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A Look at Laws, Policies, and Challenges I Restructuring, Liquidating, and Transacting Business in a Rapidly Developing World Economy

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FOREWORD

A LOOK AT LAWS, POLICIES, AND CHALLENGES IN RESTRUCTURING, LIQUIDATING, AND TRANSACTING BUSINESS IN A RAPIDLY DEVELOPING WORLD ECONOMY

Paul M. Glenn[*]

When the United States was poised at the cusp of the Great Depression, mainstream economic thought rejected government intervention to offset the economic downturn that was looming.[1] Following his election in 1932, President Roosevelt responded with a variety of government actions and programs, most notably the New Deal, to create a "better ordered system of national economy."[2] Since that time, government has become increasingly active in the economy, and today there is no question that difficult financial and economic circumstances will be met with a response from our government.[3]

In the last decade, the economy of the United States has experienced both substantial growth and significant deceleration. In the later part of the twentieth century, while traditional businesses were thriving, a revolution in technology, communications, and information was also taking place.[4]

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* The Honorable Paul M. Glenn was appointed to the bankruptcy bench for the Middle District of Florida, Tampa Division, in 1993. He has served as Chief Bankruptcy Judge for the Middle District since March 2003. Judge Glenn received his Bachelor of Arts degree *cum laude* from Florida State University, where he was a member of Phi Beta Kappa, Phi Kappa Phi, Omicron Delta Kappa, Gold Key, and was Most Valuable Player on the Varsity Basketball team in 1966-67. He received his J.D. degree from Duke University School of Law, where he was President of the Law School Student Body. He practiced corporate and commercial law in Jacksonville and Miami, Florida and has been the Chief Executive and Administrative officers of two insurance companies. In 2005, Judge Glenn was inducted as a Fellow of the American College of Bankruptcy, and in 2007, he was honored by the Hillsborough County Bar Association with the Robert W. Patton Outstanding Jurist Award.

1. For an historical perspective of the economic conditions, macroeconomic philosophy, and legal structures instituted during Franklin D. Roosevelt's presidency to counteract the economic woes of the Great Depression, see Stephen A. Ramirez, *The Law and Macroeconomics of the New Deal at 70*, 62 MD. L. REV. 515 (2003).

2. *Id.* at 531 n.105.

3. "[A] robust growth package that includes tax relief for individuals and families and incentives for business investment." President George W. Bush, State of the Union Address (Jan. 28, 2008).

4. JOHN NAISBITT, MEGATRENDS chs. 1, 2 (1982).

A combination of factors fueled significant growth in business, employment, personal income, retail sales, and the housing market. Personal borrowing also increased, as individuals obtained home equity loans and extensive unsecured credit. In the years when the economy was thriving, personal bankruptcies also reached historic levels, and Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) to prevent abuses in the use of the bankruptcy laws.[5]

More recently, the economy of the United States has experienced difficulties. Over $500 billion in adjustable rate mortgages were set to adjust in 2007.[6] Mortgage defaults and foreclosures have increased to record numbers, housing markets have become flooded, real estate values have fallen, the liquidity of lenders has been reduced, and significant amounts have been reserved or written off by lenders.[7] In these conditions, the executive and legislative branches of our government are considering various proposals that would allow homeowners more time to repay mortgages, freeze foreclosures on subprime mortgages, and allow modifications of home mortgages in some bankruptcy cases.[8] Additionally, Congress has passed temporary tax incentives for some businesses and immediate tax rebates for some individuals to stimulate employment and the flow of money into the economy.[9]

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5. "The purpose of the bill is to . . . [restore] personal responsibility and integrity in the bankruptcy system . . . ." H.R. REP. NO. 109-31, pt. 1, at 2 (2005).

6. *Mortgage Liquidity du Jour: Underestimated No More*, CREDIT SUISSE, Mar. 12, 2007, at 8 [hereinafter *Mortgage Liquidity*].

7. For a variety of articles on the current state of the economy, see Danielle DiMartino & John V. Duca, *The Rise and Fall of Subprime Mortgages*, ECON. LETTER—INSIGHTS FROM THE FED. RES. BANK OF DALLAS, Nov. 2007, *available at* http://www.dallasfed.org/research/eclett/2007/el0711.pdf; David Enrich et al., *World Rides to Wall Street's Rescue*, WALL ST. J., Jan. 16, 2008, at A1; Steven Rattner, *Let's Get Real About the Economy*, WALL ST. J., Jan. 29, 2008, at A17; Liz Rappaport et al., *New Hitches in Markets May Widen Credit Woes*, WALL ST. J., Feb. 11, 2008, at A1.

