ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11

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Thank you for the opportunity to appear here today. I stepped gingerly into the room to be sure that I had no allergic reaction—to a hearing, connected with proposals to change Chapter 11, before a Commission of distinguished volunteers, committed to a comprehensive review of the law.

It was, after all, almost precisely 16 years ago that the National Bankruptcy Review Commission submitted its 1200-page report to the Supreme Court of the United States, to the Congress and to the President. I say that not necessarily to recommend the length of that report to this Commission but to commend the seriousness and long-term significance of both efforts.

This Commission's recommendations may prove to have a little—or a lot—in common with the Chapter 11 recommendations in the Bankruptcy Review Commission's report from 1997. It is noteworthy, however, that both processes included a concerted effort to travel beyond Washington, D.C., and New York to solicit testimony and to broaden, rather than narrow, the scope of the discussion. That said, it's equally important to convey the limitations and the challenges with respect to this process. This testimony is not intended to make anyone feel comfortable.

In 1994, when Congress authorized the Bankruptcy Commission, some suggested that not enough time had elapsed since the enactment of the 1978 Bankruptcy Code—in short, that there was not enough experience to evaluate the dramatic changes the Code had made in insolvency practice, whether corporate or consumer. Those suggestions were wrong. When ABI established this Commission, some suggested—for the same reason—that not enough time had elapsed since the 2005 legislation or since the Bankruptcy Commission's report eight years earlier. Those observations were misplaced as well—particularly since the ABI Commission's focus is Chapter 11 and not the consumer bankruptcy changes that so characterized the 2005 statute, though there were business bankruptcy changes as well in that new law.

It is a fact that Congress has adopted virtually no bankruptcy legislation—whether to amend Chapters 7, 9, 11, 12, 13 or 15—since 2005. We can debate whether that is a good development or a regrettable development. But two other related facts are less debatable and far more relevant to the work of this Commission.

First, however dysfunctional Congress is today, it has been dysfunctional on the subject of bankruptcy legislation for far longer than the time consumed by the most recent crisis in Washington, D.C. For a variety of reasons, this Congress and its successors almost certainly will continue to be unable or unwilling to reach anything approaching a bare majority in both houses (let alone consensus) on bankruptcy legislation. Put another way, in the halcyon days of 1977 or 1994 or even, relatively speaking, 2005, a measure of bipartisan interest or at least expediency coincided with the need for change. Those days will not likely be seen again. And that is notwithstanding the presence in Congress, for the first time, of a law professor who has written the textbook on bankruptcy.

Second, and ironically, the changes in this country's corporate dynamics and culture since 2005 have been as dramatic and significant as in any period that preceded significant changes in the bankruptcy law, including the period that led to the Chandler Act in 1938. That is a sweeping statement, and it is meant to be. The economic catastrophe itself, five years ago this fall, validates that conclusion, not to mention the unprecedented corporate (and I include law firm) insolvencies that occurred with it or because of it. Lehman Brothers, General Motors, Kodak, Adelphia, American Airlines, ResCap—these and other names and even Code provisions, section 363 comes to mind, have become part of a new lexicon of bankruptcy and this country's economic history. As a result of these and other proceedings, the conceptual and practical value of Chapter 11 has been demonstrated, but so have its shortcomings. It is a fundamentally sound system, but one that requires change to reflect the changes in the global economy, the domestic economy, secured financing, the regulatory system, and one more: changes in public perception.

These two facts together—no prospect for significant statutory change yet a demonstrable need for it—place this Commission in a difficult position. (I speak from experience here.) You are not drafting legislation and even if you were, ABI itself—as Sam often reminds us—is not an advocacy organization. In my view, that leaves the Commission with no alternative but to address its proposals and the debate that follows them primarily to an audience other than Congress: to the Chapter 11 bar, to the courts and the rules committees, to the academic community and to the state and federal regulatory authorities. I include in that last reference the U.S. Trustee program.

That leaves the ultimate audience: the public. To steal a phrase, Chapter 11 is too important to be left to the Chapter 11 lawyers and judges. It is too important for the economy and to the public's trust in the bankruptcy system, which accommodates both corporate failure and the innovation and hard work that build success from that failure.

I am not aware of any publicly-reported survey data, but I suspect that the American public's awareness of the insolvency system, whether for consumers or corporations—or, lately, cities—has increased tenfold since 2008. That is not to say its understanding has. And the fault for that lies, at least in part, all around us. Now, more than ever, people understand that corporations fail. Now, more than ever, people understand that corporate failure can affect them directly. Now, more than ever, people are beginning to understand that with failure should come—perhaps too slowly but inevitably—accountability.

But there remains too little understanding that the legal system has a mechanism, with roots long before the Great Depression, for addressing corporate failure and making it at least possible for renaissance to follow. And whether or not a Chapter 11 renaissance that saves or restores jobs then, at the least, a system that fairly—and openly—distributes assets to those entitled to a legal or equitable share in them. General Motors is an example of the first renaissance, though under unique circumstances with the government as the DIP lender. Lehman is an example of the second, an orderly and fair distribution. And Detroit will be a test of both—renaissance or not, fair distribution or not.

