Why a Rollback of The 2005 Amendments Would Be a Setback for All Creditors, Especially Secured Creditors

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In the October issue, our esteemed colleagues (and sometimes worthy adversaries) wrote an intriguing piece calling for the repeal of certain components of the 2005 amendments to the Bankruptcy Code. (See “Some Laws are Bad for Everyone...Except Landlords” by Martin Bienenstock, Irena Goldstein and Marshall Stoddard, page 28.) It is a familiar refrain: some in the “bankruptcy community” (whatever that is) allege that these more recent additions to the code are deleterious to the sound functioning of the bankruptcy system and prevent what would otherwise be successful reorganizations benefitting creditors. We have heard these laments for some time now and with good cause have always stood in opposition. Although the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) revisions are indisputably imperfect (and what piece of legislation isn’t?), certain changes were hard-fought, well deserved and evoke greater fairness and efficiencies that directly benefit secured creditors. We thus thank our friends for their article, as it now provides a platform from which to set out our own riposte.

A Victory Well Deserved
Our worthy colleagues make much of the heightened limitations on debtors in possession (DIPs) to assume or reject commercial leases pursuant to Section 365(d) (4); and they characterize those limitations as some ominous power unfairly granted to the landowning cartel: What they do not address is that the 2005 amendment on this subject is the culmination of a battle waged for over two decades and finally won by the landlords at great cost.

From its inception, Section 365(d)(4) was fraught with abuse and unprincipled decision-making due to its far too open-ended application. Essentially, DIPs could extend — again, and again and again, ad nauseam — the time within which to decide to assume or reject a commercial lease. It was nauseating indeed to landlords that were unsure of the status of the leasehold with the debtor/tenant, as well as to adjoining tenants (particularly in shopping centers and malls) suffering from the proximity of an enfeebled neighbor or, worse yet, a “dark” store, either circumstance damaging to their own survival, let alone routine business. Few courts back then had the courage to apply the then-statute, as did the bankruptcy court in In re Coastal Industries, and rationally limit the debtor’s power to extend its time to decide the fate of its commercial lease. The statute was carte blanche for debtors to do as they pleased, with little or no consideration for the interests of the landlords or fellow tenants.

The landlord lobby was not unaware of such abuses. It had fought since at least the early 1980s via what was popularly characterized as the “shopping center amendments,” to curb such favoritism of debtors and restore some balance to the relationship between themselves and bankrupt tenants.

In sum, the current state of the law caught no one by surprise. Landlords fought for over two decades to restrain the unbridled freedom of debtors and to achieve an equitable result. Their complaints and rationales were thoroughly fleshed out and found just. They fought the good fight and, hence, deserved to win. At the end of the day, we would do well to recall the wisdom of the late Chief Bankruptcy Judge Tina Brozman, an erudite jurist of New York’s Southern District, where she reminded all that Section 365(d)(4) was “enacted to protect landlords.”

Landlords: Not Enemies, but Friends
The article in the November/December issue constructs landlords as the bitter foe of secured lenders. That is simply not so. Landlords are the ally, not the enemy, as we will see.

The readership of this magazine is composed largely of asset-based lenders (ABLs) — in other words, secured creditors. Secured creditors loan money and take security in an asset. Should the debtor fail to repay the loan, the lender seizes the asset in lieu thereof. This is the epitome of secured lending.

Landlords are the functional equivalent of secured lenders. They have an asset the debtor desires to make use of: the commercial space. The landlord extends credit by waiting in anticipation of the timely payment of rent. Should payment not occur, the landlord takes back its security (the asset itself; in this instance, the commercial property). We find that to be precisely the modus operandi of secured creditors for generations. So what is the real difference between a landlord, an equipment lessor or any other secured creditor vis-à-vis a debtor? In truth, there is none.

In many respects, landlords render a service to secured creditors. The pressure a landlord can bear via the lease assumption or rejection process instills a sense of urgency in the debtor. Remember, the debtor sits safely behind the ramparts of its leased space, making use (or disuse) of various assets serving as collateral for ABLs. It follows that, if debtors must move with alacrity as to the physical space they occupy, they then face a similar compulsion regarding the disposition of the secured assets within the commercial space. Certainly, a linchpin of the opposition’s thesis is that debtors are forced into premature and unwise decisions.

Really now? Whose fault is it that the debtor cannot adequately plan prepetition, nor move in a business-like fashion once it is officially a DIP? Time waits for no one; why should it wait for debtors? Put another way, the value is either there or it’s not. Debtors cannot be permitted to act in a leisurely manner regarding leaseholds or assets that serve as security for those that did business with them in good faith and with a legitimate expectation of being repaid not so far in the future as to render that repayment meaningless.

Let us be criticized as warmongers, debtors are not “enemies.” However, they are counterparts to significant financial obligations. Their self-interest drives them to make maximum use out of someone else’s property, while forestalling payment for as long as possible. We don’t need to spill blood here, but the plain truth is that landlords, ABLs and creditors generally are allies. As allies, they should not let debtors subvert their unity of interest and divert them from their common and paramount goal: getting paid.

Circuit City: “The Walking Dead”
Here we come to the major bone of contention. For the last two years we have
all heard the hue and cry (again) from the “bankruptcy community” that Circuit City’s Chapter 11 status is the prime example of why the 2005 amendments must be repealed. “Were it not for the ’05 amendments, we could have saved Circuit City. There was value there,” goes the chorus.

