



**WAGNER,
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JUDD, Ltd.**

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Wagner, Falconer & Judd, Ltd. is pleased to announce that Gary J. Van Domelen has joined the firm to serve as the leader of our Small Business Practice Group and is opening our office in La Crosse, Wisconsin.

Gary brings to our practice a unique combination of over 20 years of business and legal experience. He began his legal and business career as an associate in the Milwaukee law firm of Kasdorf, Lewis & Swietlik, S.C. He left private practice and pursued opportunities as in-house counsel for several large corporations. Gary started his in-house counsel career for S.C. Johnson & Son, Inc. in

Racine and later became Vice President & General Counsel for Fisher Scientific Company, LLC based in Pittsburgh, Pennsylvania. From there, Gary was Chief Legal Counsel for Trane Commercial Systems and Vice President & Chief Corporate Counsel for American Standard Companies, Inc. in New Jersey where he managed legal issues associated with mergers and acquisitions, real estate, securities and corporate secretarial functions. Most recently, Gary returned to private practice and managed the LaCrosse office of Riordan, Donnelly, Lipinski & McKee, Ltd., a Chicago litigation and business firm.

Gary has published articles in the Wisconsin Lawyer, American Bar Association Tort & Risk Journal and the Marquette Law Review and served as a guest lecturer regarding a variety of business and litigation topics. Gary is a 1986 graduate of Marquette University Law School where he served as Managing Editor of the Law Review.

We are excited about the talents Gary brings to our practice and confident he will enhance the high level of service provided to our clients. Although Gary will manage our LaCrosse office, he will serve our clients throughout the United States and Canada.

New Contact Information for Wagner Falconer & Judd

Our MN office has moved. The new address is:

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BANKRUPTCY BILL BECOMES LAW— PART 2

On April 20, 2005, President Bush signed into law the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("the 2005 Amendments"), which bring about some of the most sweeping changes to the Bankruptcy Code ("the Code") since its enactment in 1978. With limited exceptions, the 2005 Amendments took effect on October 17, 2005, and are applicable to cases filed on or after that date. The primary focus of the 2005 Amendments is clearly on consumer bankruptcies. Some of the most significant changes affecting consumer bankruptcy cases are highlighted below.

Consumer Cases

Individual debtors normally file under either Chapter 7 or Chapter 13. In a Chapter 7 case, a debtor forfeits non-exempt assets, which the bank-

ruptcy trustee sells and distributes to creditors. The benefit to the debtor filing a Chapter 7 case is that most preexisting debt is discharged, although many pre-petition liens survive the discharge. In contrast, a debtor in a Chapter 13 case uses future earnings, rather than assets, to pay off creditors. The benefit to the debtor filing a Chapter 13 case is the ability to retain assets and a broader discharge of debts at the end of the plan. The 2005 Amendments are a response to concerns that consumer debtors with some ability to pay their debts were discharging debts too easily through Chapter 7. The most significant change under the 2005 Amendments is the establishment of a "means test" to determine whether a consumer debtor is eligible for a Chapter 7 discharge. The test is intended to make it harder for a consumer debtor

to avoid paying back some of those debts under a Chapter 13 plan.

Dismissal for Abuse and the "Means Test."

Before the 2005 Amendments, the court could dismiss a Chapter 7 case filed by a consumer debtor if granting a discharge would be a "substantial abuse" of Chapter 7 relief. The court and the U.S. trustee were the only parties who could challenge a consumer debtor's right to a Chapter 7 discharge under the "substantial abuse" standard. Creditors had no right to raise the issue. In addition, the court was required to apply a presumption in favor of granting the relief sought by the debtor.

The 2005 Amendments not only eliminate the presumption in favor of granting a Chapter 7 discharge to a consumer debtor, but also create a

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"presumption of abuse" that can lead to dismissal of the debtor's Chapter 7 case, or at least force the debtor out of Chapter 7 and into Chapter 13. In addition, the 2005 Amendments now permit creditors to request dismissal of a consumer debtor's Chapter 7 case under the new abuse standard, although only in cases where the debtor's current monthly income is equal to or less than the median income of a similarly sized family in the state where the debtor resides.

In general, the new presumption of abuse arises if the consumer debtor's average monthly income, reduced by permitted monthly expenses, when multiplied by 60 (for the maximum number of months in a five year payment plan) exceeds the lesser of \$10,000 or 25% of the debtor's nonpriority unsecured claims (subject to a \$6,000 floor). In other words, the presumption of abuse is triggered if the debtor's current net monthly income, as determined by the complex statutory formula, shows that the debtor has sufficient extra monthly income to pay at least 25% of the debtor's general unsecured debt over five years.