8. For a discussion of the Treasury Department's December 2007 plan to freeze interest rates or expedite refinancing for subprime borrowers and for a new Bush administration-mortgage companies' initiative to help borrowers who are more than ninety days behind in their mortgage payments, see Ruth Simon & Tom McGinty, *Earlier Subprime Rescue Falters*, WALL ST. J., Feb. 13, 2008, at A1. For proposals that would eliminate or limit the 11 U.S.C. § 1322(b)(2) prohibition on modifications of mortgages on principal residences, among other things, see various proposed bills in the Senate and House of Representatives comprising the 110th Congress including S. 2136, 110th Cong. (2007) (proposed by Senator Durbin), S. 2133, 110th Cong. (2007) (proposed by Senator Specter), H.R. 3778, 110th Cong. (2007) (proposed by Congressman Chabot), H.R. 3609, 110th Cong. (2007) (proposed by Congressman Miller), and Conyers Amendment to House Bill 3609 in the Nature of a Substitute, H.R. 3652, 110th Cong. (2007) (amending H.R. 3609, 110th Cong. (2007)).

9. White House Press Release, President Bush Signs H.R. 5140, the Economic Stimulus Act of 2008 (Feb. 13, 2008).

Amid these dynamic conditions and interrelationships of business, economics, law, and public policy, outstanding professionals in Florida have authored excellent articles on several of the legal aspects of legislative, corporate, and consumer actions. With both reflective analysis and prospective consideration, the authors describe current circumstances and possible future developments.

One of my favorite quotes is from a concurrence by Justice Scalia, and it is an appropriate introduction to one of these articles. Interpreting a provision in an act of Congress,[10] the majority opinion of the Supreme Court referred to the legislative history of the Act.[11] Justice Scalia concurred with the decision, but commented: "Judge Harold Leventhal used to describe the use of legislative history as the equivalent of entering a crowded cocktail party and looking over the heads of the guests for one's friends."[12] In "11 U.S.C. § 707(b)(2)(A)(iii): Does It Mean What It Says and Say What It Means?"[13] my multi-talented colleague, Judge A. Jay Cristol, and Ms. Cheryl Kaplan consider whether the legislative history of BAPCPA ("the intent of the Act")[14] and the intent of a debtor may be used to infuse § 707(b)(2)(A)(iii) with more than its plain meaning as courts go beyond the words of the statute in interpreting the "means test" for certain Chapter 7 debtors.

The "presumption of abuse" under § 707(b), which may lead to dismissal or conversion of a Chapter 7 case, is now a formulaic determination under BAPCPA, based on a debtor's current monthly income and expenses.[15] The issue with various bankruptcy courts and the U.S. Trustee's office relates to payments on secured debts on property that the debtor intends to surrender. In the article, the authors assert that the "plain meaning" of 11 U.S.C. § 707(b)(2)(A)(iii) should allow debtors to deduct the secured payments that they owe on the date of their petitions, even if they intend to surrender the property securing those debts during their Chapter 7 cases.

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10. Soldiers' and Sailors' Civil Relief Act of 1940, 54 Stat. 1178 (1940) (current version at 50 U.S.C. §§ 501-596 (2003)).

11. Conroy v. Aniskoff, 507 U.S. 511, 516 (1993).

12. *Id.* at 529 (Scalia, J., concurring).

13. A. Jay Cristol & Cheryl Kaplan, *11 U.S.C. § 707(b)(2)(A)(iii): Does It Mean What It Says and Say What It Means?*, 19 U. FLA. J.L. & PUB. POL'Y 1 (2008),

14. *See In re* Hardacre, 338 B.R. 718, 725 (Bankr. N.D. Tex. 2006).

> Congress's intent with respect to the means test is well known to even the most casual bankruptcy practitioner. The means test was intended to "ensure that those who can afford to repay some portion of their unsecured debts [be] required to do so." 151 CONG. REC. S2470 (March 10, 2005).

Id. (alteration in original).

15. *See* 11 U.S.C. § 101(10A) (2007).

Mr. Chad P. Pugatch and Mr. Craig A. Pugatch, father and son, are outstanding insolvency experts in South Florida, and, with Travis Vaughn, a recent extern with this Court, have considered "The Lost Art of Chapter 11 Reorganization."[16] A recollection from the elder Pugatch introduces their article very effectively: "I can remember a time, long, long ago, before white knights came riding in on their stalking horses, when . . . there was a bargaining process to determine what it would take to satisfy creditors while allowing a troubled company to rehabilitate itself and continue in business . . . ."[17] The father nostalgically recalls an earlier era when business reorganizations involved bargaining with the debtor's creditors and continuing in business, rather than selling the company's assets.

