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MEDIA COLLECTION szabo PROFESSIONALS

SZABO ASSOCIATES, INC. VOLUME 27, ISSUE 2, JUNE 30, 2012

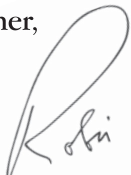
Dear Friends:

It's been seven years since the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) was passed, following much contentious debate between its proponents and opponents. So who was right? What is the present state of U.S. bankruptcy, and has the new legislation made things better or worse? This issue's feature article discusses the expected and unexpected consequences of bankruptcy reform.

The annual MFM/BCCA convention in May was both entertaining and very informative. We were pleased to present the 2012 Peter F. Szabo Career Achievement Award to Bonnie Krabbenhoft, Manager of Credit, Collections & A/R, Scripps Networks, for her valuable contributions to the organization and to the media credit and collections industry.

Our busy summer calendar includes the Broadcast Cable Credit Association (BCCA) Media Credit Seminar, July 19 in Chicago, Illinois, where Szabo will sponsor lunch; the Szabo Annual Awards Banquet, August 27 in Atlanta; the Media Financial Management (MFM) Media Outlook 2013, September 13 in New York, New York, where Szabo will sponsor lunch; and the NAB (National Association of Broadcasters) Radio Show, September 19-21 in Dallas, Texas.

Best wishes for a wonderful summer,



Robin Szabo, President
Szabo Associates, Inc.

For Better or For Worse . . . Bankruptcy Since BAPCPA

Are bankruptcies on the decline? Statistics for 2011, as reported by the National Bankruptcy Research Center (NBKRC), indicate that total annual filings fell for the first time since 2006. Nationwide, the drop was 12%, an average of vividly higher and lower rates across the country. Consumer bankruptcies, which typically account for more than 90% of filings each year, accounted for 96.6% of the total number of filings in 2011, according to the American Bankruptcy Institute (ABI).

Business bankruptcies also fell in 2011 to 47,806 from 56,282 in the previous year, according to ABI. Some experts attribute the drop in business filings to out-of-court restructuring using high-yield bonds to finance debt. If this is the case, the availability of such financing should continue to have a significant impact on bankruptcy statistics through the rest of 2012. Of course, consumer bankruptcies also have a considerable impact on business bankruptcies, especially for small- to mid-sized businesses that cannot endure contraction of their customer base.

But what about the impact of bankruptcy reform? Has it affected bankruptcy statistics and the nature of bankruptcy filings? Signed into law in 2005, when the economy was still healthy, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) has indeed made changes to the landscape of U.S. bankruptcy. Because bankruptcies have been so volatile since the law's passage, reaching a staggering high in 2009 following the economic meltdown, it is difficult to extract BAPCPA's effects from the many variables that have come into play the past seven years. Speculation and controversy still surround certain of the law's provisions, although some conclusions can be reasonably reached about its impact.

Good Intentions.
The highly debated BAPCPA was intended by legislators "to improve bankruptcy law and practice by restoring personal responsibility and integrity to the bankruptcy system and ensure that the system is fair for both debtors and creditors." Proponents argued that the Code had become a means to escape creditors and financial obligations. Opponents countered that such claims were overblown. Because the law was aimed primarily at consumer debt, media focused most attention on the impact of the law on consumers. Little attention was given to trade creditors, who also stood to be considerably affected.

Expected Benefits.
Reduction in Chapter 7 filings.
One of the main goals that the new law's backers hoped to achieve was to force more debtors out of Chapter 7 liquidation and into repayment plans under Chapter 13. The method by which this would be achieved was a set of eligibility thresholds for Chapter 7 based upon a person's income. This "means testing," along with mandated credit counseling for prospective filers, additional reporting requirements, additional attorney liability, all of which opponents argued would add substantially to the costs

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of filing, stoked the fire of controversy over the new law.

Reduction in "bad faith" filings. The Act also addressed the problem of multiple and serial filings by the same debtor. Prior to the new law, many debtors filed Chapter 7 to discharge unsecured debts, then followed with Chapter 13 to deal with secured debt. Commonly referred to as "Chapter 20," this practice was eliminated by expanding the time between subsequent discharges.

Expanded preference protections. Some of the most welcome aspects of the law to trade creditors were its modifications to the venue statute for preference actions and clarifications of issues regarding preference defenses. These changes have generally worked to the trade creditor's benefit.