That brings us, reluctantly if not inevitably, to the question of professional fees. Reluctantly, this afternoon, because Bob Keach and Al Togut do not need any data or homilies from anyone about that subject. Having spent some time on the issues, however, I have some observations designed to encourage far more discussion than the panel has time today. The focus is inevitably and primarily sections 327 through 330 of the Bankruptcy Code, but the problems inherent in professional compensation do not lie only in the vexing and anachronistic language of a few pages of Title 11—language drafted, it must be said, when high six-figure professional fees in corporate reorganization were uncommon and when ten figure fees were not even imaginable.

First, with exceptions too rare to be noteworthy, professional firms subject to court approval bill for their services honestly and openly. Which is not to say adequately or in compliance with the Bankruptcy Code. Perhaps compliance and, surely, strict compliance is simply a bridge too far—especially in large reorganizations where a single firm may have, over the course of a proceeding, more than 1,000 individual timekeepers with individual daily entries that total in the millions. The fact that the Code and court rules require this detail and data and that, with technology, professionals can provide this data wholesale does not mean that the material can be analyzed efficiently or effectively—by interested parties, by the U.S. Trustee program, or by the courts that have the ultimate responsibility for approving professional fees. Nor does it mean that the public can appreciate both the economic benefit and the efficiency reflected in even very large amounts of professional fees as a cost of effective reorganization.

Second, in the largest corporate reorganizations, the most significant shortcoming in professional fees, in my view, is the inconsistent application of billing judgment. That is a classic phrase, of course, meaning different things to different people (and billing partners). At base, however, it means that not every fractional hour that a partner, or an associate, or a paralegal commits to paper or an electronic document should be billed and paid for by the estate. Many, if not most, of the "sins" of Chapter 11 billing are subsumed in that characterization: duplicative services, work done by a senior associate that might more efficiently have been done by a paralegal, endless research, six lawyers at a hearing or deposition where one or two would probably do quite nicely, or conflicts counsel problems. And, of course, duplicative services do not occur solely within a firm in one case but across the firms representing different constituencies in one case.

We could discuss this, no doubt, for hours but it makes more sense, consistent with this Commission's practice, to save time for the question period. One subject that does not suffer from a lack of discussion is the new U.S. Trustee fee guidelines for large corporate reorganizations—effective, as it happens, today. Some of the comments, both before and after the guidelines' promulgation, have mistaken trees for the forest. The guidelines are not perfect but they were hardly ill-considered. They were adopted after a painstaking process, and the initial reaction of many in the profession—about 120 firms, to be precise—was not in the best interests, not even self interest, of the Chapter 11 process. Those comments and the resulting media attention reinforced perceptions, whether or not appropriately held, that do not enhance public trust in the process.

I want to conclude with a comment or two, though, that tie the subject of billing to the need for public trust in the insolvency system. They are tied—inextricably. That is one reason section 1104 examiners should be an alternative for the parties and the court in Chapter 11s of significant size. That is one reason fee committees or fee examiners should be an alternative in some of those same cases. That is one reason the U.S. Trustee guidelines deserve a fair hearing and fair use.

The case for all three can be made on value and cost savings. But the best measure is not quantitative. The examination process—even the prospect of it—gives the public and interested parties in the proceeding (in the broadest sense of the phrase) a measure of confidence. The new guidelines, at the least, should encourage a more diligent internal review before any external review.

Ultimately, all three of these controversial tools—and they are means, by the way, not ends in themselves—serve the public interest and the profession's interest because they enhance public trust, understanding, and transparency. Whatever the Commission ultimately concludes should have those goals, stated or not, explicit or implicit, foremost in mind.

Some changes that would improve the Code, or at least dispel uncertainty, may only be achievable through statutory change. And the difficulty of that no doubt will not deter the Commission from making recommendations. Nor should it. The use of section 503(b), for example, to permit—that is, require—the estate to pay the fees of interested parties that make a "substantial contribution" is one subject that needs expanded discussion as does new "precedent" that upends decades of well-advised restraint on the part of parties and professionals. So, too, does the inclusion in a plan of reorganization, perhaps as part of the price for supporting that plan, of a variety of mandated conduct and payments that arguably conflict with the Code itself.

Does a confirmed plan forgive all sins and permit the dissolution of boundaries established by the Code? How can fees attributable to reorganization itself be distinguished from the often far larger legal fees inherent in running an airline or a coal company? Where does advocacy for a client end and "substantial contribution" to the collective good begin? Are the procedure and substance of every Chapter 11 subordinate, in other words, to the negotiated terms of a transaction? Whatever the answer to those questions, what role do litigation tactics have to play? Those questions, in more gentle terms, are pending in a number of cases, and not just those with familiar names.

Without statutory authority, without a realistic prospect of statutory change, the Commission nevertheless has a remarkable opportunity. In the final analysis, the challenge lies not in taking testimony or fashioning a report but in communicating the goals and values of a sound reorganization system indispensable to the country's economic health.

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