

## A LEGAL PERSPECTIVE

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### The Bankruptcy Reform Act Changes to Bankruptcy Laws

At the writing of this article, the new BAPCA is printed, the changes highlighted and bankruptcy industry experts around the country are scratching their heads trying to figure out how to apply most of these changes in the law. Not only are there sections that simply do not make sense, or contain gaping holes in them, but, the new law has many technical errors, and Congress has indicated they have no intent of making amendments to the bill any time soon. The BAPCA (the “Act”) is in effect October 17, 2005, and while it is difficult to predict how many of these changes will effect Self-Storage operators, it is possible at this early date to give you at least a preview of what I expect the big and notable changes from a Self-Storage operator’s or manager’s perspective will be. Again, keep tuned to this column on other articles for *Inside Self-Storage Magazine* for updates on how this actually shakes out after the new law goes into effect on October 17<sup>th</sup>.

There really are only a few important things that the Self-Storage operator/manager needs to know as far as substantial changes to the way bankruptcy will operate.

The first thing you need to understand is that most everything you knew or may have known about bankruptcy previously still exists. The new Act is a large amount of revisions to the existing law, therefore my previous cautions about an automatic stay going into effect upon the filing of a bankruptcy and your not being able to immediately continue with a foreclosure or lien sale procedure if a tenant files bankruptcy before you get an opportunity to conduct the lien sale are still *generally* the same.

The major change which is expected will be the difference in the number of debtors who may be eligible to file a Chapter 7 bankruptcy which is the complete discharge of a debt as opposed to a Chapter 13 which is some form of a repayment plan to unsecured creditors. The much ballyhooed change that was expected to occur in Chapter 7s is that debtors would not be able to so easily file a Chapter 7 because they would be forced to face a “means test” before being eligible to file a Chapter 7. The means test looks at income and expenses against a national standard for expenses, adjusted for regions. If the proposed debtors have income in

excess of the national standard for expenses, then in theory, the debtor would be forced into a Chapter 13 bankruptcy with some sort of repayment plan to, in this case, the self-storage operator as a creditor. Although this is a much welcomed change to any Self-Storage operator who has had a debtor walk away completely from a self-storage debt, or stop a lien sale, only to tie up the space for several more months, on national average, 78% of the people who have previously filed Chapter 7 based on their income, would meet the means test and post enactment of the law would still be eligible to file a Chapter 7 bankruptcy. Chapter 7 remains pretty much unchanged once a debtor is determined to be eligible to file one. That is, a relatively low filing fee and an immediate automatic stay that would tie up the self-storage space from several to many more months, while the operator will receive no pre-bankruptcy filing debt repaid to them (in most circumstances) and the only way to get a debtor out unwillingly during a bankruptcy is to spend a considerable amount of money on attorney's fees and filing fees to file a Motion for Relief from Stay. None of that information is new.

Also, Chapter 7 or 13 debtors are supposed to go through some sort of debt counseling, to help them try to avoid a Chapter 7 or 13. This debt counseling is a prerequisite to filing, and the debtor must actually present a certificate of completion of a non-profit debt relief counselor, before a bankruptcy can be filed. Although this also seems like a positive change to a Self-Storage operator, that maybe some people will be able to find a way to adjust their debts and avoid a bankruptcy in its entirety, there is really no information available on what this debt counseling is going to look like or work like on October 17<sup>th</sup> and forward. The United States Trustees' Office, of the Department of Justice, is supposed to promulgate standards for debt counselors, but as of the writing of this article, approximately one month before the Act goes into effect, the standards have not been released, and although there were expected to be 5,000 not-for-profit debt counseling services lined up in place, certified and ready to go by October 17<sup>th</sup>, as of the date of this article, I am aware that one service claims to have been approved by the United States Department of Justice. Therefore, there is some question about what kind of debt counseling will be feasible once the Act goes into effect, and whether or not this condition will be suspended or waived, if possible, for a long period of time. Further, although celebrated by creditors as a victory because more people will have to file a Chapter 13 than a Chapter 7, many

United States Court Districts around the country approve very low percentage rate repayment plans. Some states have something that is so low it is called a “pot plan” that is the amount of money to unsecured lienholders like self-storage operators is so low it is not even determined as a percentage, but what is left in the proverbial “pot” at the end of repayment of all other expenses and secured obligations in the Chapter 13 bankruptcy. Thus, although more of your tenants may be filing a Chapter 13 than a Chapter 7, it is possible that you will see in your area of the country, one or two cents on the dollar repayment plans. In the meantime, you will almost have to have an attorney complete the Proof of Claim for each debtor which is required to be submitted in order for you to be eligible to participate in the whatever percentage repayment plan. Claims that do not have a Proof of Claim filed by a certain date known as the “bar” date in bankruptcy, are excluded and other creditors will get a higher percentage payout. The filing of a Proof of Claim is still a reasonably sophisticated and technical process that is best handled by your legal counsel, even though it may cost you more legal fees to pay for this sort of processing than you may receive in some cases.