In this interesting article, the authors review the historic development of business reorganizations under the bankruptcy laws in the United States. They begin with reorganizations prior to the Bankruptcy Act of 1898, then discuss developments under the Bankruptcy Act as the country passed through various economic cycles (such as the Great Depression), reorganizations under Chapters X, XI, and XII, developments under the Bankruptcy Code, and the effects of the 2005 amendments on business reorganizations.

The emphasis of their presentation is the current tendency to sell assets, rather than reorganize, and they describe the considerations involved in selling a Chapter 11 debtor's assets either "outside of a plan" or through a confirmed plan. They also consider factors leading to asset sales through Chapter 7 procedures. The authors describe several reasons for the transition from reorganization to asset sales. Interestingly, among the reasons are the changes in global economic circumstances—while businesses once restructured debt to return to profitable operations, the reorganization and continued operation of some businesses may no longer be realistic because they simply cannot compete successfully in the world market.

Mr. Harley E. Riedel and Mr. Edward Peterson, insolvency experts residing in Tampa and recognized nationally, follow with a treatise on the sales of businesses as going concerns through the Chapter 11 process.[18] They explore both practical and legal issues relating to "going concern" sales.

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16. Chad P. Pugatch et al., *The Lost Art of Chapter 11 Reorganization*, 19 U. FLA. J.L. & PUB. POL'Y 39 (2008).

17. *Id.* at 40.

18. *See* Harley E. Riedel & Edward Peterson, *Practical Issues Surrounding Section 363 Sales*, 19 U. FLA. J.L. & PUB. POL'Y 75 (2008).

Often all of the assets of a business debtor are subject to liens and mortgages which secure a total indebtedness that exceeds the value of the assets. Of course, the value of a business as a going concern is generally greater than the value of its "furniture, fixtures and equipment." When is the sale of a business preferable to the surrender of its assets to the lender? Can this be done through Chapter 11? If so, may a secured creditor promise a portion of the sale proceeds to subordinate creditors (a "carve-out") as an incentive for their support? May a secured creditor purchase subordinate claims to obtain approval by a committee or a class of subordinate creditors? Must the distribution of the "carved out" portion of the sale proceeds follow the priority provisions of § 507 or the absolute priority rule of § 1129(b)(2)(B)? Is the agreement enforceable if the case is converted to Chapter 7 prior to the sale? Mr. Riedel and Mr. Peterson address these questions, among others, in an article that is of marked import today as sales of "going concerns" are regularly accomplished in bankruptcy proceedings.

The distinguished Professor Jeffrey Davis educates us about the possible advantages of an insolvency procedure that takes place in the Florida State Courts rather than the Bankruptcy Court.[19] This procedure, known as an "assignment for the benefit of creditors" (an "ABC"), is in some instances "simpler and almost always less expensive."[20]

Professor Davis first provides an overview of the ABC procedure and its history. He begins with the adoption of the procedure by the Florida legislature in 1889 and the amendments in 1987, and then describes amendments in 2007 that made significant improvements to the procedure.

Professor Davis then illustrates the advantages of the procedure by two examples, one comparing the procedure to a Chapter 7 case, and the second comparing it to a Chapter 11 case. The first client comes in with no possibility of reorganizing, and Professor Davis takes us through the conference that leads to the conclusion that an ABC would be the best procedure for the liquidation of the client's assets. The second client is an investor who financed the acquisition and operation of a pair of restaurants by an acquaintance. The restaurants were not successful, and the acquaintance had been less than straightforward in his reports and in his dealings. The businesses had incurred substantial debts, engaged in questionable transactions, made various possibly preferential payments and fraudulent transfers, and were subject to a recorded judgment. Professor Davis reviews the considerations that make an ABC preferable in these circumstances.

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19. *See* Jeffrey Davis, *Florida's Beefed-up Assignment for the Benefit of Creditors as an Alternative to Bankruptcy*, 19 U. FLA. J.L. & PUB. POL'Y 17 (2008).

20. *Id.*

Professor Davis reminds us that "[b]ankruptcy, of course, offers numerous advantages not available in an ABC."[21] But when the advantages of bankruptcy are not needed, he advises that an ABC may be the better choice. This article is a "must read" for insolvency lawyers in Florida.

Two outstanding students at the University of Florida Levin College of Law have authored the final two papers, and these excellent papers consider problems arising from the technological advancements that are rapidly becoming a part of our daily lives.

