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The Business of Bankruptcy

Rise in Filings Means Some Firms are Busier than Ever

By Thom Senzee

SAN FERNANDO VALLEY BUSINESS JOURNAL STAFF

Bankruptcy.

It's a word that strikes fear in the hearts of creditors and even debtors. But it's also a word that means business—more business than you can shake a stick at for attorneys specializing in that practice area these days.

“It always happens in a recession, but I’ve never seen anything like this,” said attorney Gary Barr. Barr said insolvency-oriented business at the firm where he is a shareholder, Encino-based Alpert, Barr & Grant, has doubled.

LAW: THE BUSINESS OF THE DOWNTURN



In fact, nationwide, bankruptcy filings are way up. In the 12-month period ending in June 2007 there were more than 750,000 filings overall, including business and non-business, while in the same period of 2008, there were a total of almost 970,000, an increase of 28.9 percent.

In the San Fernando Valley, the increases are substantially higher. A total of 9,709 business and non-business bankruptcies were filed in the 12-month period ending in June 2008, a figure that represents an increase of nearly 102 percent compared to the 12 months ending in June 2007.

At the same time, filings were up by 92 percent in 2008 for the U.S. Bankruptcy Court's Central District as a whole. The district encompasses all of Los Angeles, Orange, Riverside, San Bernardino, San Luis Obispo, Santa Barbara, and Ventura Counties.

There is no single reason the Valley's increase was higher than the rest of the counties. However some believe it may simply reflect a higher concentration and a wider diversity of business activity here than in most other parts of Southern California region.

By contrast, when David Hagen began practicing bankruptcy law in the Valley there was little local competition and just enough business doing bankruptcies for individuals and small businesses for his practice to stay in business. Today it can take two weeks before he can begin to work on a new client's

case.

Hagen's Encino firm, Law Offices of David S. Hagen, has seen recessions come and go, and with them a fairly predictable ebb and flow of business.

"This situation has the potential to be far worse than anything we've ever seen," Hagen said.

Lawyers understand the perils of appearing to relish the misfortune of others, and tend to want to express their gains resulting from the current "BK" epidemic in macroeconomic terms.

But the fact is, all four of the firms the Business Journal interviewed for this article said their business in the bankruptcy and/or foreclosure practice area was up 100 percent over last year.

However, this feast follows a mild famine, as bankruptcy cases had been falling year after year since shortly after the beginning of this decade.

"Then (Congress) changed the law in '05," recalled Hagen. "During that last month you could file under the old laws, our business was up by 300 percent."

But after the new, more restrictive laws went into effect, filings tumbled. In 2008, everything changed. The march toward doubled filings gathered steam throughout last year and was at full-throttle by October.

Yet with record numbers of bankruptcy and foreclosure cases hitting the market there is bound to be some friction between attorneys who have been in the bankruptcy arena for decades and the Johnny-come-lately's.

At least one longtime bankruptcy specialist is worried that some attorneys may be exploiting the boom times, however unintentionally, to the detriment of their clients' financial wellbeing.

"How do you define success in Chapter 11?" Attorney Steven Fox asked rhetorically. "The court defines success as a payment plan confirmed, but in reality that's just one step toward a successful bankruptcy."

Fox, who is principal attorney at the Law Offices of Steven R. Fox in Encino, believes the real test of a successful business bankruptcy is whether the company is still in business a year later.

"My guess is that historically a third of all Chapter 11s are dismissed shortly after filing or converted to Chapter 7," he said. "Of the remainder, about half actually confirm a payment plan and go on to do business."

Indeed, said Fox, today at the Woodland Hills branch of the U.S. Bankruptcy Court, the rate of dismissal or conversion to another type of protection is about one out of every three cases. A source at the court said that figure sounded realistic, but was not authorized to confirm the information formally.

Chapter 11 is the section of bankruptcy law that calls for restructuring of debt, while Chapter 7 is liquidation. The former aims to keep a company in business, while the latter is, for all intents and purposes, a white flag of surrender. Fox said he sees signs in every case that tell him whether or not the filer has a viable Chapter 11 case.

"The signs to look at are: who was the attorney representing the debtor and how much of a retainer did the attorney take?"

Fox believes it is impossible for attorneys charging fees more accordant to individual bankruptcies than to those of companies to do the job well.

"I don't recognize a lot of these attorneys' names," he said. "And they are taking 1980s retainers of five, 10 and 15,000 dollars."

Fox doesn't believe there is any way an attorney can give the necessary time to properly shepherd a firm through the process at those prices. He typically charges from \$30,000 to \$40,000 for a small-business bankruptcy.

Larger companies can pay attorneys hundreds of thousands, or even millions of dollars to complete bankruptcy, as is likely the case for Circuit City, according to Fox.

A sign of a "good" Chapter 11 bankruptcy case, said Fox, has to do with ego and denial.

"A sign of a good Chapter 11 is a leader who recognizes they've done wrong," Fox said. "A real leader will be repentant and willing to learn a new way of doing business."

Fox is a bankruptcy attorney who draws no quarter for his clients when it comes to what he says is facing reality.

"Most bankruptcies might be blamed on slowdowns, changes in industry, or vendors," he said. "But it's a failure in leadership. Sometimes you have to let them sink further before they're willing to check their ego and let me help them build a new way of leading."

On the other hand, California and a few other high-priced real estate markets get more individuals filing for Chapter 11 reorganizations than other states because of the asset limit of just more than \$1 million for Chapter 13 filings. Traditionally, Chapter 13 has been the bankruptcy of choice for households wanting to restructure their debt.

"When I see there is really just a single major creditor on the filing, I know the debtor is probably someone trying to save their house," said Fox, whose primary business is helping companies stay in business through Chapter 11.

Conversely, Attorney Gary Barr specializes in foreclosures, representing creditors, who often find themselves on the "receiving end" of bankruptcies.

"We've estimated we're up about a hundred percent increase in the last six months," Barr said. "That's compared to the number of foreclosure cases we were handling for the financial institutions we represent in the same period the year before."

Barr's firm also handles bankruptcies, and both practice areas are humming like never before.

"The number of foreclosures and bankruptcies is the biggest change," he said. "And what's really different is that it ranges across the entire socioeconomic spectrum."

Barr believes the big difference between this recession and those in the past—and part of the driving force behind his firm's current twofold increase in bankruptcy and foreclosure business—is the depth and breadth of the casualties.

"People who you never thought would have their home foreclosed on are," he said. "These loans were made on a much higher value for the homes than they have now, and even people with high

FICO scores aren't able to get credit to refinance."

Attorney James R. Felton, managing partner at Greenberg & Bass in Encino, told the Business Journal companies seeking bankruptcy representation from his firm are also up 100 percent.

"I guess the ratio is about 75 percent for Chapter 7 and 25 percent for Chapter 11s," he said. "If you do the front-end analysis, what you find is that most bankruptcies are business owners in over their heads. They belong in Chapter 7."

Felton said the key to a successful bankruptcy is retaining a bankruptcy attorney early in the process.

"A business owner has more options earlier on in the process," he said. "It's like preventative dentistry."

Felton had another metaphor about getting a bankruptcy advocate early:

"Our expression is do they need a lawyer or do they need a priest?"