

ABI Commission to Study the Reform of Chapter 11 Recommendations

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COMMISSION TO
STUDY THE REFORM 2012-2014
OF CHAPTER 11
FINAL REPORT AND RECOMMENDATIONS
SPONSORED BY THE ARTHUR H.N. SCHALLING ENDOWMENT FUND

ABI Commission to Study the Reform of Chapter 11

Overview of Selected Recommendations and Findings
ABI Rocky Mountain Bankruptcy Conference
Denver, CO
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Why Reform? Why Now?

- An effective and predictable business bankruptcy scheme rebuilds companies, preserves jobs, and fosters economic growth
- Distressed companies are not using chapter 11, or are waiting too long to use it, undercutting its utility for all stakeholders
 - Perception is chapter 11 does not work for many distressed debtors

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Approach to Reform

- Who: The 18 voting and four *ex officio* Commissioners are among the most prominent chapter 11 professionals in the U.S. today, supported by more than 130 others who served on 13 topical advisory committees
- Objective study of chapter 11: *What is working and what is not working as well as it could?*

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Approach to Reform

- How: Commissioners held 17 field hearings around the country to gather testimony, while considering hundreds of other written submissions, and evaluating empirical data
- Process included perspectives and significant input from representatives of all major stakeholders in chapter 11 cases

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Approach to Reform

- There were no pre-determined principles, agendas, or outcomes
- Commission studied and considered all potentially competing interests in working to strike balanced approach under proposed principles

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Key Themes of Recommendations

- Reduce barriers to entry
- Facilitate certainty and more timely resolution of disputed matters
- Enhance exit strategies for debtors
- Create an effective alternative restructuring scheme for small and medium-sized firms

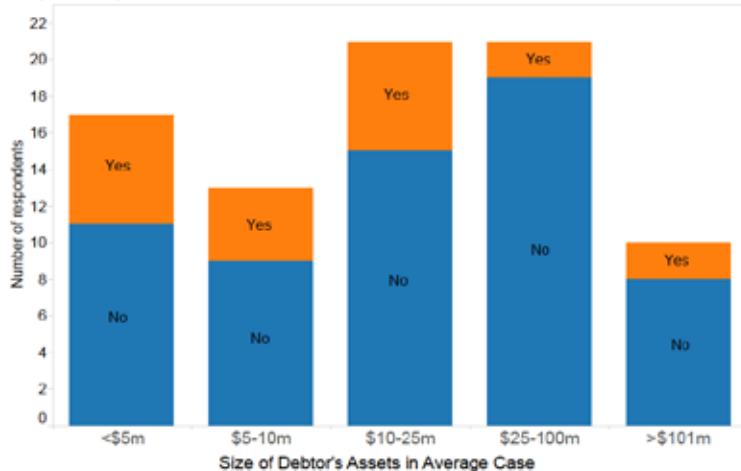
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Small and Middle Market Issues

- Does one-size-fit-all in chapter 11?
- Is chapter 11 working for smaller and middle market companies?

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Have you recommended that a client use ABC or receivership instead of bankruptcy in the past five years?



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DEBTORS' ASSETS BASED ON SCHEDULES			
Asset Ranges	Number of Cases	Percent of Total Number of Cases	Cumulative Percent of Cases
\$0 – \$ 100,000	111	17.4%	17.4%
\$100,001 – \$500,000	119	18.6%	36.0%
\$500,001 – \$1 million	91	14.2%	50.2%
\$1,000,001 – \$2.19 million	117	18.3%	68.5%
\$2,190,001 – \$5 million	99	15.5%	84.0%
\$5,000,001 – \$10 million	47	7.4%	91.4%
\$10,000,001 – \$50 million	44	6.9%	98.3%
\$50,000,001 – \$100 million	4	0.6%	98.9%
Over \$100 million	7	1.1%	100%
Total	639	100%	

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Key Principles: SME

- For purposes of these principles, the term “***small or medium-sized enterprise***” (“***SME***”) means a business debtor with—
 - (i) No publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor’s case; and
 - (ii) Less than \$10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the petition date
- SAREs excluded from SME principles

(Report, at 279)

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Key Principles: SME

- No mandatory creditors' committee; may appoint estate neutral to help with business and plan
- No mandatory deadlines, but SME must propose, and court will approve, timeline tailored to particular case
- Prepetition equity holders may retain their interests, subject to certain conditions
 - These conditions include satisfying section 1129(b) for secured creditors
 - Granting unsecured creditors 85% of economic ownership interests in reorganized company with limited voting rights

(Report, at 291, 294, 297)

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Key Principles: Executory Contracts and Unexpired Leases

- Adopts Countryman definition of executory contracts, provided that forbearance does not constitute performance
- Trustee would have no obligation to perform pending treatment decision, other than paying for goods or services needed and delivered postpetition
- Nonmonetary obligations that cannot be cured would not preclude assumption of any contract or lease
- Rejection would be treated as breach
- Period to assume or reject nonresidential real property leases would be extended to one year
- Definition of rent would be clarified, as would calculation formula for rejection damages claims under section 502(b)(6)