The other change that Self-Storage operators *thought* they were going to get was some additional clarification on tenant’s holding over in a Self-Storage unit after bankruptcy for a limited period of time before the Self-Storage operator could proceed again with an eviction or certifying a lien sale. A change was made to Section 362 of the Bankruptcy Code. Unfortunately, it appears Self-Storage did not get the same advantages as apartments. Under Section 362 (B)(20), the Code says that “any action to enforce any lien against or security interest in real property following entry of an order . . . as to such real property in any prior case under the title, is not stayed.” However, your lien is generally not in real property, but in the personal property stored in operator’s real property. Section 362(B)(22) discusses the permission for the continuation of any eviction, unlawful detainer action, or similar proceeding by a lessor against a debtor involving “residential property in which the debtor resides as a tenant under a lease or rental agreement and with respect to which the lessor has obtained before the date of the filing of the bankruptcy petition, a judgment for possession of such property against debtor.” Again, you are not operating residential property and therefore, while the apartment industry got a little bit of a bonus in the Act, it appears there is no acceleration or change in the procedure for your forcing

a tenant out post-bankruptcy in the new Act. A Motion for Relief from Stay, with all of its trappings and filing fees still appears to be the only way that you can get a tenant out of your unit during the pendency of a bankruptcy if the tenant chooses not to pay their rent to you post-petition. Please note that distinction. The tenant will always be discharging under Chapter 7 or paying into a payment plan under Chapter 13 the rent *owed up to the date of filing*. You are only entitled to ask the tenant to leave generally if the tenant does not pay regularly and on time post-petition which is after the filing of the bankruptcy, but still you must get relief of the automatic stay from the court to proceed in this direction. This is why it remains imperative that you keep your collection deadlines tight so you do not find yourself having three or more months of pre-petition rent completely discharged.

You may also notice that your attorney – because he or she will be giving you some advice about how to handle Proofs of Claim, or Motions for Relief from Stay, etc., as your business attorney may start referring to themselves in their letterhead and other communications as a “debt relief agency”. Please understand this is one of the worst changes to the Bankruptcy Act but the fact that your attorney calls him/herself/firm a “debt relief agency” does not mean that they are providing the debt counseling or assisting debtors from getting out of paying your bills. It just so happens, or at least appears, that *every* attorney who gives any advice that may even involve the specter of bankruptcy is now supposed to put people on notice of the fact that that attorney or their firm operates as a “debt relief agency”. If this has to be done, and your attorney follows the requirements, please do not be put off by this statement in your attorney’s correspondence.

Because of this change in the law that requires anyone who give advice which may correspond or touch the area of bankruptcy law to call themselves a “debt relief agency”, I must strongly caution all owners, operators and managers – at least until this area of the law settles down a little bit – to steadfastly refuse to discuss any aspect of a potential bankruptcy with your tenants. Almost certainly do not recommend your tenants file bankruptcy, but what you also want to avoid now is having any sort of discussion with your tenant should they inform you that they may wish to file or consider filing a bankruptcy. Naturally, the normal questions of “who is your attorney?”; “when do you expect to file?”; or “have you filed and what is your case

number?” are always acceptable. To go any further than that at this point may throw you into the same area that attorneys have been thrown into whereby you may have to put on your correspondence that you are also a “debt relief agency”. Can you imagine your Self-Storage facility letterhead and lien notices saying that you are a “debt relief agency?” Perish the thought! However, make sure you and your employees understand that at least until we give you some further notice about how this section is being worked and interpreted to *avoid* any sort of substantive discussion with your tenants about *any* bankruptcy related issues.

In summary, you may notice that your tenants are not quite as quick to rush into bankruptcy after October 17<sup>th</sup>. There is certainly going to be a learning curve to figure out some of the procedures and, there will be some question after October 17<sup>th</sup> about how to handle the debt counseling and the certificates that the debtor must have before filing bankruptcy. You may see some increase in the number of Chapter 13s over Chapter 7s, however, I am not certain that this change will actually result in a benefit to you as a facility owner/operator/manager, in that the percentage payment plans may be very low and you will require legal assistance to file the proof of claims that will now be required in order to be able to participate in the collection of that small percentage of the debt owed. Otherwise, you will be walking away from the money just as if you might have done so in a Chapter 7.

Sometime soon, it is really worth a sit-down meeting with your local counsel to make sure that you understand how policies and procedures in your district are going to work. The first Chapter 13 that you see is a good time to discuss with your attorney the value and cost of filing a Proof of Claim versus the value of what you may receive back from that Proof of Claim at the end of the case.

Once the changes in the Code have some opportunity to take hold, and I do expect some of the provisions to be appealed to federal courts rather quickly, I will follow with an update in this column.

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