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Keynote Address

The Honorable Mary Grace Diehl

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KEYNOTE ADDRESS

*The Honorable Mary Grace Diehl**

Good morning. Mark asked me to speak about the last forty years. So—

The year is 1979. I am a second year associate at Troutman Sanders Lockerman & Ashmore one of Atlanta’s largest law firms at seventy lawyers. I am a member of the litigation section—one of three groups at the firm (others being corporate and real estate). There is no bankruptcy or restructuring group. Our pleadings are typed on legal size paper using state-of-the-art IBM Selectric typewriters. All communications with clients, colleagues and adversaries are in person, by telephone, or U.S. mail—there is no voicemail, e-mail, text messages—not even faxes.

The Bankruptcy Court for the Northern District of Georgia is located at 56 Forsyth Street—the present home of the Eleventh Circuit Court of Appeals. Of course, in 1979 there is no Eleventh Circuit. We are part of the Fifth Circuit headquartered in New Orleans. We have four bankruptcy judges—who have only recently gained that title from their prior status as bankruptcy referees. I am quite sure they did not have law clerks. And—the law we are dealing with is the Bankruptcy Act of 1898, as revised by the Chandler Act of 1938.

I know all four judges because they preside at the first Meeting of Creditors in each case. One of my assignments as a young associate was to represent Georgia Power Company at these first meetings. Georgia Power financed electric appliances for the customers and I had to go and ask about the location and condition of the washing machine, dryer, or refrigerator they had purchased on credit from the power company. The bankruptcy judges were required to listen to these questions and answers.

By the end of 1979, a lot had changed. The Bankruptcy Code of 1978 became effective on October 1, 1979. It was the result of the recommendations of the Commission on Bankruptcy Laws created by Congress in 1970 and then modified in certain ways by a competing proposal by the National Conference of Bankruptcy Judges. In the end, three main corporate reorganization chapters

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(X, XI and XII) had been merged into one: chapter 11. Large corporations, which had previously been forced into chapter X with its mandatory Trustee appointment, were now able to remain as Debtors-in-Possession. Other business debtors, who were unable to modify secured debt in the old chapter XI, were now empowered to do so. Chapter XII, for real estate reorganizations, disappeared as a separate entity and was also now a part of chapter 11.

From the bankruptcy lawyer's perspective, the Code shunned the "miserly fee" standards which had been typical under the Act. Bankruptcy lawyers could now be compensated at market rates. It is no coincidence that major law firms got into the bankruptcy business, particularly on the debtor side, as the 1978 Code unfolded.

I was young and inexperienced at the time, but those who were more "seasoned" with bankruptcy law tell me that the original 1978 Code was a masterpiece, balancing the rights of debtors and creditors and fostering real business reorganizations. Our own Judge Homer Drake was instrumental in designing the statute which Georgian Jimmy Carter signed into law.

On the consumer side, the biggest change in the bankruptcy code was its approach to chapter 13. The new chapter 13 provided for all debtors with a regular income (as opposed to only wage earners under the Act) and removed the necessity of obtaining creditor approval of chapter 13 plans. The only real legal standard the plan had to meet was the "best interests of creditors" test (creditors had to receive as much as they would in a chapter 7 case) and secured creditors could be "crammed down" to the value of their collateral (except for home mortgage loans). Chapter 13 also resulted in a "super discharge" of all debts except alimony and child support and long term debts.

All chapters also now included an automatic stay, which had previously only been provided in a bankruptcy rule.

The original, unamended code, did not last long. Lobbying efforts by various groups and changes in the financial structure of our economy resulted in periodic amendments. We have the U.S. Trustee system everywhere except North Carolina and Alabama; we have a permanent chapter 12 for farmers and family fishers; we have chapter 15 for cross-border cases; we have added protections for intellectual property licensees and shopping center owners and specialized provisions for dealing with collective bargaining agreements and retirement benefits.

There are broadened protections for the commodities and securities markets.

On the consumer side, Congress changed chapter 13 to mandate that a debtor commit all of her “projected disposable income” to the plan in addition to meeting the “best interests” test. The super discharge became less super as time went by and additional exceptions were added. Similarly, additional exceptions to discharge and dischargeability crept into chapter 7.

The bankruptcy system also survived a constitutional crisis following the Supreme Court’s 1982 decision in *Northern Pipeline v. Marathon Oil* which questioned the ability of a non-Article III bankruptcy court to decide certain issues. A 1984 amendment clarified the role of the bankruptcy court and designated certain matters as core and non-core matters. This “fix” worked fine until a similar issue emerged in *Stern v. Marshall* in 2011 where the Supreme Court looked to define the constitutional limits of the entry by the bankruptcy court of a final order in certain matters designated as “core” in the judiciary code. It took two more Supreme Court cases. (*Executive Benefits v. Arkison* and *Wellness International*) and the adoption of rules dealing with the concept of “consent” for the system to breathe a collective sigh of relief and pretty much return to normalcy.