(Report, at 112, 115-116, 119, 129-130)

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Key Principles: Costs in Chapter 11

- Promote efficiencies and reduce litigation costs by resolving uncertainty and circuit splits in current law
 - Other cost savings:
 - No mandatory committee in SME cases
 - Replace examiners who have open-ended charge with task-specific estate neutrals
 - Streamline confirmation process
 - Simplify and clarify rules to govern asset sales
 - Allow payment of employees' and vendors' priority claims without motion
 - Subject estate-paid creditors' professionals' fees to reasonableness review under section 330
 - Promote innovation in professionals' fee structures by permitting alternative fee arrangements

(Report, at 55, 59-61)

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Key Principles: General Plan Provisions

- Move to a "one creditor, one vote" rule for numerosity
- Expressly permit third party releases and exculpation clauses satisfying certain conditions
- Eliminate section 1129(a)(10) and codify the new value corollary
- Market-based approach to cramdown interest rate (rejects *Till*)
- Provide distribution to junior creditors *if* supported by reorganization value of firm

(Report, at 257, 252, 250, 224, 234, 207-211)

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Preference Claims

- Commission heard substantial testimony on preference claims from trade creditors, as well as those who serve as bankruptcy trustees and lenders
- Commission considered all possibilities, including eliminating preferences completely; shifting burden of proof on creditor defenses; fee shifting; and maintaining the status quo

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Preference Claims

“The trustee knows [that preference defense] is going to get expensive to me to continue to defend and is counting on a monetary settlement just to get rid of them.”

- Oral Testimony of Valerie Venable: NACM Field Hearing Before the ABI Comm’n to Study the Reform of Chapter 11, at 34–37 (May 21, 2013)

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Key Preference Principles

- “The trustee should be precluded from issuing a demand letter to, or filing a complaint against, any party for an alleged claim under section 547 unless, based on reasonable due diligence, the trustee believes in good faith that a plausible claim for relief exists against such party under section 547, taking into account the party’s known or reasonably knowable affirmative defenses under section 547(c).”
- is the quote from our recommendations? If so we should say so

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Key Preference Principles

- “The trustee must plead with particularity factual allegations in the complaint that establish a plausible claim for relief under section 547.”
- Increase small claims defense to \$25,000 and venue provision to \$50,000 (and clarify that the latter applies to preference litigation)

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Key Related Principle

- “A court should not approve any proposed postpetition financing under section 364 that grants a lien on, or any interest in the estate’s avoidance actions or the proceeds of such actions under chapter 5 of the Bankruptcy Code (including through a superpriority claim).” (moved)

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Section 503(b)(9) Claims

- Commission heard competing testimony regarding the impact of section 503(b)(9) claims—some witnesses emphasized the importance of this treatment to trade creditors while others suggested such claims imposed barriers to confirmation and successful reorganizations
- Commission carefully balanced competing interests, considering overall chapter 11 scheme and its objectives for debtors *and creditors*

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Section 503(b)(9) Claims

- Proposed principles relating to section 503(b)(9) claims and reclamation rights include:
 - Maintain section 503(b)(9) in current form, with the following clarifications:
 - Include drop shipment transactions
 - Should be in lieu of any other remedies, including reclamation and critical vendor treatment
 - Remove concept of reclamation from Bankruptcy Code

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Key Principles: Avoiding Powers and *In Pari Delicto*

- Heightened due diligence requirements for demand letters and pleading requirements for complaints
- Increase small claims defense to \$25,000 and venue provision to \$50,000
- Eliminate *in pari delicto* defense as to bankruptcy trustee only

(Report, at 148, 186)

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Key Principles: Estate Neutral

- Appointed by U.S. Trustee
- Never mandatory
- Would replace examiners
- Flexibility, with some limitations, is the key
 - Role is defined by parties and court's order, and
 - Tailored to particular case

(Report, at 32)

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Key Principles: IP

- All IP licenses could be assumed and would be freely assignable, subject to nondebtor licensor's right to object if proposed assignee is a competitor
- Trademarks would be included in definition of IP, subject to certain modifications to section 365(n) particular to trademarks
- Foreign IP would be included

(Report, at 122, 126)

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Key Principles: Section 363x Sale

- New procedures for sales of substantially all of a debtor's assets
- Not permitted during first 60 days of case, absent extraordinary circumstances proven by clear and convincing evidence
- Must satisfy certain conditions customary in plan process and provide sufficient notice
- Section 363(f) expanded to include claims in context of section 363x sales (or smaller sales meeting similar conditions)

(Report, at 83, 201, 141-142)

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Conclusion

- Principles intended to, among other things, create certainty and efficiencies in process
- Commission hopes that the Report will facilitate debate and meaningful dialogue concerning necessary and beneficial reforms to chapter 11

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