Influence and information. BAPCPA's modification pertaining to creditors' committees empowers the court to direct the U.S. Trustee to change the membership of a committee if the court determines that the "... change is necessary to ensure adequate representation of creditor or equity security holders." Additionally, the new law provides greater creditor access to information from the committee.

Exclusivity and leases. By placing additional time restrictions on the process, the law sought to move cases through the courts with greater speed. Prior to BAPCPA, the law did not impose a time limit for court-granted extensions of the time period that Chapter 11 debtors are allowed to file a plan and obtain acceptance. BAPCPA now sets the time limit for exclusive rights to a maximum of 18 months for filing a plan and 20 months for obtaining acceptance. Additionally, the Chapter 11 provision of BAPCPA shortened the time frame for companies to decide whether they will keep their property leases. This provision was imposed to protect landlords from diminished mall traffic when troubled anchor retailers maintained their leases.

Small business clarification. Congress created an accelerated Chapter 11 for small business, designed to allow the case to move more quickly through the courts, in 1994. BAPCPA attempted to further address issues affecting the impracticality of Chapter 11 for small business debtors by clarifying qualifications and requirements. Those businesses able to meet the deadlines imposed by the new law stood to save considerable money and time. (For a more detailed explanation of this provision and others in the law, see *Collective Wisdom,* September 2008.)

Unintended Consequences. With every complex law passed, another invariably follows–the Law of Unintended Consequences. The first consequence happened as the ink was drying on the new law. Confusion and uncertainty about what consumers would face after it went into effect caused a mad rush to the courthouse before they had to comply. (More than 600,000 consumers filed for Chapters 7 and 13 between October 1 and October 17, 2005, when the new law went into effect.) This phenomenon also largely explains why bankruptcy filings dropped dramatically the following year.

Impact on Chapter 7 filings. A review of Chapter 7 filings between October 17, 2005 and June 30, 2006, by The United States Trustees Office indicated that 94% of the debtors automatically qualified for Chapter 7 under the means test based on income alone. Another 5.4% qualified when expenses were taken into account, bringing the total to 99.4%. The Government Accounting Office also issued a report indicating that BAPCPA's credit counseling requirements did not substantially affect the number of filings. It reasoned that by the time most consumers receive counseling, their financial situations leave them with no choice but to file for bankruptcy.

In the first 12 post-BAPCPA months, Chapter 7 cases represented about 57% of filings as compared to 71% pre-BAPCPA. During the same period, Chapter 13 cases increased from 29% to 42%. This redistribution subsided in 2008, when Chapter 7 cases were about 70% of total filings, and the percentage of Chapter 7 filings has remained fairly constant at pre-BAPCPA levels since then—70% in 2009, 71% in 2010, 72% in 2011.

The Administrative Office of the U.S. Courts found that the growth rate of pro se filings (without the use of an attorney) doubled that of regular filings during the period studied, between the Bill's 2005 enactment date and June 30, 2011. The study indicated that debtors with legal representation increased 98% during the 5-year period, while pro se filers increased 187%. The filings are predominately Chapter 7, which are form-driven rather than litigation-driven processes. Among the possible reasons for the surge in pro se filings are the BAPCPA provisions that increase the potential liability of bankruptcy attorneys, also increasing the likelihood that counsel will turn down certain cases, and the additional costs of post-BAPCPA representation. The state of the economy and access to Internet resources are also likely contributing factors. Unfortunately for pro se filers, the additional requirements imposed by the new law make it more difficult to keep their cases viable in bankruptcy in order to obtain a discharge.

Cost. A study funded by the American Bankruptcy Institute Anthony H.N. Schnelling Endowment Fund and National Conference of Bankruptcy Judges Endowment for Education showed that BAPCPA made the bankruptcy system cumbersome and costlier for both debtors and bankruptcy professionals. The results, released in December 2011, were reached through analysis of quantitative and qualitative data gathered from court dockets and professionals working within the bankruptcy system. Debtors' attorney fees, filing fees, and debtor education fees have increased total direct access costs for both consumer Chapters 7 and 13 cases. The study also found that BAPCPA has created "statistically insignificant" change in unsecured creditor returns.