Mr. Joshua R. Levenson's note, "Strength In Numbers: An Examination Into The Liability of Corporate Entities For Consumer and Employee Data Breaches,"[22] is a very timely one as we deal with the global economy, technological innovation, and future privacy issues. A significant amount of personally identifiable information is stored by various businesses throughout the world, and security breaches are a very real threat to the aggregated data. Using economic theory, Mr. Levenson asserts that a private cause of action against a corporation for a security breach will result in the devotion of more corporate funds to security procedures for individuals' personal data, and consequently more protection for consumers. Mr. Levenson's note is thought-provoking as it sets forth a study of existing law, the economics of corporate accountability, and an argument for liability by corporations for breaches of their store of personal data.

Just as Mr. Levenson's note looks to the world of business and technology, Mr. Seldon J. Childers's note, "Don't Stop The Music: No Strict Products Liability For Embedded Software,"[23] describes a driving force in our global economy today. "Embedded software," like that in an iPod, is software that is an essential component of many electronic products in the exploding market created by technology. As Mr. Childers points out, cell phones, cordless phones, cable boxes, TiVO systems, stereo systems, clock radios, digital cameras, personal computers, automobiles, airplanes, medical devices and much more are powered by complex electronic software. The question of who should bear the cost of injury or death caused by defectively designed software is a question that we will face in the future. After discussing the question of whether embedded software is even a "product," Mr. Childers argues that strict products liability should not be extended to the software industry.

These articles and student notes are excellent. They present thoughtful analyses of the topics, and provide guidance to those who will be involved

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21. *Id.*

22. Joshua R. Levenson, Note, *Strength in Numbers: An Examination Into the Liability of Corporate Entities for Consumer and Employee Data Breaches*, 19 U. FLA. J.L. & PUB. POL'Y 95 (2008).

23. Seldon J. Childers, Note, *Don't Stop the Music: No Strict Products Liability for Embedded Software*, 19 U. FLA. J.L. & PUB. POL'Y 125 (2008).

in planning and pursuing legal, business, and individual actions in these areas. Significantly, they capture the essence of issues facing our profession today, both locally and globally.

In the early 1980s, in his best selling book *Megatrends*, John Naisbitt described the emergence of interdependent communities comprising a world economy.[24] This is certainly becoming true. Businesses in the United States rely on world resources and world markets. Manufacturing and assembly are no longer territorial,[25] nor are finance and economics. The "All American" student lender Sallie Mae recently obtained a $31 billion line of credit from a syndicate of national and international banks.[26] Sub-prime mortgage problems in the United States have affected world-wide financial markets,[27] and foreign investors have infused billions into financial institutions in the United States.[28] Recognizing the development of international transactions and financial relationships, and difficulties relating to the restructuring of these relationships, Congress added a chapter to the Bankruptcy Code that addresses international insolvencies.[29]

Over 400 years ago Shakespeare reminded us that "All the world's a stage . . . ."[30] Today, all the world is indeed our stage. The global economy, the advancements in technology and communications, and the interdependence of businesses and financial institutions in the world affect us all, not just as commercial attorneys but also as individuals. We are no longer just "Florida," or just "the United States." The world of business and finance is becoming a global world, and business workouts and insolvency resolutions will be accompanied by global considerations as well. As we educate ourselves with the articles in this journal, we not only look for solutions to present problems, but we continue to analyze and plan our laws, our policies, our businesses, and our lives for our future in the world economy.

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24. JOHN NAISBITT, MEGATRENDS 55 (1982).

25. A Dell computer is a global consumer product, both in its creation and in its market. *See* THOMAS L. FRIEDMAN, THE WORLD IS FLAT ch. 12 (2005).

26. Andrew Dowell, *Sallie Scores Funding As It Ends Deal Fight*, WALL ST. J., Jan. 29, 2008, at C5.

27. *See Mortgage Liquidity*, *supra* note 6.

28. *See* David Enrich et al., *supra* note 7.

29. Chapter 15, Ancillary and Other Cross-Border Cases, was added to the Bankruptcy Code in 2005 as part of BAPCPA and incorporates the Model Law on Cross-Border Insolvencies promulgated in 1997 by the U.N. Commission on International Trade Law. 11 U.S.C. §§ 1501-1531 (2005); H.R. REP. NO. 109-31, pt. 1, at 105 (2005) (tit. VIII).

30. WILLIAM SHAKESPEARE, AS YOU LIKE IT, act 2, sc. 7.