Another Bankruptcy Commission was created in 1994. Its report was issued in 1997 and eleven years later a number of its suggestions were incorporated into the Bankruptcy Abuse and Consumer Protection Act of 2005, commonly known as BAPCPA. While technically an amendment to the Bankruptcy Code, BAPCPA fundamentally overhauled the consumer provisions of the Bankruptcy Code and, while not quite as extensively, altered the business reorganization as well.

BAPCPA made business reorganizations more difficult in several ways: the introduction of an administrative priority claim for goods received by the debtor within twenty days of case commencement, thus requiring payment of those claims in full to confirm a plan; the debtor’s exclusive period to propose a plan was limited; the time for a debtor to assume or reject non-residential real estate leases was shortened, peculiarly affecting retail bankruptcies; the ordinary course of business defense for preference defendants was altered in favor of the defendants; KERPS (key employee retention plans) were curtailed, making it more difficult to maintain the management force needed to effect the reorganization.

The consumer landscape changed even more dramatically with the introduction of the “means test” for individual consumers who sought to file under chapter 7. Creditors with interests in personal property (particularly cars) had their position strengthened as the debtor’s ability to cram down was limited;

the determination of projected disposable income was made the subject of objective rules for those above the median income of the state where they are filing. The chapter 13 super discharge became even less super. Exceptions to the automatic stay came to fill twenty-eight sub-sections of § 362(b).

In many ways, the 1978 Code became unrecognizable.

These changes in the law since 1978 (for better or for worse) merely built upon the existing code without really taking account of the changes in the financial markets (in both the business and consumer fields) over the last forty years. In 2012, The American Bankruptcy Institute undertook to study the reform of chapter 11. Its report was issued in 2014. The ABI undertook a similar task for the consumer provisions and its full report will be unveiled at the ABI's Spring meeting in April.

The genesis of the ABI's study was a recognition that today's credit markets, derivative instruments, and corporate structures are vastly different from what existed in 1978. Companies today have fewer hard assets and more services, contracts, and intellectual property. Moreover, businesses are much more highly leveraged, making financing a chapter 11 case very different from what it was in 1978. Businesses today are multi-national. Lenders are less likely to be traditional banks who retain their interest throughout the reorganization process and more likely to be hedge funds or private equity who do not approach restructuring in the same way. Loan-to-own was not a "thing" in 1979. Holders of claims now frequently seek to sell their claims or are solicited to do so in an effort to influence the chapter 11 process.

Chapter 11 has also become too expensive for many businesses. This fact combined with the shortened timelines and the increasing control exercised by the DIP lender as a result of market conditions has made § 363—the sale of property of the estate—the "reorganization plan of choice" for well over half of chapter 11s filed by operating businesses. It is a real tribute to the creativity of the bankruptcy bar that the Bankruptcy Code has been able to withstand these market changes. However, treatment of these sales has not been uniform among bankruptcy courts. Some courts refuse to approve a sale of substantially all of a debtor's assets that does not leave sufficient funds in the estate for a meaningful distribution to unsecured creditors. Other courts consider only the administrative insolvency of the business after the § 363 sale. The Code has no clear guidelines. It has certainly made for some very interesting lawyering and judging.

The ABI's report on business bankruptcy is now five years old, and (no surprise) Congress has taken no action. Lawyers continue to be creative:

horizontal and vertical gifting plans, structured dismissals, the appointment of chief restructuring officers before a chapter 11 filing.

The ABI Consumer study is focused on general consumer provisions and then specifically on improvements in chapter 7 and chapter 13 cases. It will come as no surprise to many of the students in the audience that the first topic they have tackled is student loans. Historically, student loans were fully dischargeable prior to 1976 (of course, prior to 1976, education was not very expensive and borrowing was not as common as today. My total tuition bill for three years at Harvard Law School was under \$9,000.) In the 1978 Code, change was made to make government student loans non-dischargeable (except for undue hardship) until five years of the repayment period had passed. So—after five years, the loans were dischargeable in full. That period was then extended to seven years and in 1998, the time frame removed. In 2005 BAPCPA, the protections were extended to private student loans. The Commission has published some preliminary recommendations in this area which really amount to a bright line definition of “undue hardship”.

The current expense of consumer bankruptcy filings is also a major problem. The complexities of the law and the land mines of the means test are pricing many would-be debtors out of the market and sending them to sometimes unscrupulous bankruptcy petition preparers or to make the filing pro se—without the benefit of counsel (which makes for a very difficult experience for the court, creditors, and the trustee).

Considering that the earliest bankruptcy statutes in the nineteenth century lasted an average of two years, forty years is a long, long time. As a profession, the practice of bankruptcy law is still an intellectually challenging one and the bankruptcy bench and bar are the best there is. I hope many of the students will join the lawyers and judges in the audience in making the 1978 code, wounded as it is, a better and better statute and will continue to explore ways to accord individuals and business who experience financial setbacks the “fresh start” that they deserve.