Time Restrictions. Many restructuring and turnaround professionals have blamed BAPCPA for the rash of Chapter 11 liquidations that have plagued the economy over the past few years. Those making the claim point to the numerous creditor-friendly provisions that make it nearly impossible for retailers, in particular, to reorganize, regardless of economic conditions. Others target a variety of factors, including over-leveraged capital structure, scarcity of capital since the credit crisis, online sales growth, decline in real estate values, and dominance of big-box retailers. While the influence of these factors cannot be discounted, it has become clear that BAPCPA has significantly compromised retailers' ability to get post-petition financing and to test and implement a reorganization strategy. Consequently, retail cases over the past few years have usually chosen one of two options: 1) to file the case as a liquidation, or 2) to utilize Bankruptcy Code Section 363, whereby the debtor is allowed a small period of time to conduct a going-out-of-business sale. The second option generally reaps only enough revenue to cover administrative costs and secured creditors.

Some experts argue that the BAPCPA's "hard cap" on exclusivity unfairly limits a debtor's leverage in terms of duration and outcome. Others argue that repeated extensions could give debtors an unfair advantage in the plan negotiation process, citing the Eastern Airlines case, which dragged on for six years.

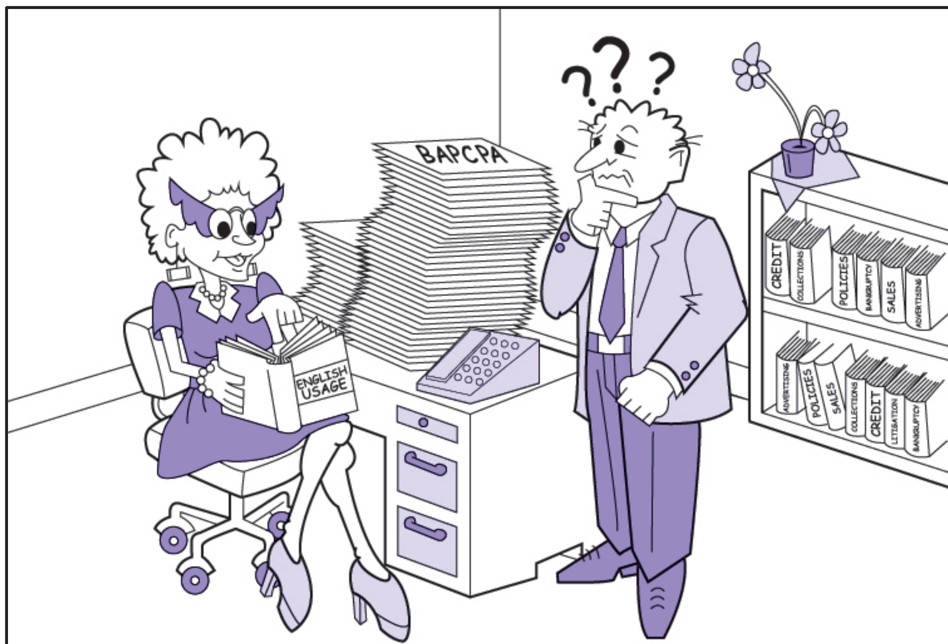
The law also requires debtors to assume or reject real property leases within 120 days of filing, subject to an additional 90-day court-approved extension. Extensions beyond 120 days must have the consent of the landlord. This requirement, along with several other provisions of the law, makes it difficult for Chapter 11 retailers to obtain post-petition financing, which is critical to fund ongoing operations. It also limits the company's ability to use what financing it is able to get to implement reorganization.

Before BAPCPA, lenders were more likely to supply financing because there was an indefinite period of time to market and assign a debtor's below-market leases to third parties at a premium. Now, there is too little time allowed for retailers to evaluate their businesses and determine which commercial leases are necessary for successful reorganization. Consequently, the cases are subject to either full-chain liquidation or an abbreviated sale process.

BAPCPA provisions have a general effect of encouraging Chapter 11 filers to reach a quick resolution, and some are aimed specifically at prepackaged plans. "Prepacks," which require the debtor to negotiate and solicit votes for the plan from creditors prior to filing the petition, have increased in popularity among many types of industries, reaching an all-time high in 2009. BAPCPA's amendments regarding exclusivity periods, unexpired leases, and mandates for dismissal or conversion for cause all support the prepack option. Additionally, BAPCPA permits the continued post-petition solicitation of votes if the solicitation begins prior to the petition date and provides that the court, for cause, may order the U.S. Trustee not to hold a creditors' meeting if the plan has solicited acceptances prior to petition.