Here is the fallacy of that argument. Circuit City did not fail because of alleged imperfections in the Bankruptcy Code (if it did, how do you explain other, even mildly successful Chapter 11s since 2005?). Circuit City failed because it could not compete, plain and simple. Circuit City was driven out of business by Best Buy, which took its shared “big box” retailer model and simply executed it far better. Is it mere coincidence that, wherever a Circuit City and a Best Buy went head-to-head in a market, Best Buy became the customer’s vendor of choice?

How did the 2005 amendments preordain long lines at Best Buy and empty aisles at Circuit City? We gladly admit our evidence is anecdotal, but it does not make it any less obvious nor any less true.

Best Buy took Circuit City and, to put it in the vernacular, “ate them for lunch.”

Pre-2005 code or post-2005 amendments thereto, Circuit City was a corpse before it even filed for Chapter 11. What the current law did do, however, was prevent a long, agonizing and fiscally wasteful quagmire of a Chapter 11. It allowed the company to move forward and return what little value was left to the creditors of this doomed enterprise. In sum, don’t blame the 2005 amendments for the demise of Circuit City (or similarly situated retailers); instead, blame the Great Recession, blame the Internet and finally, blame businesses that could not run their businesses and hence became debtors.

Other Musings
The arguments in the preceding article sound a lot like arguments some have used to support the repeal of other provisions of the 2005 amendments. Let us disabuse creditors and readers of those ill-guided notions.

Flawed Notion #1: Limitations on Time to File a Plan Are Too Restrictive
As is well known, the debtor usually enjoys an exclusive period of 120 days in which to file a plan of reorganization; said period is capable of being extended. The 2005 amendments set an outside limit of 18 months, measured from the petition date, in which the debtor may file its Chapter 11 plan.8 The overt purpose is to outlaw unlimited extensions.

The motivation for delimiting the time to file a Chapter 11 plan was to attain a long-overdue restoration of balance in the competing forces at work in the nation’s bankruptcy courts. In the past, debtors not only extended their time to decide to assume or reject commercial leases into the distant future, they extended their time to file Chapter 11 plans to similarly unexplored limits. This was all designed to put off judgment Day, that being emerging from bankruptcy and repaying creditors, if that were even possible. And if it were not possible, well then, all the more reason to remain shrouded in the protective folds of Chapter 11.

But whose purpose does this serve, aside from that of the debtor reluctant to leave the comfort zone of the reorganization court? Simply put, repayment delayed is repayment denied. Creditors, be they ABLs, landlords or plain old unsecured claimants, need and deserve to be repaid. The 2005 amendments simply put the debtors on a rationalized clock and forced them to realize that Chapter 11 has many quid pro quos, among them that the stout umbrella of the reorganization chapter is eventually put away and the debtor must come out into the sunlight. If it survives, all the better. And if it does not, then so be it, and let creditors pick up the pieces as the law so provides. Thus, these limits, all well founded, should stay intact.

Flawed Notion #2: Section 503(b)(9) Claims Hurt Debtors
Many debtors and their advocates complain that this remedied proviso drains valuable cash resources from the reorganization process. But these same stalwarts fail to mention that the absence of the amended Section 503 would drain assets from the victimized creditors, possibly, in turn, hurling them into insolvency.

The critics refuse to acknowledge the harm to vendors that the new Section 503(b)(9) now seeks to undo. In several respects, the new statute, which prioritizes a vendor’s claims for goods sold and delivered within the 20 days before it files for bankruptcy,9 is merely a partial restoration of basic rights of reclamation under state law that in recent years have been trodden into dust by the bankruptcy process. Rights statutorily recognized by the code have in modern days proven to be hollow promises, largely because the goods are long gone.

You cannot reclaim what is not there.

The 2005 amendments invigorate a vendor’s rights and bestow a slight advantage in that a creditor has a better chance of being repaid for whatever goods it delivered to the debtor in those last, desperate days before the bankruptcy filing. This somewhat ameliorates the bad news of a customer’s bankruptcy. And with the Great Recession upon us, oft times the Section 503(b)(9) recovery is, in truth, the only money a vendor will ever see.

Moreover, goods supplied by a vendor on the eve of bankruptcy are often the

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same goods that provide some modicum of operating funds for the debtor as it transitions into its new life as a DIP. Therefore, there is some logic behind according the vendor some equivalence with postpetition priority creditors, because, in many respects, the prepetition vendor was unwittingly enlisted as a participant in the debtor’s postpetition financing. Finally, a debtor that willingly accepts goods as its Chapter 11 petition is being readied for court is not exactly “on the level” with its vendors. Therefore, section 503(b)(9) restores some equity in a forum that is, after all, a court of equity.

Flawed Notion #3: The Bankruptcy Code Must Be Kept “Pure” Please. What piece of legislation isn’t marked by some “special interests,” whatever they might be? All laws represent a compromise among competing interests. The Bankruptcy Code is no different. Indeed, it is no worse than some, and it is far better the others (we need only mention the inglorious Internal Revenue Code). Our vaunted Bankruptcy Code isn’t any different. Indeed, it is no worse than some, and it is far better the others.

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All opinions expressed herein are those of the authors alone.

The authors dedicate this article to the memory of the late Mary Jane C. Sabino, attorney, professor, author, and, most of all, beloved wife and mother.

1. These reforms were promulgated by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, otherwise known as the difficult to pronounce “BAPCPA.”
3. Although the underlying article is indeed correct in setting out that the debtor has a cumulative 210 days in which to decide to assume or reject a commercial lease, it notably fails to point out the “escape hatch,” whereby a subsequent extension is available upon the prior written consent of the landlord. 11 U.S.C. § 365(d)(4)(B)(ii).