For example, if a debtor has average net monthly income of \$4000 per month, and permissible monthly expenses of \$3600 per month, the debtor theoretically has an extra \$400 per month that could be applied toward payment of unsecured debt. Whether the debtor should be entitled to file Chapter 7, which might permit discharge of all of the unsecured debt, depends on how big of a dent the debtor could be expected to put in the debt over the course of five years if all of the excess income were applied toward payment of the debt. If the debtor has an extra \$400 every month on average, the debtor could theoretically pay \$24,000 toward the unsecured debt over the course of five years (\$400 per month x 60 months = \$24,000). If the debtor has \$90,000 in unsecured debt, \$24,000 would pay 26.6% of the debtor's unsecured debt. In this scenario, the presumption of abuse is triggered and the debtor may be ineligible for Chapter 7.

In contrast, if the debtor has \$100,000 in unsecured debt, the same \$24,000 paid over the course of five years would amount to only 24% of the total unsecured debt. In this scenario, the presumption of abuse is not triggered and the debtor may be eligible for Chapter 7, under which *all* of the unsecured debt might be completely discharged.

If the presumption of abuse is triggered, the debtor may rebut the presumption only by showing "special circumstances" that justify additional expenses or adjustment of the debtor's income, such as a serious medical

condition or an order to active duty in the Armed Forces. If the debtor can't rebut the presumption of abuse, the case will be dismissed or the debtor may elect to convert the case to Chapter 13, under which the debtor will be required to apply future income toward payment of the existing debts.

Congress carved out a safe harbor for consumer debtors whose current income does not exceed the median annual income of similarly sized families residing in the same state. If the current monthly income (without deduction of monthly expenses) of the debtor *and the debtor's spouse*, when multiplied by 12, is equal to or less than the median annual income of a similarly sized family in the state where the debtor resides, the means test does not apply at all, even if its application would otherwise create a presumption of abuse.

For example, if the debtor's current monthly income is \$3000 per month, and the current monthly income of the debtor's spouse is \$3000 per month, their combined current monthly income, multiplied by 12, is \$72,000 (\$6000 x 12 = \$72,000). If the debtor resides in Minnesota where the median income of a two person family is \$52,922, the means test will apply since the debtor's combined household income exceeds the median income of a similarly sized family in the same state. In contrast, if the monthly income of the debtor's spouse is only \$1000 per month, their combined monthly income (\$3000 + \$1000 = \$4000), multiplied by 12 (\$4000 x 12 = \$48,000) is less than the median annual income for a similarly sized family in the same state. As a result, the means test does not apply so the debtor may still be eligible for a Chapter 7 discharge.

Despite the safe harbor exception to the means test, some observers speculate that the means test implemented by the 2005 Amendments could force between 30,000 and 100,000 cases out of Chapter 7 and into Chapter 13 each year, which may discourage some individual debtors from filing for bankruptcy at all.

Restriction on Time Between Discharges Extended.

Before the 2005 Amendments, a debtor was ineligible for a Chapter 7 discharge if the debtor received a discharge under Chapter 7 or Chapter 11 within six years prior to the date the current bankruptcy case was filed. Under the 2005 Amendments, the required amount of time between discharges is extended to eight years. In addition, the court may not grant a Chapter 13 discharge if the debtor received a discharge under Chapter 7, 11, or 12 in a prior case filed within four years before the current

case was filed, or if the debtor received a Chapter 13 discharge within two years of the date the current case was filed.

Limitation on Homestead Exemption

The Bankruptcy Code permits debtors to shield or "exempt" certain assets from claims of creditors. In some states, debtors can elect to claim the exemptions available under the Code or exemptions available under state law, but not both. In other words, the debtor can't mix and match exemptions from both schemes.

One of the most significant of exemptions available to consumer debtors is the homestead exemption. Most states limit the amount of equity in a primary residence that a debtor can shield from creditors. Other states, including Florida, impose no such limits. Some debtors have taken advantage of this fact by buying expensive homes in these states prior to filing for bankruptcy. Prior to the enactment of the 2005 Amendments, a debtor could claim a new state's homestead exemption after living in the new state for only six months.

