The Future of Bankruptcy: The Good, the Bad and the Supreme Court's View

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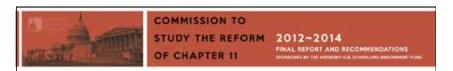
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ABI Commission to Study the Reform of Chapter 11

Overview of Recommendations and Findings

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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

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

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

Key Principles: Resolving Splits

- The permissibility of cross-collateralization and roll-up provisions in postpetition financing facilities
- The use of the doctrine of necessity in chapter 11 cases
- The standard of review applicable to the appointment of a chapter 11 trustee under section 1104

Key Principles: Resolving Splits

- The definition of "executory contract" for purposes of section 365
- The effect of rejecting an executory contract or unexpired lease under section 365
- The ability of a debtor to assume intellectual property licenses under section 365(c) (i.e., the hypothetical test versus the actual test) and the treatment of trademark licenses generally
- The proper calculation of a landlord's claim against the estate (i.e., the accrual approach versus the billing date approach)

Key Principles: Resolving Splits

- The application of the safe harbor in section 546(e) to bar fraudulent transfer actions brought under applicable nonbankruptcy law
- The treatment of ordinary supply contracts as qualified financial contracts subject to the protection of the Bankruptcy Code's safe harbor provisions
- The meaning of "for the benefit of the estate" under section 550

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Key Principles: Resolving Splits

- The permissibility of gifting and nonconsensual third party releases
- The application of the new value corollary
- The calculation of the cramdown interest rate
- The fiduciary duties of a debtor (as opposed to a debtor in possession) proposing a chapter 11 plan

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

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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

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