Housing Crisis Impact. Why did subprime foreclosures surge (and home prices peak) right after BAPCPA took effect in October of 2005? According to a report by the Federal Reserve Bank of New York, issued in November 2008 and revised in February 2009, the new law contributed to the foreclosure problem by shifting risk from unsecured credit card lenders to secured mortgage lenders. Prior to the law, households could file Chapter 7 bankruptcy and have credit cards and other unsecured debts discharged, leaving more to pay the mortgage. Post-BAPCPA, better-off households seeking bankruptcy protection were forced to file Chapter 13, in which they must continue paying unsecured lenders. Additionally, BAPCPA eliminated the "super discharge" of tax liability which had been previously offered by Chapter 13 to encourage Chapter 13 filings rather than Chapter 7. Filing for Chapter 13 temporarily halts foreclosure proceedings, but only as long as the borrower is making mortgage payments. States with higher homestead exemptions had a greater number of Chapter 7 filings, ostensibly because debt was discharged and equity was protected.

Attempts to Address Shortcomings. In April 2009, Congressman Jerrold Nadler (D-N.Y.) proposed changes to



"So Congress gives us a 500-something-page law to streamline bankruptcy. Would this be an example of an 'oxymoron,' 'contradiction in terms,' or 'situational irony'?"

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the Bankruptcy Code that he claimed would make it easier for retailers to restructure. The "Business Reorganization and Job Preservation Act of 2009" would change BAPCPA provisions regarding deadlines to assume or reject non-residential property leases; utility deposit requirements; administrative priority claims; and reclamation of goods. The Bill was introduced on the heels of a sharp increase in Chapter 11 filings in 2008 which, according to the American Bankruptcy Institute, nearly doubled to 9,272 from 5,736 in 2007.

The Bill, known as HR 1942, was argued compellingly by both proponents and opponents. Supporters said that removing some of BAPCPA's trade credit provisions would help debtors get debtor-in-possession financing, emerge as an operating entity, and provide vendors the possibility of making future sales with the customer. Opponents noted that if reorganization fails and liquidation results, vendors would face a reduced chance of getting paid on its 20-day claims. Regarding the issue of property leases, the National Retail Federation called for repealing the limit and returning to the previous system. Landlords, on the other hand, lobbied heavily against HR 1942, arguing that BAPCPA's limits allowed them more flexibility to fill vacancies. The Bill failed to pass and was referred to committee.

Catalyst for Collapse? According to a 2008 article in *Financial Times,* Wall Street's support of BAPCPA may have "created one of the catalysts for the collapse of Bear Stearns, Lehman Brothers, and American International Group." The 2005 changes, intended to protect financial companies from the collapse of a large client, such as a hedge fund, may actually have accelerated the demise of the three companies. The law prescribes that certain derivatives and financial transactions are exempt from provisions in the Code that freeze a failed company's assets until a court decides how to apportion them among creditors. Obstacles were thus removed for banks and hedge funds that wanted to close positions and demand extra collateral, increasing the liquidity squeeze on these companies. The Securities Industry and Financial Markets Association, which lobbied for the law, rejected the criticism, insisting that the 2005 law enhanced legal certainty and reduced risk.

Orders in the court. Many provisions of BAPCPA reduced the discretion of bankruptcy judges. Now these judges must apply the law and are finding that many of its provisions are confusing and subject to various interpretations. In a number of court cases, BAPCPA changes have created more uncertainty in the interpretation, administration and application of bankruptcy law.

Whether or not the hundreds of changes to bankruptcy law and procedure enacted through the Bankruptcy Abuse Prevention and Consumer Protection Act will provide the benefits promised by its backers has yet to be fully determined. Attempts to analyze study data and anecdotal evidence are complicated by the many variables, most notably the economy, that have been introduced into the mix since the law was enacted. No doubt there will be attempts in future legislative sessions to address BAPCPA's shortcomings and possible solutions. At present, however, it appears Congress has much bigger fish to fry. ♦

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