The 2005 Amendments restrict this practice by providing that a debtor who moves to a new state can't claim the new state's homestead exemption unless the debtor has lived in the new state for two years. If the debtor has lived in the state for less than two years, the homestead exemption of the state where the debtor resided prior to moving will generally apply.

Longer Chapter 13 Plans.

Under existing law, a consumer debtor's Chapter 13 repayment plan generally can not exceed three years. For cause shown, the court can extend the plan to no more than five years. Under the 2005 Amendments, whether a debtor's Chapter 13 is three or five years long is a function of the debtor's current monthly income compared to the median income for a family of the same size in the state where the debtor resides.

Conclusion

The impact the 2005 Amendments will have on the number of future bankruptcy filings is not yet clear. However, the impact of the 2005 Amendments is already being felt. Bankruptcy filings reached record levels in 2005 as consumer debtors raced to file before the tougher laws took effect on October 17. If the 2005 Amendments achieve their intended purpose, at least some consumer debtors will face more difficulty when attempting to discharge debts, and others may be discouraged from filing at all.

PROTECTION OF MINNESOTA STATUTES SECTION 541.051

In 2005, Wagner, Falconer & Judd, Ltd. (“WFJ”) represented a defendant in a case in which WFJ relied on Minnesota Statutes section 541.051 in order to obtain dismissal of the plaintiff’s “slip and fall” claim. In 2000, the plaintiff fell in the hallway of his apartment during a carpet-replacement project. The plaintiff slipped when he stepped onto bare concrete covered by a slippery glue. Three years later, the plaintiff served a Complaint upon the defendant alleging that the defendant negligently failed to warn him of the dangerous condition.

WFJ argued to the court that the plaintiff’s claim should be dismissed because it was time-barred by the two-year statute of limitations under Minnesota Statutes section 541.051. The statute provides that for a person to recover for a bodily injury that arose

from a defective and unsafe condition of an improvement to real property, that person must bring a claim within two years after the discovery of the injury.

The case centered on whether the carpet-replacement process was an improvement to real property and whether the injury arose from a defective and unsafe condition. The court agreed with WFJ that replacing carpet was an improvement to real property and laying glue for new carpet was part of the process of constructing the improvement, even though the new carpet had not been laid.

The court also agreed with WFJ that the injury arose from a defective and unsafe condition. The plaintiff argued that there was nothing inherently defective about the glue and, therefore, the statute did not apply and

the plaintiff was not time-barred from bringing his claim. WFJ argued that the glue stage of the carpet-replacement project was defective in the sense that it was incomplete or imperfect because it resulted in a slippery surface. As a result, the plaintiff’s claim was time-barred and he was precluded from going forward.

The holding of this case highlights the importance of being aware of statute of limitation periods, regardless if a person or entity is bringing a lawsuit or defending against one. To ensure the protection of your rights, it is advisable to contact legal counsel when dealing with statute of limitations issues.

RECLAMATION: Demanding the Return of Goods from Insolvent Buyers

Reclamation is an important right for unpaid sellers of goods on credit. In essence, reclamation allows creditors to demand the return of goods sold to an insolvent buyer. Important statutory requirements must be met in order to effectively reclaim goods. Reclamation carefully used can assist creditors in reducing their losses.

Uniform Commercial Code (UCC)

The reclamation rights of a seller of goods on credit are set forth in Minnesota Statutes § 336.2-702(2). The statute provides that where a “seller discovers that the buyer has received goods on credit while insolvent the seller may reclaim the goods upon demand made within ten days after the receipt.” Minn. Stat. § 336.2-702(2). Therefore, two conditions must be met to successfully reclaim goods sold on credit. First, the buyer must receive the goods while insolvent. Second, the seller must make a demand for the return of the goods within ten days of the delivery of the goods to the buyer. The statute also provides that if the buyer has made a written misrepresentation of solvency within three months before delivery, the seller may reclaim without regard to the ten-day notice limitation. *Id.* The seller’s right to reclaim based upon Section 336.2-702 is exclusive and excludes all other remedies with respect to such goods. Minn. Stat. § 336.2-702(3).

Minnesota Statutes § 336.2-702(3) provides that a reclaiming seller’s right to

reclaim is subject to the rights of a buyer in the ordinary course. The seller must prove that the sale of the goods in question was made in the ordinary course of the business of the seller. *In re Morken*, 182 B.R. 1007, 1016 (Bky. D. Minn. 1995). A seller’s right to reclamation is also subject to the right of a good faith purchaser. Minn. Stat. § 336.2-702(3); *Matter of Reliable Drug Stores, Inc.*, 70 F.3d 948, 950 (7th Cir. 1995).

