing protocol that calls for the committee to distribute case updates by email to creditors who request them, to provide and maintain telephone numbers for creditors to submit questions and/or comments, and to respond to requests for information within 20 days. The court further provided for a procedure for creditors to seek disclosure of confidential information as to which other resolution could not be reached. More expressly, the court required the committee to establish a website that provides, without limit: (a) general information about the case (including access to docket), (b) monthly committee reports, (c) highlights of significant events, (d) a calendar of upcoming significant events, (e) access to the claims docket, (f) a general overview of the chapter 11 process, (g) any press releases by committee or debtors, (h) answers to frequently asked questions, and (i) links to other websites. The order also provided for the exculpation for the committee and its agents for acts taken in connection with the protocol.

Numerous orders have been entered since Refco clarifying that creditors committees are not authorized or required to provide access to confidential or privileged information and/or providing protocols for the committee to provide information to creditors. See, e.g.:

- In re Glycogenesys, Inc., Case No. 06-10214 (Bankr. E.D. Mass. May 11, 2006) (providing broad protection for confidential and privileged information and requiring committee to respond to queries with pleadings etc. by "means that the Committee believes, in its reasonable business judgment, are relevant and informative");

- In re Global Home Products, LLC et al., Case No. 06-10340 (Bankr. D. Del. May 4, 2006) (providing protection for confidential or privileged information where privilege is controlled by committee; protocols approved after committee formation; further providing for exculpation of committee members and counsel for actions taken in compliance with the protocols);

- In re Oneida Ltd., Case No. 06-10489 (ALG) (Bankr. S.D.N.Y. May 2, 2006) (adopting a protocol similar to that in Refco, described above, authorizing use of claims agent to maintain website, and providing protections for confidential and privileged information; providing for exculpation of committee and its gents for actions taken in accordance with the protocols);

- In re Riverstone Networks, Inc., Case No. 06-10110 (Bankr. D. Del. Apr. 11, 2006) (providing committee, inter alia, discretion to establish password protected web site and establish email address for comments and broad protection for confidential information and committee's privilege; requiring response to queries from creditors within 20 days; exculpation for both debtor and committee, and counsel, for actions taken in compliance with the protocol);

- In re Dana Corp., Case No. 06-10354 (Bankr. S.D.N.Y. Mar. 29, 2006) (providing protection for confidential information but permitting access to privileged information where privilege is committee's; protocol like Refco but without 20-day response date);

- In re G+G Retail, Inc., Case No. 06-10152 (RDD) (Bankr. S.D.N.Y. Mar. 9, 2006) (providing protection for confidential information, for committee privileged information, and for joint debtor-committee privileged information; determining committee must respond to creditor queries and should provide information that in its reasonable business judgment it believes is relevant);

- In re Pliant Corp., Case No. 06-10001 (MFW) (Bankr. D. Del. Mar. 9, 2006) (committee motion, implementing protocols including establishment of web site and providing broad protection for confidential and privileged information; also providing exculpation for committee and counsel for actions taken in accordance with protocol);

- In re Nellson Nutraceutical, Inc., Case No. 06-10072 (PJW) (Bankr. D. Del. Feb. 22, 2006) (granting debtor's motion for order providing protection for confidential or privileged information);

- In re Nobex Corp., Case No. 05-20050 (MFW) (Bankr. D. Del. Feb. 10, 2006) (providing protection for confidential or privileged information; protocols approved after committee formation);

- In re FLYi, Inc., Case No. 05-20011 (MFW) (Bankr. D. Del. Nov. 17, 2005) (providing protection for confidential information, for committee privileged information, and for joint debtor-committee privileged information; protocols approved after committee formation, including ability to set up website);

- In re Calpine Corp., Case No. 05-60200 (BRL) (Bankr. S.D.N.Y.) (confidentiality protections and protocol like Refco, also specifying information to be provided through website);

- In re J.L. French Automotive Casting, Inc., Case No. 06-10119 (Bankr. D. Del. 2006) (adopting protocol similar to Refco and also requiring, inter alia, debtor's noticing agent to be available to respond to queries re: claims process); and

- In re Amcast Automotive of Indiana, Inc., Case No. 05-33322 (FJO) (Bankr. S.D. Ind. 2006) (providing broad protection of confidential and privileged information and requiring, inter alia, committee counsel to respond to telephonic creditor queries and provide pleadings upon written request).

The office of the United States Trustee has, in fact, required a website and mechanism for electronic communication for chapter 11 cases pending in Delaware and the Southern District of New York.

In light of the orders and protocols adopted, it appears that concerns about the effect of section 1102(b)(3) were exaggerated. Time will tell whether creditor challenges to the sufficiency of such protocols and the enforceability of such confidentiality provisions may still turn the section into a greater burden than benefit.

VIII. Cap on Exclusive Plan Filing and Solicitation Periods

A. Redline of Revised Section

11 U.S.C. § 1121(d)**(1) Subject to paragraph (2), on** ~~On~~ request of a party in interest made within the respective periods specified in subjections (b) and (c) of this section and after notice and a hearing, the court may for cause reduce or increase the 120-day period or the 180-day period referred to in this section.

(2) (A) The 120-day period specified in paragraph (1) may not be extended beyond a date that is 18 months after the date of the order for relief under this chapter.

(B) The 180-day period specified in paragraph 1 may not be extended beyond a date that is 20 months after the date of the order for relief under this chapter.

B. Discussion

Prior to BAPCPA, there were, in theory, no limits to the debtor's ability to have extended its time to exclusively file a plan and solicit votes thereon. The revisions to section 1121(d) now impose a bright line limit on extensions of exclusivity of 18 months and on exclusive solicitation of 20 months. These new limits increase the need for prepetition planning and encourage the use of prepackaged and prearranged cases. Given the fact that, as of yet, 18 months has not passed since BAPCPA went into effect, we have yet to see any efforts by debtors to determine if courts will find any flexibility within this seemingly plain-language standard.

Even if courts conclude, as seems necessary, that section 1121(d) now provides for no discretion outside of the 18 and 20 month periods provided for therein, debtors may decide to approach the problem from the position of limiting the ability of other parties to submit proposed plans. Debtors, of course, could delay solicitation on competing plans by tying them up with objections to the disclosure statement and/or to proposed solicitation procedures. In addition, while a debtor could theoretically seek a broad injunction prohibiting the filing of non-debtor plans, on the theory that section 1121(d) limits exclusivity but does not confer a right on other parties to file plans, such a broad decision would render section 1121 nugatory and would, therefore, seem unlikely. However, a debtor may have some fortune in seeking injunctive relief prohibiting a particular party from filing a competing plan, particularly on the grounds that such party has actively impeded the debtor's efforts to timely comply with section 1121 in filing its own plan. Doubtless these and other possibilities will come into play as the 18 month deadline approaches for the first cases filed after BAPCPA's effective date.