Bankruptcy

The Bankruptcy Code recognizes the right of reclamation, subject to the prior rights of a holder of a security interest in the goods. 11 U.S.C. § 546(c). Section 546(c) of the Bankruptcy Code requires that (1) the debtor be insolvent when the goods are delivered and (2) the goods were delivered in the ordinary course of the seller’s business.

Following the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, effective October 17, 2005, the Code now requires that the seller demand reclamation *in writing* (1) **not later than 45 days after the debtor receives the goods** or (2) if the 45-day period expires after the commencement of the bankruptcy case, the demand must be made **no later than 20 days after the date of commencement of the bankruptcy case**. 11 U.S.C. § 546(c) (1).

In *2005 Bankruptcy Reform Legislation with Analysis*, the authors identified a potentially perilous interpretation of the amended § 546(c):

Reclaiming creditors should be sensitive to a dangerous interpretation of this rule. Congress may have intended to allow reclamation within 20 days or the remainder of a 45-day reclamation window, whichever deadline occurs last. The language does not clearly say “whichever occurs later,” however, and therefore some courts may conclude that the smaller window applies. For example, suppose the seller delivers to the buyer 10 days prior to the filing of debtor’s petition. The 45-day period would not run until 35 days after the petition. Because the 45-day period expires after the commencement of the case, however, the notice might have to be given in writing “not later than 20 days after the date of commencement.” 11 U.S.C. § 546(c)(1)(B).

Thus, the time to reclaim is either (1) not later than 45 days after receipt or (2) not later than 20 days after the date of commencement of the case. The second deadline seems to apply by its terms only if the 45-day window expires post-petition. It is unclear which deadline would apply. Moral: Make a demand within 20 days after the date of bankruptcy. *2005 Bankruptcy Reform Legislation with Analysis*, Hon. William Houston Brown and Lawrence R. Ahern III, (Thomson West 2005).

The 2005 Amendments to the Bankruptcy Code also provide that a creditor who fails to make a timely written de-

RECLAMATION...continued

mand to reclaim goods may still assert an "administrative expense claim." 11 U.S.C. §§ 546(c)(2) and 503(b)(9). However, this claim is limited to the value of the goods received by the debtor in the ordinary course of business within 20 days prior to the commencement of the case. 11 U.S.C. § 503(b)(9).

The ability of a seller to reclaim extends only to goods that were in the possession of the buyer at the time the demand for reclamation was made. *In re Morken*, 182 B. R. at 1016-17 (Bky. D. Minn. 1995). The seller in a reclamation case has the burden of proving that the debtor possessed the goods when it received the reclamation demand. *In re Adventist Living Ctrs. Inc.*, 52 F.3d 159, 163 (7th Cir. 1995); *Matter of Flagstaff Foodservice Corp.*, 14 B.R. 462, 469 (Bky. S.D. N.Y. 1981). There is no presumption that the goods remained with the debtor simply because the goods were delivered. *In re Adventist Living Ctrs. Inc.*, 52 F.3d at 163; *In re Rawson Food Service, Inc.*, 846 F.2d 1343, 1350 n.11 (11th Cir. 1983). Therefore, if the goods have been disposed of by the buyer, the

seller's rights of reclamation will not extend to any proceeds of sale. *In re Morken*, 182 B.R. at 1016-17.

The goods subject to reclamation must be identifiable. *In re Morken*, 182 B.R. at 1016. A seller of goods is only entitled to reclaim goods it has specifically identified in its written demand for reclamation. *In re Braniff*, 113 B.R. 745, 752 (Bky. M.D. Fla. 1990); *In re Landy Beef Co.*, 30 B.R. 19, 21 (Bky. D. Mass. 1983). The court in *Braniff* held that if the written reclamation demand was not sufficiently detailed in the description of the goods subject to reclamation, then the reclamation claim must fail as a matter of law. *In re Braniff*, 113 B.R. at 752.

Conclusion

Reclamation rights are important rights to creditors faced with insolvent debtors. Timing is crucial. While the UCC does not appear to require a reclamation demand to be in writing, the best practice is to always make the demand in writing, especially given the Bankruptcy Code's written notice requirement. Reclamation rights are short-lived. Therefore, it is

imperative that creditors exercise their rights in a timely manner. If you have questions about whether reclamation may be an available or advisable remedy, always seek legal advice as soon as possible.

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